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BRITISH DIRECT INVESTMENT IN JAPAN

The impact of deregulation and the changing economic environment since the collapse of the bubble economy

**KEYWORDS**

Foreign direct investment (FDI)

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**ABSTRACT**

This is an overview of the rapid changes in the FDI climate in Japan, particularly since 1999, which saw a quadrupling of inward investment over the previous year. In tracing the background behind the very low level of FDI, it identifies the main inhibitors up to the early 1990s as culture, low labour mobility, *keiretsu* relationships, a taboo against mergers and acquisitions, and the high cost of proving the market. Drawing on a combination of published material and interviews with British officials and executives directly involved in FDI in Japan, it proceeds to examine how the environment has changed and why.

Although deregulation has played a role, the main drivers of change have been Japan's prolonged economic slump and collapse in stock prices, resulting in the unwinding of cross-shareholdings, weaker *keiretsu* relationships, corporate restructuring, and a more mobile labour market. Mergers and acquisitions are no longer taboo, they are the main method of entry into Japan.

The experience of British companies that have recently entered Japan reveals that culture and high costs remain serious inhibitors, although the potential rewards of being in the world's second largest economy are so great, they believe it is worth the effort. Two cultural issues that emerge strongly are lack of understanding of Japan by parent companies, and difficulty in getting staff to work the way they want them to. British officials attribute lack of understanding of Japan in large part to the media's heavy emphasis on Japan's economic difficulties.

BRITISH DIRECT INVESTMENT IN JAPAN

The impact of deregulation and the  
changing economic environment since  
the collapse of the bubble economy

by

David Powers

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## **PREFACE**

As BBC Tokyo correspondent from 1987 to 1992 and again in 1994, I observed at close quarters Japan's amazingly speedy recovery from the global stock market crash on Black Monday (19 October 1987), the dizzy rise of asset values that became known as the 'bubble economy', and its subsequent burst. It was a fascinating time to talk to business people, government ministers and officials from Britain, the USA and Japan about trade and investment. Although the overriding impression they conveyed was of difficulties and obstacles, those with long experience of Japan also clearly believed that the size and importance of the Japanese market made it worth the effort trying to overcome them. Most British efforts were aimed at increasing exports, notably the launch in 1988 of Opportunity Japan, a government campaign that set out to double exports over a period of three years – and succeeded. Virtually all direct investment activity was aimed at attracting Japanese companies to add to their already considerable stock in the UK. A notable exception was ICI, which purchased an 18-hectare site at Tamatsukuri and announced the construction of a new factory there, as part of a series of investments worth nearly £150 million to develop and produce polyester film for the local market.<sup>1</sup>

My interest in the subject was rekindled in October 1998, when the Department of Trade and Industry (DTI) invited me to chair a seminar to encourage UK businesses to invest directly in Japan. This was part of the DTI's Action Japan campaign, which

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<sup>1</sup> Personal interview with Denys Henderson, Chairman of ICI, in Tokyo, 13 September 1988.

received the active participation of the Japanese government through the Japan External Trade Organization (JETRO). There was a striking parallel with the 1980s, when the Thatcher government vigorously courted Japanese direct investment to help Britain overcome its economic difficulties. By the end of the 1990s, Japan had gone through a decade of similar problems, and the governments of both countries had again turned to foreign direct investment (FDI) – only this time, they were collaborating to promote the flow in the opposite direction.

This research project would have been impossible without the assistance of many people, particularly the executives of companies that have recently entered Japan, who gave up a great deal of time to share their insights of this fascinating, but complex market. I would like to thank them by name, but cannot do so to preserve the anonymity their companies requested. Those I can name are Peter Woods and Mike Ingle of Trade Partners UK, who offered detailed information, combined with warm support and encouragement.

I owe a special debt of gratitude to John Sparkes and Hafiz Mirza, two members of the Bradford team, whose earlier research forms an important background to this project. Hafiz earns particular thanks for guiding me patiently through the drafting process.

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**NOTE ABOUT CURRENCIES**

All figures are quoted as given in original sources, including those instances where equivalents for US dollars, sterling and yen are given in other currencies. The only exceptions are on pages 64 and 66, where the average amount of individual expenditure on work-related education and the price of cheap consumer goods have been converted at the rate prevailing in early March 2001 (£1 = ¥175).

# 1 INTRODUCTION

## 1.1 Overview

Exports are no longer the main driver of international trade. That role now belongs to the sales of foreign affiliates, which reached \$14 trillion worldwide in 1999 – virtually double all global exports (UNCTAD, 2000a: xv-xvi) – making FDI an important consideration for the strategy of any business. Yet FDI cannot be undertaken lightly. It is the most expensive and risky method of expanding outside a company's domestic market, involving operations innately more complex, diverse and uncertain (Bartlett & Ghoshal, 2000; Hill, 2000; Madura, 2000). FDI in Japan is doubly problematic, as it is regarded as difficult for outsiders to do business in (Mirza et al, 1995; Trompenaars & Hampden-Turner, 1997) and – until recently – as 'closed to new entrants' (Takahashi & Oyama, 2000; Tett, 2000). In spite of these perceived difficulties, there has been what UNCTAD describes as 'a remarkable and sudden shift' in the flow of FDI into Japan, which reached a record \$13 billion in 1999 – four times greater than the previous year (UNCTAD, 2000a).

Why such a change? What implications are there for UK business? Has Japan genuinely become what the Japanese and British governments call a 'land of opportunity' (JETRO, 2000; BTI, 2000), or do difficulties still exist? These questions became particularly pertinent in March 2001, when the Japanese stock market fell to a 16-year low, and the finance minister admitted government finances were on the verge of collapse if nothing was done.

### 1.2 Project methodology

The most comprehensive way of answering these questions would be a full survey of all British FDI in Japan in recent years, covering motives, degree of success, and perceptions of the Japanese market. This would be a major undertaking: figures published by the Japanese Ministry of Finance (MoF), reveal an average of 55 cases a year of British FDI in Japan during Fiscal Years<sup>2</sup> (FY) 1992-99 (MoF, 2000a), and a further 45 in the first six months of FY 2000 (MoF, 2000b). Although such a survey would be extremely valuable, it was beyond the scope of this project.

The approach adopted, therefore, has been to conduct a critical review of published research and literature in both English and Japanese, including promotional material created by government and other agencies in Japan and the UK. The review builds, in particular, on earlier research by the Bradford Management Centre into European FDI in Japan (e.g. Buckley et al, 1993; Mirza et al, 1996). To test how appropriate the Bradford team's findings remain in today's rapidly changing environment, a series of in-depth structured interviews was conducted, first with officials promoting British FDI in Japan, and then with companies that have entered Japan in the past five years. Where appropriate, reference has also been to the author's own notes, scripts and tape recordings from the 1987-92 period.

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<sup>2</sup> The Japanese Fiscal Year runs from April to the following March.

## **2 AN ATTRACTIVE, YET DIFFICULT MARKET**

### **2.1 A brief historical perspective**

In spite of Japan's image as a country hostile to FDI, it has not always been that way. During the first three decades of the 20<sup>th</sup> century, there were no severe restrictions on foreign investment in Japan. In fact, the city of Osaka did everything it could to encourage American carmakers to set up production in its area; and by 1930 Ford and General Motors controlled 95 per cent of the domestic Japanese car market (Wood, 1994: 204). The rise of the military in the 1930s, coupled with active lobbying by Japanese manufacturers for government assistance and protection, signalled the end of the open door policy. Even when policy was dictated by the American-led Occupation authorities after the war, restrictions on FDI were kept in place out of concern that foreign companies might take undue advantage of weakened and therefore temporarily vulnerable Japanese firms (Wood, 1994: 206-7).

