

INTERNATIONALIZING THE JAPANESE CONSTRUCTION INDUSTRY ISSUES OF OPENING THE MARKET AND RECOMMENDATIONS

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1. PREFACE

To deal with the WTO requirement related to the procurement of public projects is now becoming one of the most essential issues in the Asian countries. Japan is one of the countries who has accepted WTO requirements when the issues were shifted from GATT to WTO. It was in January 1996 when Japan implemented the new system of the procurement of public projects in accordance with WTO. It has already passed over 10 years since then. However, the construction industry in Japan still keeps many matters that shall be maintained and/or restructured. Very few people in the construction industry and the governmental organizations have become aware of its necessity.

The fundamental difference in business practices between Japan and the other nations underlies in the recognition of a contract. Unlike to a contract prepared with the aim of managing the area of mutual trust in other nations, a contract in the Japanese society is comprehended as a thing that complements “**the confidence**” in the contracting parties.

Looking at the stipulations of the standard conditions of construction contract being applied now in Japan, although it incorporates necessary provisions to respond to various problems to be encountered during the execution of construction work, the settlement of disputes is left to deliberations between the parties. The provisions have not been developed to describe the methods of settling the disputes as specifically as possible as

often seen in international construction contracts.

As such the construction contracts do not envisage “**the mutual mistrust**” among the contracting parties and are accordingly prepared to complement the confidence of the contracting parties. The Japanese construction management assumes “the mutual trust” in implementing projects and significantly lacks management technology required for managing “the mutual mistrust area”.

The internationalization of the market necessitates bringing the management field of mutual mistrust into the core place. If the Japanese construction market is opened without doing so, there will be a strong likelihood that Japan’s construction industry managed with inadequate protective functions would suffer great loss. Moreover, if the present system, which has many unsuitable matters to WTO requirements, remains unchanged, confusion will reign amongst Japanese owners, contractors and foreign construction firms leaving Japan in a very difficult position in relation with other countries.

A foreign contractor may feel uncomfortable to accept the unclear provisions and one-sided clauses in the Japanese construction contracts, and mutual confidence assumption in the contract is not practical to be the basis of international contract. Open competitive tendering system, fair contractual provisions and clear procedure for the claim and dispute settlement are necessary in order to fully internationalize the Japanese construction market and to make the industry fair, transparent and attractive to the global players of the construction.

The problems for implementation in accordance with WTO requirements are not the existence of the unique business philosophy but many systems established based on the unique business practices. The contents of the standard conditions of contract, the tendering system, awarding and contracting system, quality management system, payment system in Japanese construction industry are all established based on the “the mutual trust”. Therefore those systems basically were not structured with the mind of the defense and/or protection from other parties. Once some one who has no idea to respect “the mutual trust” system, and tries to treat those systems with offensive mind, he easily will be able to manipulate the systems. This is the essential problem that is seen in the Japanese construction industry. The author made a study describing contemporary situation of opening market and those problems and the counter measures. Some of the characteristics of the Japanese construction market which would be the major concern to the foreign contractors are discussed. Contrasting features of the Japanese construction market which are not encouraging foreign contractors as compared to the international market are presented. Necessary changes required for internationalizing the Japanese construction market are recommended.

2. THE HISTORY AND CONTEMPORARY SITUATIONS OF OPENING THE CONSTRUCTION MARKET

The issue of entry for foreign firms into the Japanese construction market was triggered when the USA demanded US contractor participation in the tendering for the Kansai International Airport construction project in 1986. The negotiations in the Japan-US Construction Arrangements in May 1988 had reached to Major Project Arrangement regarding the participation of the foreign firms in Japanese public works. The talks had listed some specific public construction projects in order to provide opportunities for foreign firms, mainly the US construction firms to enter the Japanese market.

On the other hand, through negotiations over a long span from 1986 to 1994 in the Uruguay Round negotiations of the General Agreement on Tariffs and Trade (GATT), a final comprehensive proposition for Agreement on Government Procurement was adopted on 15 December 1993 and it was become effective in Japan from January 1996. The result of Uruguay round negotiations made the opening of the Japanese construction market more realistic. The extent to which the agreement is to be applied in the construction sector as decided by the GATT is shown in Table-1.