Eighteen months after the Occupation ended, a Japanese delegation to Washington indicated that 'the furnishing of more capital to Japan, either in the way of direct investment, loan or credit will be welcome'. The American response was that Japan should liberalize its laws and regulations governing private foreign investment, coupled with the creation of a domestic economic climate conducive to such investment (Dower, 1988: 455). Moreover, Joseph Dodge, who during the Occupation had imposed tight fiscal conditions on Japan aimed at stabilizing the economy and

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promoting self-sufficiency, firmly advised the Japanese to avoid ‘over-emphasis on the need for foreign investment and an under-emphasis on methods for providing greater investment from domestic sources’ (Dower, 1988: 577 note). This response was to prove ironic in view of the subsequent accusations that Japan had deliberately built up its domestic industries as a way of keeping out foreigners.

The process of dismantling formal restrictions on FDI began in 1956 and was largely completed by 1973 (Porter et al, 2000: 24). Accounts of this process are frequently partisan. A participant in the often-acerbic trade negotiations between the United States and Japan, Clyde Prestowitz, asserts that in the immediate post-war period, ‘licensing and joint ventures were the only way for foreign companies to enter Japan’s market’ (Prestowitz, 1988: 176). This is contradicted by the founder of the Tokyo office of the Boston Consulting Group, who points to Coca-Cola, which took the risk of forming a ‘yen company’ in the late 1950s, when there was no guarantee it would be able to repatriate capital or profits until and unless the yen became convertible (Abegglen & Stalk, 1987: 218-9). As a result of taking this risk, Coca-Cola now derives roughly 20 per cent of its global income from Japan (Coca-Cola, 2000: 66).

While acknowledging that government restrictions on FDI did exist, Abegglen and Stalk contended that:

The second type of protection – no less effective and much more lasting – has been provided by the indifference and ignorance of possible foreign investors regarding Japan, and their unwillingness in many cases to pay the price in effort and patience to make the investment. (1987: 217)

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The Europeans were equally unwilling. The head of the economic and trade department of the EC Delegation in Tokyo in the 1970s, Endymion Wilkinson, noted there were about as many Christian missionaries from the EC in Japan as businessmen. He added that the missionaries had been no more successful, with less than one per cent of the Japanese population converted to Christianity (Wilkinson, 1983: 213).

Yet even 20 years after most restrictions on FDI had been lifted, the Wednesday Group, a Washington-based policy caucus of leading Republican members of Congress, found that Japan still had the lowest level of inward FDI per capita of all the industrial countries: \$180, compared with \$1,600 in Germany, some \$2,000 in America and more than \$4,000 in Britain. This was not due to any objection to the principle of FDI. In fact, Japan had more than 20 times more money invested abroad than other countries had invested in Japan (quoted in Wood, 1994: 202).

### **2.2 From government regulation to private restrictions**

In spite of the lifting of formal restrictions, why was the flow of FDI so biased? Was it ‘indifference and ignorance’ as Abegglen and Stalk suggested, or were there other, hidden barriers? Dennis Encarnation of Harvard Business School was in no doubt the fault lay squarely with ‘unfair’ Japanese practices:

From a position of unrivalled strength, Japanese oligopolists have moved to replace government regulations with private restrictions on business relationships among shareholders, buyers, suppliers, and other “stakeholders.” In effect, such private restrictions work to deny foreigners access to the Japanese market long after all formal government controls are abolished. (1992: 7-8)

Nevertheless, it would be false to imply that Japan was closed either to foreign goods or to the establishment of foreign multinationals. As Emmott pointed out in his highly perceptive analysis of the problems Japan was likely to face in the 1990s, many foreign multinationals – including Nestlé, Unilever, IBM Japan, Coca-Cola, Philips, Procter & Gamble, Texas Instruments, and 3M – were already producing and selling their goods in Japan (Emmott, 1989: 64).

Although not a closed market, there was – and still is – a marked imbalance between inward and outward flows of FDI.

### **2.3 Bradford research – a more measured approach**

Three academics from Bradford Management Centre, Peter Buckley (now of Leeds University), Hafiz Mirza and John Sparkes, have been studying European FDI in Japan since 1983, focussing on 21 companies (all in the manufacturing sector) from nine European countries. In 1996, they published a comparison of their own research with that carried out among US companies by the American Chamber of Commerce in Japan. What emerges is a clear picture, stripped of emotional undertones, of why companies undertake (or reject) FDI in Japan and the difficulties they face. The following discussion is based largely on their findings (Mirza et al, 1996).

#### **2.3.1 Motives behind FDI into Japan**

The normal motives behind FDI can be loosely classified under three broad categories:

1. Desire for market access
2. Cost reduction – access to cheap labour and other factor costs
3. Attempts to control raw materials

Since Japan has virtually no raw materials of its own and is generally regarded as a high-cost country, this leaves only one key motive for FDI in Japan – to achieve market access. In fact, Japan's high costs and search for raw materials explain why Japan has been so active in pursuing *outward* FDI.

As the world's second largest single-country economy, Japan accounts for roughly 13 per cent of the world's GDP (1998 figures, quoted in BTI, 2000: 7). The fact that it is a high-income country with a large domestic market *should* make Japan an attractive location for FDI. However, the Bradford research concluded that:

...it is not *location* factors that disfavor Japan as a target for FDI, it is *internalization* factors. (Mirza et al, 1996: 43 – emphasis in original)

### 2.3.2 Inhibitors to investment in Japan

According to the theory of internalization, multinational companies come into being because international transactions can be carried out more profitably *within* a firm (internally) rather than between firms (Krugman & Obstfeld, 2000: 172). The Bradford research identified five factors facing foreign companies in Japan, imposing uniquely high costs and inhibiting the internalization process:

## Chapter 2 – An attractive, yet difficult market

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1. Cultural barriers – difficulties in language, customs and business procedures, buyer behaviour, the distribution system, and stringent Japanese standards and norms
2. Immobile labour market – loyalty of Japanese workers to long-established employers and distrust of ‘unknown’ foreign entrants; taboo against poaching
3. Close interrelation of Japanese companies through vertical and horizontal *keiretsu*<sup>3</sup> – makes it difficult for foreign firms to establish a stable supply base and links with major purchasers; the banks’ close links with the *keiretsu* also make local financing more difficult
4. Entry has to be by building from scratch because of cultural barriers to take-overs
5. Difficulty of export access makes it difficult to ‘prove’ the market and to justify the fixed set-up costs of direct investment

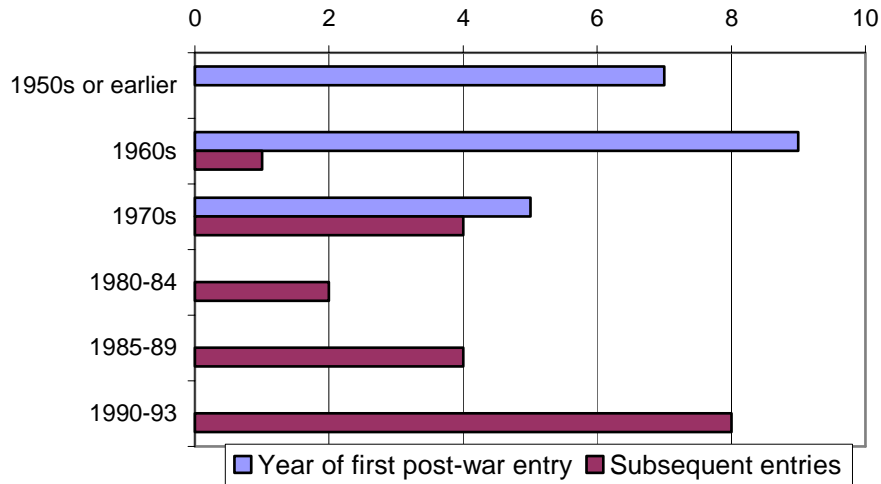
### 2.3.3 An additional cost – ‘two-stage’ entry

With regard to European firms, another significant factor raising the cost of FDI in Japan was discovered – the frequent need for ‘two-stage’ entry. Most companies entered Japan through joint ventures, but then encountered major problems in moving to a wholly- or majority-owned stage, when the Japanese partner was unwilling to sell its stake. This resulted in the need to make a second entry, usually replacing or circumventing the original joint venture (see Figure 2.1).

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<sup>3</sup> Groupings of firms that support each other through cross-shareholding, normally centred on a main bank with ties to all of them.

Figure 2.1: 'Two-stage' entry into Japan by European companies



Source: Buckley et al (1993, fig 10)

### 2.3.4 The benefits of investing in Japan

In spite of these high costs and inhibiting factors, the surveys of both American and European companies showed a high level of commitment to Japan, particularly among the Europeans, once the decision had been made to establish operations there. Indeed, the Bradford team drew the conclusion that ‘the restrictions and difficulties identified by surveyed firms as specific to them and their industries *paradoxically represent a convincing case for investment in Japan*’ (Mirza et al, 1996: 46 – emphasis in original). Being there was considered the best way to address any problems. Between 50 and 60 per cent of the companies surveyed said they were in Japan and would continue to invest there because of:

- The opportunity to grow sales and profits in Japan
- The importance of Japan in global strategy

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Nearly two-thirds of European companies had increased their investment in Japan by more than 100 per cent since 1985. The proportion of American companies doing so was much smaller, but this was attributed to the fact that the cheap dollar had boosted exports to Japan instead. 1985 was the year of the Plaza Accord that resulted in a dramatic shift in the value of the dollar, which fell from around ¥250 to roughly half that value within two years (Krugman & Obstfeld, 2000: 590-1; Asahi Shimbun, 1998: 112).

There was clear agreement among both European and American companies surveyed about their reasons for manufacturing in Japan (Mirza et al, 1996: 45). The four main reasons in descending order of importance were given as:

1. To meet Japanese quality requirements – this was particularly important for firms in the chemical, pharmaceutical and industrial machinery sectors
2. To meet Japanese special product requirements
3. To show commitment to customers
4. To provide a stable supply source

Significantly, regulatory issues were rated *low* by both European and American firms, although the legacy of past disputes seemed to weigh more heavily on the Americans.

The majority of companies not only had manufacturing facilities, but also carried out research and development in Japan, principally to meet customer needs. Those that decided not to establish R&D facilities in Japan cited cost and staffing issues as their

main reasons for not doing so. The high cost of land was also the one common factor emerging from companies that decided not to establish a manufacturing base in Japan.

### 2.3.5 Success factors

When asked to list the three critical factors for success, the European and American companies came up with exactly the same answer (Mirza et al, 1996: 47):

- Innovative, quality products
- Good local staff
- Support from the parent company

This led the Bradford team to the conclusion that ‘a long term commitment is necessary, backed by knowledge of the Japanese market and respect for business traditions’. This could, in fact, be argued about any market, but given the history of Japan’s allergy to FDI and the particular inhibitors discussed above, it underlines the point that Japan is *not* a place to make a quick buck – unless you are very lucky.

## 2.4 A highly competitive market

Many of the same ideas were conveyed to the author at the launch of Opportunity Japan. As Michael Connors, a leading analyst at a British securities company in Tokyo put it:

You have to accept the brutal logic... that if you don’t market the product to the customer in a way which he’s going to understand and find acceptable – and in the face of very stiff domestic competition – then you’re going to lose... You just have to be prepared to pay a lot of money up front to build a sensible presence here, and to deliver a decent product or service (Powers, 1988).

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The then President of the British Chamber of Commerce in Japan, Bob Pearce, echoed this view, and spoke of the need for British businesses to study the particular needs of the Japanese market. Equally upbeat about the prospects for British business several months later was the Chairman of ICI, Denys Henderson, who ascribed success in Japan to two factors: local research and selectivity – not trying to sell the same things as your competitors.<sup>4</sup>

Research by Michael Porter and two Japanese colleagues shows that these messages are just as valid today as they were in the 1980s. They concluded that one of the fundamental causes behind Japan's prolonged economic slump is fierce domestic competition forcing Japanese companies to imitate and emulate their competitors, and the absence of strategic focus (Porter et al, 2000: 82). Japan is no different from any other market – at least in the need to offer the right product, at the right price, and at the right time. Such judgements are more easily made by being there.

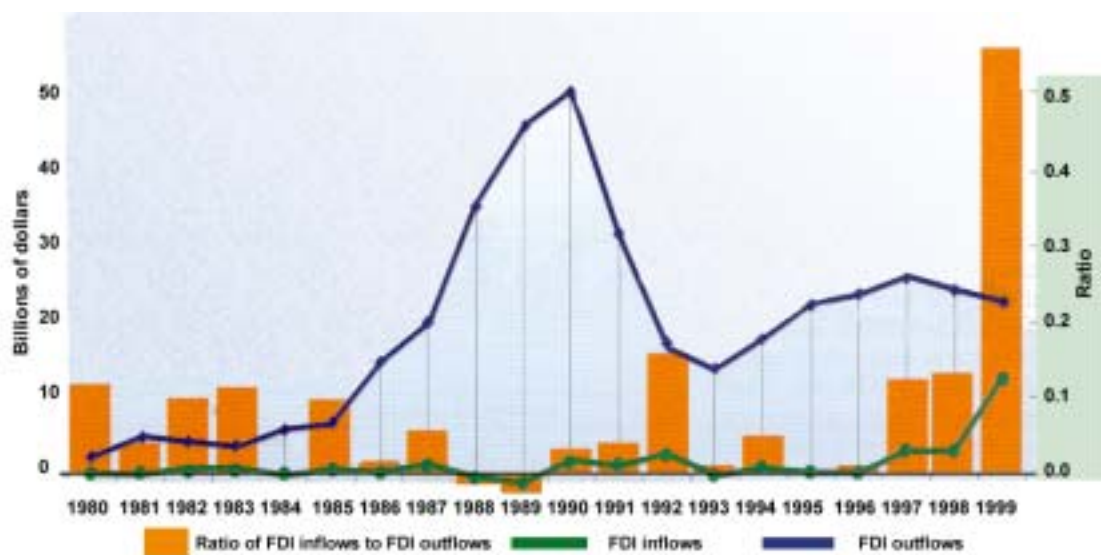
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<sup>4</sup> Personal interview with Denys Henderson cited earlier.

### 3 'A REMARKABLE AND SUDDEN SHIFT'

After years of resisting foreign direct investment on levels comparable to other parts of the world, Japan has suddenly opened the gates, with the amount of inflows quadrupling to \$13 billion in 1999. At the same time, outflows of FDI from Japan declined by six per cent to \$23 billion. Although this means Japan still acquired considerably more FDI stock abroad than foreign companies acquired in Japan, the imbalance between inflows and outflows fell to the lowest level since Japanese authorities started to collect FDI statistics comparable to other major developed countries (see Figure 3.1). In the view of the UN Conference on Trade and Development, this represented 'a remarkable and sudden shift' (UNCTAD, 2000a: 38).