Table-1. Standard amounts stipulated by GATT on Government Procurement Agreement			
Organization Work classification	National Government	Local Government	Governmental Organization
Construction Services	Contract amount SDR 4.5 million (JPY 730 million) or more	Contract amount SDR 15 million (JPY 2,430 million) or more	Contract amount SDR 15 million (JPY 2,430 million) or more
Design and Consulting services	Contract amount SDR 0.45 million (JPY 73 million) or more	Contract amount SDR 1.5 million (JPY 250 million) or more	Contract amount SDR 0.45 million (JPY 73 million) or more

Although the Japanese construction market is one of the largest in the world the flow of foreign firms to Japanese construction market was not so exciting. The number of foreign firms registered in Japan for doing construction business since 1988 is shown in Figure 1. Some of the problems which have inhibited in internationalizing the Japanese construction market are discussed below.

3. Fundamental issues in internationalizing the Japanese Construction Industry

a) Recognition of foreign firms

As shown on the Fig-1, 94 foreign firms have already got license for construction in Japan as of year 2007. However, the number of licensed firms had not drastically changed since early 1990s, and it did not change even though after the Agreement on Government Procurement was become effective. Why the number of licensed firms had not drastically changed?

One of the reasons that can be considered is that the Japanese construction industry is very conservative to accept foreign contractors. Almost all of big contractors have their own grouped sub-contractors who will work for them but not work for other contractors. They should be called “Meigi-nin” that

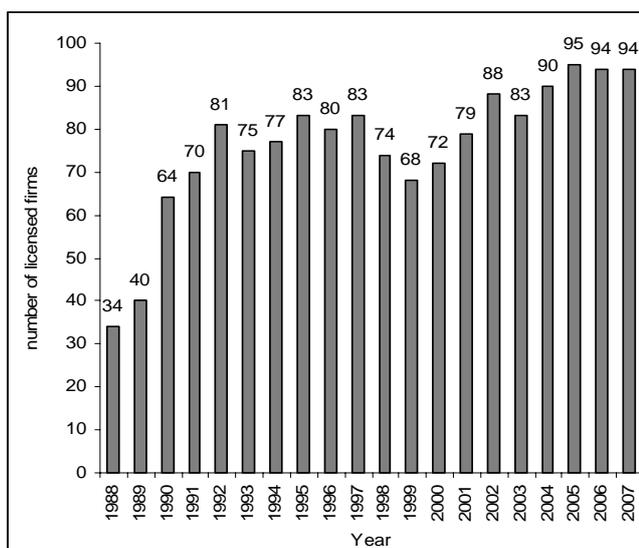


Fig-1. Number of foreign firms licensed for construction in Japan. Source: Hand Book of Kensetsu Gyo 2007

means the authorized sub-contractors. This system shall be big barrier for foreign contractors when they want to start business. The problem for foreign contractors entering the market is not limited to above mention matter. The main problem shall be “a culture gap”. In consideration to the reality in the international construction market place operating under the principle of fierce competition, the Japanese construction market seems very strange.

Japanese industry has maintained and still functions under the business environment stabilized by the principle of cooperation. Because of such unique culture foreign firms have been received as guests, which mean the guests are not regarded as competitors on an equal footing. As the matter of fact, all most all of foreign contractors had not got project by themselves. They became member(s) of Joint Venture or Consortium led by Japanese firms. This is the situation so far we can see about foreign firms’ issue. Many people in Japanese construction industry say that the foreign firms’ issue will not big problem because they can not expand their business easily. However, the author has the different opinion. There is other way to expand business in the market for them foreign firms. To expand business is not only to get projects as a contractor but also to merge or to acquire a Japanese construction firm. It means they do not come into the market with scoops and hammers but with management techniques and money. That is much realistic and safer way for expanding business in the foreign markets. Actually many EU contractors are using this way for entering foreign markets. This scenario will not only be talked about Japanese construction market but also in other countries.

b) Business practices

The fundamental difference in business practices between Japan and the western nations underlies in the recognition of a contract. Unlike to a contract

prepared with the aim of managing the area of mistrust in the western and other nations, a contract in the Japanese society is comprehended as a thing that complements the confidence in the contracting parties. Looking at the stipulations of the Standard Conditions of Contract being applied now in Japan, although it incorporates necessary provisions to respond various problems to be encountered during the execution of construction work, the settlement of disputes is left to deliberations between the parties. The provisions have not been developed to describe the methods of settling the disputes as specifically as possible as often seen in international construction contracts.

c) Management in the construction business

As such the construction contracts do not envisage the mutual mistrust among the contracting parties and are accordingly prepared to complement the confidence of the contacting parties. The Japanese construction management assumes mutual confidence in implementing projects and significantly lacks management technology required for managing the mutual mistrust area. Doing business under circumstances where mutual confidence cannot be established requires a management system that always takes into account the potential risk of being attacked by a contractually opposite party and one that is equipped with the functions of protecting from such attacks.