Figure 3.1: Japanese FDI flows and ratio of inflows to outflows, 1980-1999

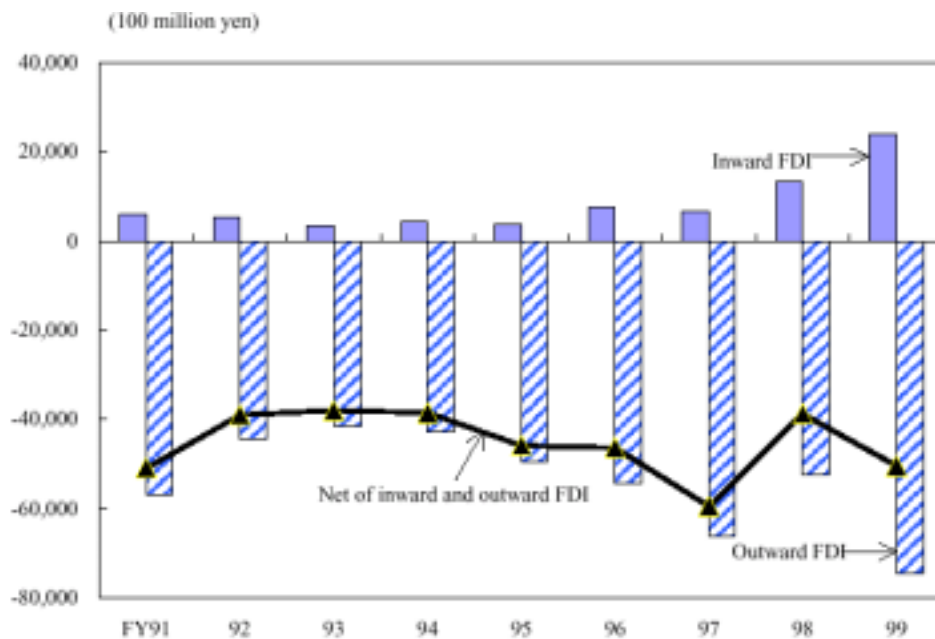


Source: UNCTAD (2000: 39)

### 3.1 Interpretation of statistics

A somewhat different picture emerges from one of the most widely available sets of statistics – those published by the Japanese Ministry of Finance (MoF) – which give the impression that the imbalance between inward and outward flows of FDI reached its lowest point a year earlier, and is widening once more (see Figure 3.2).

**Figure 3.2: FDI flows based on MoF statistics (gross FDI)**



Source: Takahashi & Oyama (2000b)

Takahashi and Oyama (2000a, b) explain this discrepancy by pointing out there are two kinds of FDI statistics in Japan – those compiled by MoF, which add up newly implemented investments only (gross FDI); and those compiled by the Bank of Japan, which comply with IMF standards. The latter are based on balance of payments figures, and take into account withdrawals of investments previously implemented – and

therefore present a more accurate picture (net FDI) corresponding to that shown in Figure 3.1. The MoF figures do not take into account the active liquidation and sale by Japanese companies of weak overseas subsidiaries during FY 1998 and 1999 as part of their restructuring process.

Another drawback of the MoF figures is that they classify investments made by foreign subsidiaries based in Japan as coming from Japan itself, and not from the country of the parent company. After subsidiaries are set up, these often become a major source of investment. This has become particularly noticeable since April 2000. In the first six months of FY2000, 52 per cent of all FDI came from local reinvestment by foreign subsidiaries (MoF, 2000c – see also Section 3.3).

Wherever possible, reference will be made to net FDI figures produced in accordance with international standards, but where this is not practicable, it is important to remember that they may not represent the full picture.

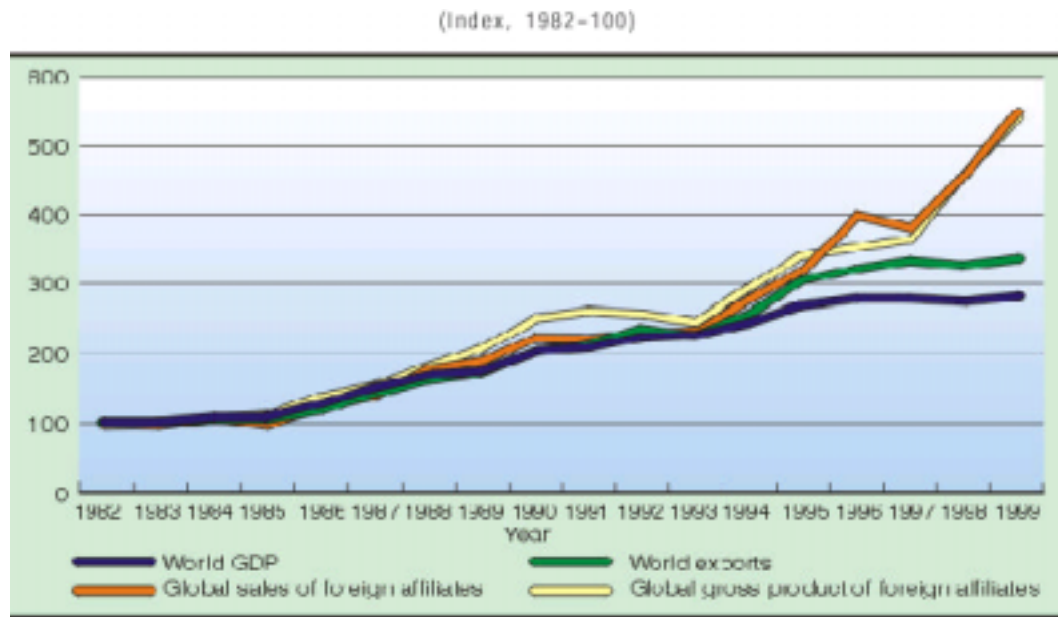
### **3.2 The international context**

As Figure 3.3 shows, an overseas presence through foreign affiliates has increasingly become a key source of competitive strength in a globalizing economy. Over the past two decades, the gross product and worldwide sales of foreign affiliates have both outpaced the growth of global GDP and global exports. Roughly one-tenth of global GDP now comes from international production, double the level of 1982. Sales by

### Chapter 3 – ‘A remarkable and sudden shift’

foreign affiliates worldwide have grown nearly five-fold over the same period, reaching \$14 trillion in 1999, nearly twice global exports (UNCTAD, 2000a: xv-xvi).

**Figure 3.3: Global sales and gross product of foreign affiliates, 1982-1999**



**Source: UNCTAD (2000a: 6)**

This is a fundamental change, and one of vital significance to such an export-driven economy as Japan. Exports are no longer the leading engine of growth.

The UK has long been active in FDI, both as an investor and as a recipient. Its holdings of outward FDI stock are second only to the United States, and in 1999 it invested £127.2 billion (\$199 billion) – making it that year’s largest outward investor (National Statistics, 2000; UNCTAD, 2000a: xvi). The net flows of FDI in and out of Japan were much smaller – \$12.7 billion in, and \$22.7 billion out (see Table 3.1).

Table 3.1: Comparison of FDI flows in and out of Japan, UK and USA

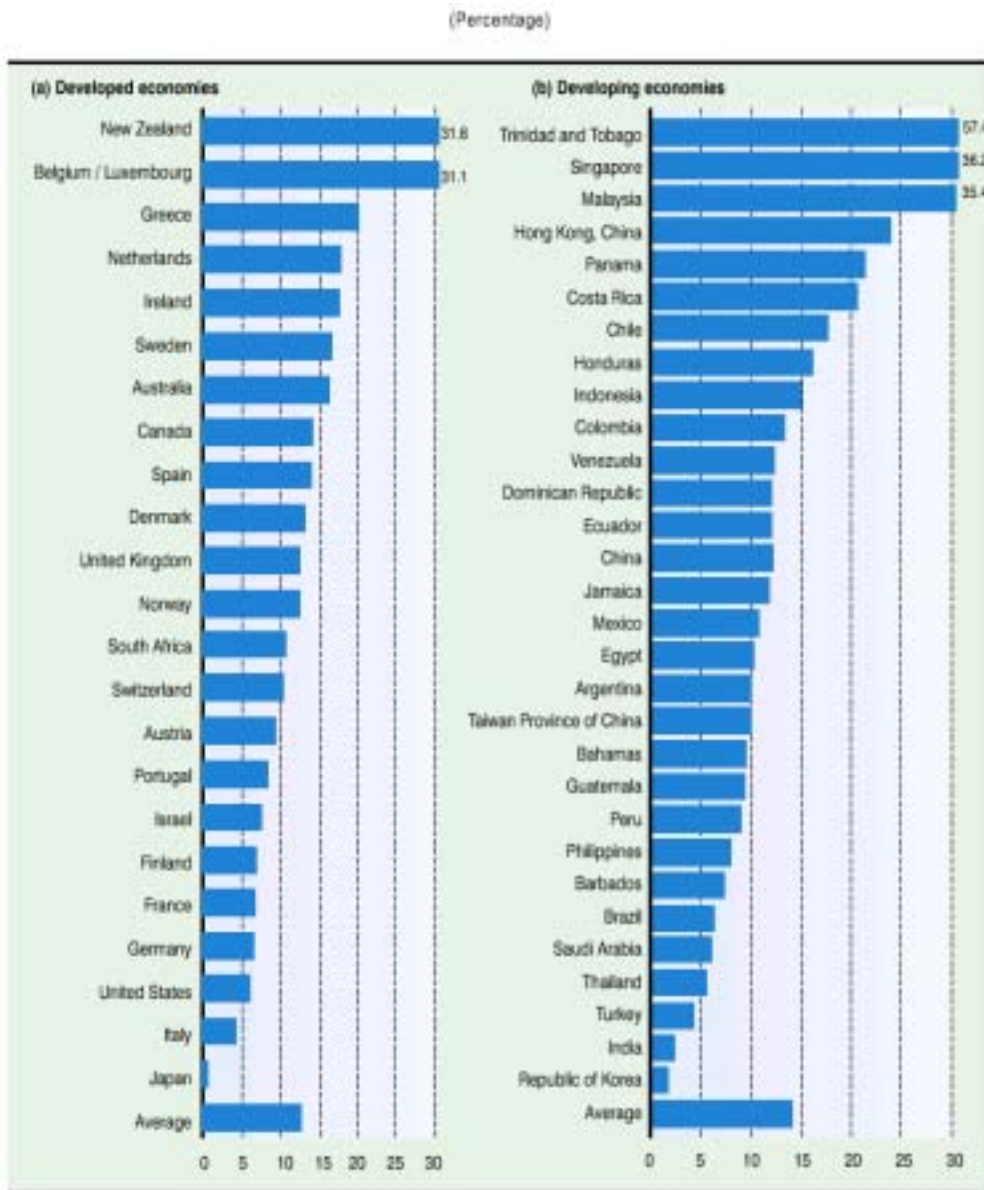
Foreign direct investment overview, selected years (Billions of dollars and percentages)									
Foreign direct investment flows					as a percentage of gross fixed capital formation				
	1985-1995 (Annual average)	1996	1997	1998	1999	1985-1995 (Annual average)	1996	1997	1998
<b>Japan</b>									
Inward	0.7	0.2	3.2	3.2	12.7	0.1	0.015	0.3	0.3
Outward	25.2	23.4	26.1	24.2	22.7	2.6	1.7	2.2	2.4
<b>Member states</b>									
<b>United Kingdom</b>									
Inward	17.0	24.4	33.2	63.0	82.2	10.8	12.5	15.1	25.7
Outward	26.0	34.0	61.6	119.0	199.1	16.5	17.4	28.0	45.0
<b>United States</b>									
Inward	44.4	84.5	105.5	186.3	275.5	5.2	7.0	8.0	12.8
Outward	41.0	84.4	99.5	146.1	150.9	4.8	7.0	7.6	10.0
<b>Developed countries</b>									
Inward	129.3	219.8	275.2	480.6	636.4	3.9	4.8	6.2	10.9
Outward	182.1	332.0	404.2	651.8	731.8	3.5	7.2	8.2	14.8
<b>World</b>									
Inward	182.6	377.5	473.1	680.1	865.5	4.1	5.9	7.5	11.1
Outward	201.1	390.8	471.8	687.1	790.9	4.8	6.2	7.6	11.5

Source: UNCTAD (2000b)

Just how effective Japan’s restrictions – both official and unofficial – have been in keeping out inward FDI is illustrated by UNCTAD’s transnationality index<sup>5</sup> (see Figure 3.4). Japan not only comes at the bottom of the list of the 24 most developed economies; it barely registers on the index. Moreover, it shows that the business environment in Japan is less international than in many developing countries, including potential rivals in East Asia. This affects not only foreign companies seeking access to the world’s second largest economy; it means Japan has excluded itself from the most rapidly growing part of the global economy. Also, an important – and often beneficial – side-effect of FDI lies in new ways of thinking it can bring the host country, as the UK learned when Japanese companies brought new managerial styles in the 1980s.

<sup>5</sup> UNCTAD’s transnationality index takes the average of four items: 1) FDI inflows as a percentage of gross fixed capital formation for the three previous years; 2) FDI inward stocks as a percentage of GDP in the current year; 3) value added of foreign affiliates as a percentage of GDP in the current year; and 4) employment of foreign affiliates as a percentage of total employment in the current year.

Figure 3.4: Transnationality index of host countries, 1997



Source: UNCTAD (2000a: 23)

Furthermore, in spite of the perception that Japan spent much of the 1980s building a massive economic empire overseas, UNCTAD figures show that Japan owns only six per cent of the world’s stock of outward FDI – less than half that owned by the UK and a quarter of that held by the United States (see Table 3.2).

## Chapter 3 – ‘A remarkable and sudden shift’

**Table 3.2: Comparison of FDI stocks held by Japan, UK and USA (1999)**

		Billions of dollars	World share
Japan	Inward	38.8	0.81%
	Outward	292.8	6.15%
UK	Inward	394.6	8.27%
	Outward	664.1	13.95%
USA	Inward	1,087.3	22.78%
	Outward	1,131.5	23.77%
World total	Inward	4,772.0	100%
	Outward	4,759.3	100%

Source: UNCTAD (2000b)

### 3.3 Who invests in Japan?

It is only to be expected that, as the world’s second largest holder of outward FDI stock, Britain would seek to be among the most active investors in Japan. Japanese figures of gross inward direct investment show that the UK is, indeed, one of the main investors, although by no means the largest. In fact, it ranks number 7 over the past decade (see Table 3.3).

**Table 3.3: Main sources of FDI in Japan since 1990**

	1990-1997	1998	1999	2000 (Apr-Sep)	Total
USA	1,290.7	807.8	248.7	659.9	3,007.1
Netherlands	544.7	128.0	471.2	17.8	1,161.7
France	86.8	16.8	745.7	15.6	864.9
Cayman Is	66.0	21.7	251.7	127.1	466.5
Canada	194.5	1.7	168.6	0.2	365.0
Germany	262.8	33.5	46.7	10.5	353.5
UK	217.1	37.0	89.8	6.5	350.4
Reinvestments by local affiliates	459.9	172.9	161.5	984.0	1,778.3

Unit: Billions of yen

Source: MoF (2000b, c)

### Chapter 3 – ‘A remarkable and sudden shift’

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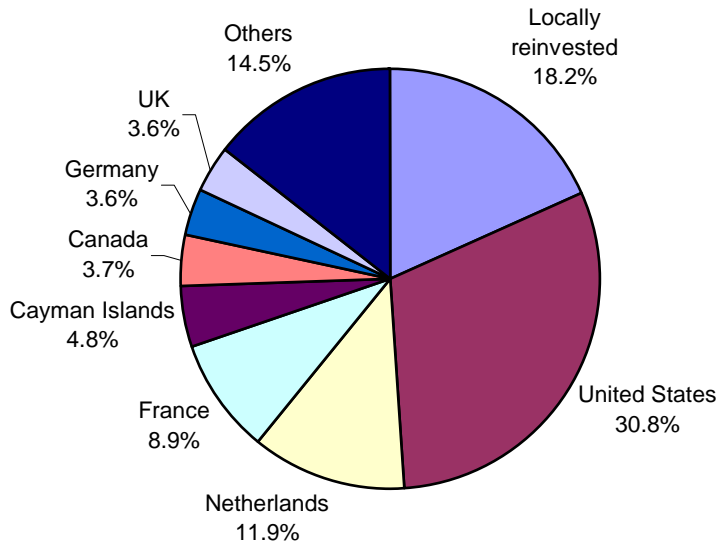
Because the overall stock of inward FDI in Japan is so small, it is difficult to draw any firm conclusions from these figures. Neither France nor the Cayman Islands invested particularly large amounts in the period up to April 1999, but then a sudden surge catapulted them into third and fourth place. In fact, 86 per cent of France’s total investment took place in just one year (1999), when Renault acquired the controlling stake in Nissan, and French buyers took over failing Japanese insurance companies.