Figure-2 conceptually illustrates the project management functions as in international construction market with the mutual mistrust at its core. However, the Japanese management system does not envisage the mistrust area and will be hollowed out at its core in fig-2 if used in international market place. This is one of the reasons why it has been difficult for Japanese construction and consulting firms to gain real

competitiveness in the international construction marketplace, even though they possess many capacities such as high degree of engineering prowess, quality control, safety control, timely completion, etc. appreciated by their owners. The present system of management in the Japanese construction industry on the basis of mutual confidence where problems are coped with through a spirit of cooperation between the client and contractor can be understood spiritually but would hardly be accepted practically by foreign firms entering the Japanese market.

The internationalization of the market necessitates bringing the management field of mutual mistrust into the core place. If the Japanese construction market is opened without doing so there will be a strong likelihood that Japan's construction industry managed with inadequate protective functions would suffer great loss. Moreover, if the present system remains unchanged, confusion will reign amongst Japanese owners, contractors and foreign construction firms leaving Japan in a very difficult position in relation with other countries.

4. IMPROVEMENT REQUIRED IN OPENING THE CONSTRUCTION MARKET

Some of the unique systems prevailing in Japanese

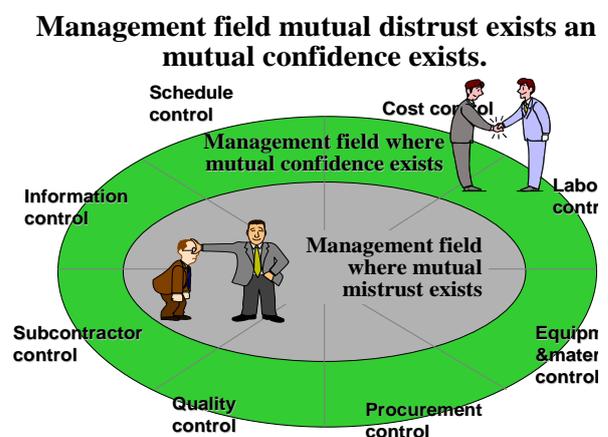


Fig-2. Management field mixed with mutual confidence and distrust

construction market that may not be equally valued by other sense of values, the western for instance, which prefer clear stipulations on the roles and responsibilities of the contracting parties with legal protection, are discussed below.

a) Tendering system

The tendering system in Japanese public works consisted of selective designated tendering in which an owner selects certain number of contractors from his list and the designated tenderers require to tender for a lump sum contract. The tenderers estimate their tendering amount with the basis of the amount that the project owner set up as the project budget. However, this project budget will not be simple meaning of the budget. It is called “Yotei Kakaku” in Japanese. It can be translated to “the scheduled price”, actually it is “target contract price”. The interest of the listed contractors in tendering for the project is not considered in advance, and if a designated contractor declines to tender for a project the contractor may not be selected by the owners for certain period of time to tender for future projects. Moreover, the tender is rejected outright without any negotiation if the tender price is greater than the owner’s target contract price for the project, and in case of that all tenderers put prices more than the target contract price, they shall be asked to put new prices without changing the tendering conditions. The submission of tender requires a contractor to submit a single page tender document stating the total tender price without breaking down the cost. The client evaluates the total tender price with the target contract price without assessing the details of the items of work and corresponding rates. The tender is awarded to the lowest tenderer.

A designated competitive tendering is not an unusual system in international construction market. However, the contractor selection method in Japan is less transparent, and penalizing the contractor for not submitting tender for a project and rejecting the

higher tender (than the target contract price) outright are very unusual practices as compared with other nations’. The incorporation of a transparent system for selecting contractors and detailed tender evaluation are prerequisite for making the industry transparent and providing fair opportunities for the foreign contractors.

Now days the public project owners led by MLIT; the Ministry of Land, Infrastructure, Transport and Tourism, started to change their tendering system. They stopped the selective designated tendering system and started new system so call “Open competing tender” that has no limitation of tender participation. They also started to ask tenderers to submit a short statement explaining idea related to execution of the works and the breakdown of the tender price. The problem is that this kind of actions are not restructuring the system for opening the market, but it is for getting back the public confidence. Therefore, it will not be the measure devised to deal with the issue of internationalization of the construction industry.

b) Standard conditions of contract

Procedures for settling issues

The standard conditions of contract for public construction works incorporates provisions for mutual deliberations between the parties to settle the issues such as change in scope, completion date, adjustment to the contract amount due to design change, etc. without stipulating clear provisions for settling the claims and disputes. The settlement of issues is limited only to arbitration referred to a “dispute settlement committee for construction works”. However, a supplementary clause followed by the arbitration provision dictates that “matters not prescribed in contract documents shall be settled by the parties through deliberations as required”.