The sudden surge in investment from the Cayman Islands can almost certainly be attributed to multinational companies exploiting offshore tax benefits. Similarly, although the Netherlands rank as the second largest individual country investing in Japan, the figures are distorted by the fact that a tax loophole means that US and UK companies often base their overseas investment vehicles in holding companies in the Netherlands (National Statistics, 2000; Tett, 2000).

Looking at the overall cumulative share of each country over the past decade, as shown by Figure 3.5, two things stand out in particular:

- The United States was by far the largest foreign investor in Japan, outstripping the UK nearly 9:1 – a very different picture from their overall global positions
- Reinvestments by local affiliates represent the second largest total, and were particularly strong in the first six months of FY 2000, suggesting that companies already established there believe Japan is a good place to invest

Figure 3.5: Gross inward investment in Japan by country, Apr 1990 – Sep 2000

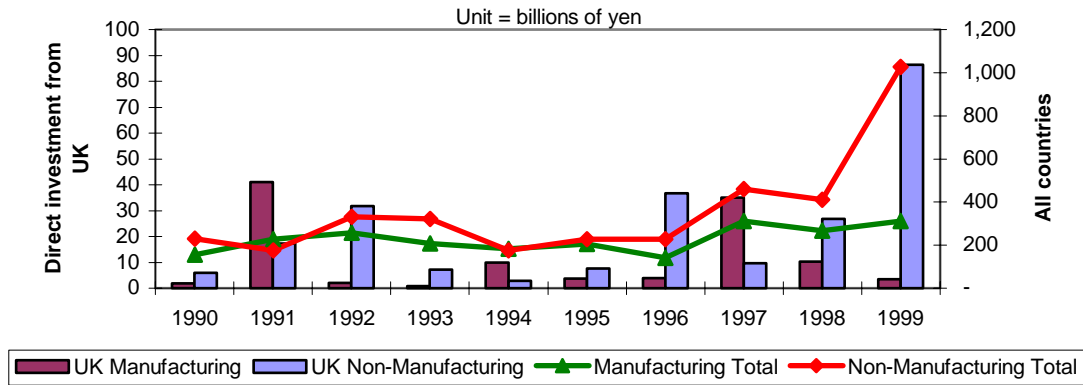


Source: MoF (2000b, c)

### 3.4 A new emphasis on the service sector

An important feature to note about FDI into Japan is the way in which gross investment in non-manufacturing has outpaced or equalled manufacturing investment ever since 1992. Investment from the UK has followed this same pattern, except in 1994 and 1997, with the non-manufacturing sector accounting for two-thirds of gross FDI into Japan over the past decade (see Figure 3.6). Among the many reasons for this shift in emphasis are the foreign takeover of failed Japanese financial institutions; the international explosion of investment in telecommunications, for which Japan represents a key international market; and (as noted in the previous chapter) the fact that high costs had already prompted Japanese companies to move manufacturing offshore. Demographic change is also opening up opportunities as the average age of Japanese gets rapidly older (this will be dealt with in Section 6.3.1).

Figure 3.6: Manufacturing and non-manufacturing gross FDI (1990-1999)



Source: MoF (2000a, d)

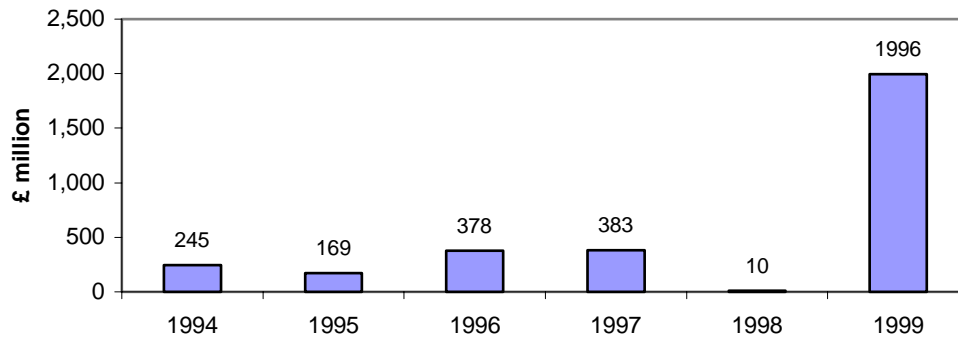
The significance of this shift from the research point of view is that the Bradford team’s studies since 1983 have concentrated solely on the manufacturing sector. The lack of research into FDI in service industries guided the selection of the companies studied for this project, but more work needs to be done in this area.

### 3.5 British investment in Japan

UK statistics, which adopt the internationally preferred principle of recording net figures, also show steady investment in Japan during the past decade, except in 1998. However, this was followed by a massive surge in 1999 – more than five times the average level of investment in 1996 and 1997 (see Figure 3.7). The most notable feature about the 1999 figures is that more than half of the UK’s FDI in Japan was accounted for by Cable & Wireless’s purchase of the telecommunications company, IDC. This reflects the emergence of the mega-deal – a trend not simply confined to Japan, but affecting investment patterns all over the world. UNCTAD records that

nearly 70 per cent by value of all cross-border mergers and acquisitions in 1999 were accounted for by just 109 deals in excess of \$1 billion (UNCTAD, 2000a: 108).

Figure 3.7: UK net direct investment in Japan, 1994-1999



Source: National Statistics (2000)

The continuing impact of such mega-deals is dramatically illustrated by the pattern of UK investment in Japan in FY 2000. The gross figures, as reported by MoF for the first six months of the year (see Table 3.3), convey the false impression that Britain has lost interest in Japan – with investment down 91 per cent in comparison with the same period a year earlier. Since the MoF figures were published, UK companies have announced at least three major investments in Japan:

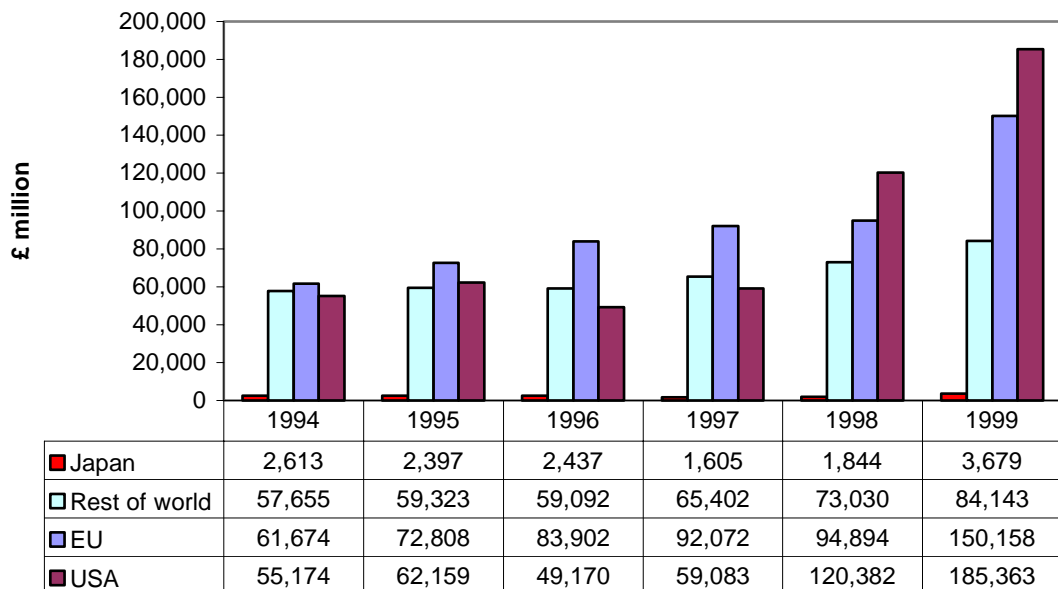
- The acquisition by Vodafone of 25 per cent of Japan Telecom – in two deals worth £2.43 billion) (Vodafone, 2000, 2001)
- The management buyout of Vantec for ¥15 billion (£85 million) organized by 3i – the first large western-style MBO in Japan (Tett & Harney, 2001)
- Prudential’s acquisition of Orico Life Insurance Company for ¥23 billion (£133 million) (Insurance News, 2001)

### Chapter 3 – ‘A remarkable and sudden shift’

These deals alone – announced within the space of just over two months from late December 2000 – are worth more than the whole of the UK’s gross investment in Japan in the previous ten years. Not only is the size of the deals remarkable, like the Cable & Wireless deal in 1999, they are all direct acquisitions – breaking down one of the major inhibitors to FDI in Japan revealed by the earlier Bradford research (see Chapter 2.3 above). This will be explored further in the following chapter.

In spite of this dramatic turnaround, it is necessary to put UK investment in Japan in its international perspective by examining the net book value of British FDI stock worldwide (see Figure 3.8).

**Figure 3.8: Global distribution of British FDI stock (net book value)**



Source: National Statistics (2000)

### Chapter 3 – ‘A remarkable and sudden shift’

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Even though the net book value of UK direct investments in Japan increased by 40 per cent between 1994 and 1999, British FDI in Japan is just a fraction of what companies have invested in the EU, the USA and the rest of the world. In 1994, the net book value of investments in Japan was just 1.5 per cent of the UK’s global stock of FDI. By 1999, it was down to 0.9 per cent. This raises the obvious question as to why UK companies have such a small presence in what the Bradford research identified as an attractive location. Several possible explanations present themselves:

- Changes in the investment climate are too recent for the imbalance to have been redressed, but this will begin to correct itself automatically
- British companies do not believe the changes are sufficient to divert investment from other, more profitable areas of the world
- British companies are ignorant of the changes
- British companies do not believe the economic conditions are right
- FDI is shifting towards the mega-deal, so fundamental patterns of FDI will become more irregular as companies invest or divest in particular markets

By way of comparison, even the United States has located only a small proportion of its global FDI stock in Japan – just 4.2 per cent in 1999 (Bargas, 2000: 59)<sup>6</sup> – in spite of the fact American firms enjoy a much closer affinity with Japan because of the US post-war influence on Japan and closer concordance between US and Japanese

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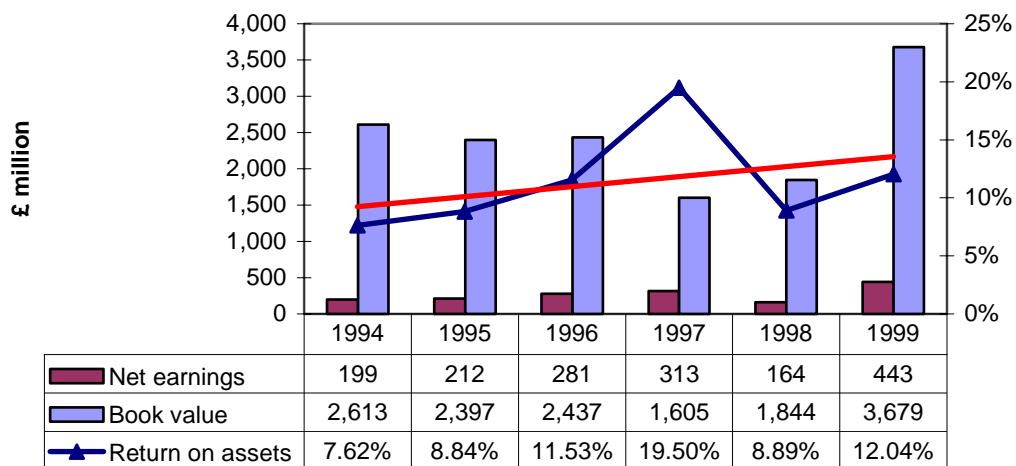
<sup>6</sup> The US Department of Commerce Bureau of Economic Analysis reports figures for direct investment abroad on a historical cost basis, which are not directly comparable with UK statistics. However, the purpose here is to compare trends rather than absolute figures.

standards (Mirza et al, 1996: 47). It is also worth noting that, even though the United States has invested heavily in Japan since 1994, like Britain the proportion of its global FDI stock held in Japan has declined – from 5.6 to 4.2 per cent (BEA, 2000). It is too early to say whether the sudden opening up of Japan during 1999 will reverse this trend through continued investment by multinational companies.

### 3.6 Return on assets of FDI

Making the decision to invest directly in any country involves complex analysis of such key variables as the costs of servicing the local market, demand conditions in that market, host market growth, and the action of competitors (Luffman et al, 1996: 120-121). The conditions affecting each industry will differ, but a very crude measure of the attractiveness of Japan as a market can be gauged from national statistics reporting net earnings from direct investment (see Figure 3.9).

Figure 3.9: UK return on direct investments in Japan, 1994-99

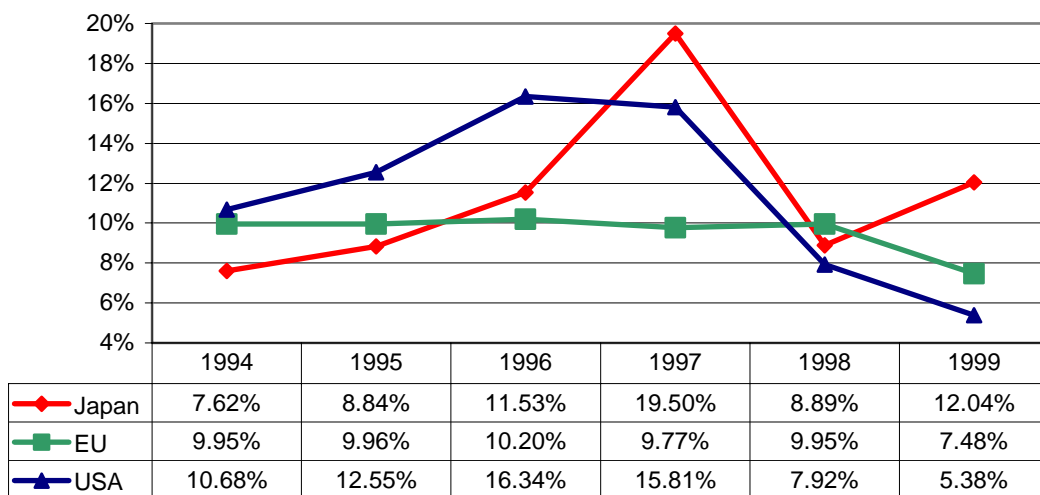


Source: National Statistics (2000)

## Chapter 3 – ‘A remarkable and sudden shift’

Although there is considerable variation in the return on assets in 1997 and 1998, this can almost certainly be attributed to adjustments in the total stock of UK FDI in Japan. However, the general trend (as shown by the red line) is clearly upwards, suggesting an improvement in the performance of those companies that have invested in Japan. Applying the same measure to British FDI in the EU and the USA shows that Japan is now providing higher returns than the two main investment targets (see Figure 3.10).