As such mutual confidence is the basis of Japanese contracting system both the parties (project

owners and contractors) considering their positions make efforts to find their bearings through deliberations without clearly specifying the methods of settling the issues. However, if in case the base of respecting other's position is off-balanced deliberations may turn into collision of feelings making it more difficult to settle the issues. Internationalizing a market allows the entry of different ideas and sense of values. The deliberation used for settling the issues in traditional Japanese practice can not function well as the different sense of values enters the market. Clear and transparent methods of settling disputes become necessary in internationalizing the market. The author has been explaining this matter in his papers since WTO matter was started to discuss but very few people could understand the magnitude of the problem.

Unilateral conditions in the standard conditions of contract

Unilateral conditions are observed in the standard conditions of contract for public construction work. These provisions are mainly related to the contractor right to demand for addition cost and/or time aroused due to change in design, conditions, etc. For instance, the article on procedure for adjustment of contract price reads as follows

'Adjustment of the contract price shall be determined through consultations between the owner and contractor. However, if an agreement on adjustment of the contract price is not reached between the owner and the contractor within (...) days of initiating consultations, the owner shall determine the adjustment of the contract price, and the owner shall notify the contractor of the adjustment'.

Similar provision can be seen on adjustment of construction period also. In addition, there is no

distinct provision on contractor's claim. Such situation in Japanese construction contracting system might have arisen from the idea that the contract has been made on the basis of mutual confidence, however such stipulations restricts the contractor rights to demand for his rightful due where a contract is made on legal basis.

There is strong likelihood of demanding more rights than realities through use of unilateral conditions intentionally and is done as a routine matter in the international marketplace. The Japanese client will suffer a great deal from the inflow of the foreign contractors if the current unilateral conditions are remained uncorrected properly to protect the rights of the contracting parties and to block contractor's unfair demands.

Diversified contractual provisions

In Japanese, public construction contracts are made in lump sum basis and there are only a few contract documents from which the scope of work can be grasped systematically. Bill of quantities (BOQ) is not a binding document and the drawings are only the sources to estimate quantities. Thus the actual scope of work remains at large and the contractor estimate depends on the quality of drawings prepared for the project. The contract do not incorporate provisions for re-measurement, progress payment, value engineering and do not accept alternative proposal in the tendering. In addition, the Japanese public construction contracting system has not envisaged the CM; construction management contracting system.

In order to improve the efficiency in the execution of the construction project through the use of diversified foreign as well as local contractors and consultants Japanese contracting system need to reform to incorporate provisions for re-measurement, progress payment, value engineering and construction management.

c) Process Control system

The bill of quantities, the method statement and construction schedule chart, these important documents for the execution of project are not a binding document on the contractor or owner in Japan. Why are these documents not binding in the contract? The explanation note of the standard conditions of contract says that since the contract is the lump sum, it is not reasonable to contractually bind the process of each activity but only contract amount and completion date shall be contractually bound. The idea may be understandable by the people who do not have an experience working at the actual project site._

Since the construction schedule chart is not a binding document, it will not be the common practice to use CPM schedule method but a simple bar chart method has been employed as the common scheduling practice in Japanese public works execution.

The supervision and progress monitoring depends on the client's interest and if the specifications or drawing requires the client to observe the works and materials. The contractor can change the work sequence freely provided that the completion date is ensured. Thus supervision and monitoring of works is not systematic because the completion date is the only milestone of the project, and the quality of the works depends on the honesty of the contractors.

The change management in Japanese public works is more abstract as the BOQ and work schedule are not the binding on the client or contractor, and the time and/or cost compensation for the change conditions of the contract depends generally on the mercy of the owners. The mutual confidence between the client and contractor in Japanese construction industry may be lost due to unclear process control system when significant number of

contractors with different sense of values entered the market. In order to track the changes and maintaining the required progress the critical path method (CPM) scheduling and its computer soft wares should be employed and be made binding on both the contractor and client.

5. CONCLUSIONS

A foreign contractor may feel uncomfortable to accept the unclear provisions and unilateral clauses in the standard construction contracts, and mutual confidence assumption in the contract is not practical to be the basis of international contract. Open competitive tendering system, fair contractual provisions and clear procedure for change management including claim/dispute settlement are necessary in order to fully internationalize the Japanese construction market and to make the industry fair, transparent and attractive to the global players of the construction. It is not only for the new comers from other countries but also the local people working in the industry as well.

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