**Figure 3.10: Return on UK-owned direct investments in Japan, EU and USA**



**Source: National Statistics (2000)**

From the preceding discussion, it is clear that in spite of the considerable difficulties and peculiarities of the Japanese market, British direct investment there has been successful. Important considerations for companies contemplating entering Japan for the first time or increasing their presence there are why Japan has suddenly opened up to

### **Chapter 3 – ‘A remarkable and sudden shift’**

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FDI and whether the more favourable conditions are likely to be sustained. In plain terms – is now the right time to invest in Japan?

## **4 WHY THE FDI ENVIRONMENT IN JAPAN HAS CHANGED**

As noted earlier (see p 4), most formal restrictions on FDI had been dismantled by 1973, yet only a trickle of inward investment followed. Even after the enactment in 1992 of the Extraordinary Measures for the Promotion of Imports and the Facilitation of Inward Investment (JETRO, 2000: 26), the flow could hardly be described as overwhelming. It was not until 1999 that the floodgates opened, and the trend seems set to continue – at least for the time being.

### **4.1 Removal of major investment inhibitors**

The title of a pamphlet issued by the semi-governmental Japan External Trade Organization (JETRO) in November 2000 – *Japan: A Golden Opportunity for Investment* – makes it clear that this inflow has official blessing. Not surprisingly given the pamphlet's authorship, it goes into considerable detail about deregulation measures designed to make the Japanese market more open and amenable to western ways of doing business. No doubt these have helped, but it will be recalled that the Bradford research found that regulatory issues did not rate highly among the concerns of companies investing in Japan (see p 10).

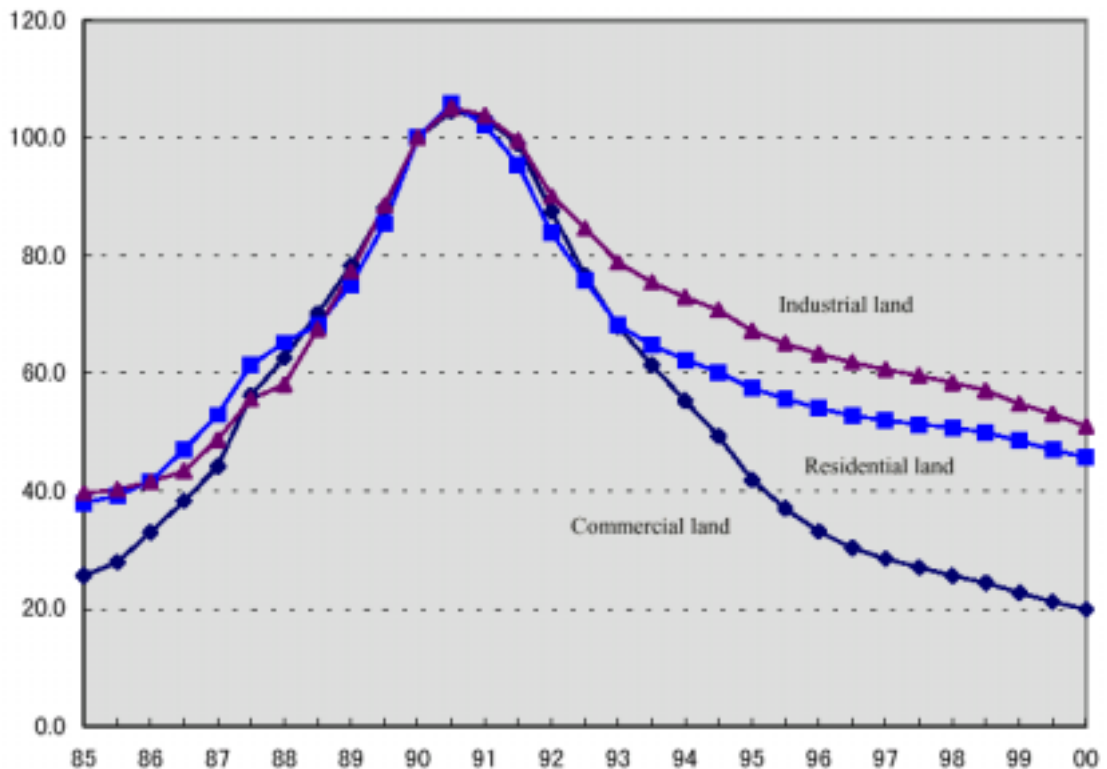
One thing the Japanese government has done that will please all businesses is to reduce the effective rate of corporate tax in two stages from 49.98 per cent to 40.87 per cent – still considerably higher than the UK – but roughly in line with the United States (JETRO, 2000: 6). However, it is not so much government-led deregulation,

## Chapter 4 – Why the FDI environment in Japan has changed

but fundamental changes in the Japanese economy that have made it cheaper and easier for foreign companies to operate in Japan:

- Land prices and rents have more than halved, and are back to their 1985 levels (see Figure 4.1)

Figure 4.1: Changes in real estate value, 1985-2000



Source: Japan Real Estate Institute (reproduced in JETRO, 2000: 11)

1990=100

- Unemployment and restructuring by Japanese companies have created a much more flexible labour market
- Japanese share prices have fallen to less than half their 1989 peak, forcing many companies saddled with bad debts to liquidate some or all of their cross-

## **Chapter 4 – Why the FDI environment in Japan has changed**

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shareholdings, weakening the traditionally strong bonds of the *keiretsu*, and making the acquisition of Japanese companies by outsiders much cheaper

- Perhaps most important of all – mergers and acquisitions are no longer the taboo they once used to be

The result is that, almost at a stroke, three of the five main inhibitors identified by the Bradford team (see Section 2.3.2), have been lifted – labour immobility, *keiretsu* solidarity, and the need to set up from scratch. Lower costs in Japan should also go some way to alleviating the problems of ‘testing’ the local market before deciding whether to take the plunge to invest directly. That means the only real inhibitor remaining lies in the cultural differences of the Japanese market – a conclusion supported by Peter Woods, a businessman with nearly 20 years’ experience at the highest level in Japan, now Senior Investment Adviser to the UK government’s Exports to Japan Unit.<sup>7</sup> While such cultural differences represent a serious hurdle, it is important to remember they exist to some extent in any foreign market, and can rarely be ignored in international business (see e.g. Trompenaars & Hampden-Turner, 1997).

While the removal of these inhibitors is to be welcomed, it is necessary to understand why the change has come about in order to assess whether this is sufficient to warrant optimism about investment in Japan, or whether new problems might take their place.

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<sup>7</sup> Personal interview with Peter Woods (22 January 2001). Peter Woods was Chairman and Chief Executive of Rover Japan for 13 years. He also served as Chairman of the European Business Community Council, with responsibility for negotiating trade policy with the Japanese government on behalf of 30 commercial sectors.

## **4.2 Impact of the ‘lost decade’**

The collapse of the bubble economy and the Japanese government’s repeated failure to lift the economy out of its longest post-war slump has been well documented in the press and literature about Japan (e.g. Curtis, 1999; Krugman, 1999; Mulgan, 2000; Porter et al, 2000; Stockwin, 1999). Krugman, with his characteristic flair for a pithy turn of phrase, calls Japan in the 1990s ‘the future that didn’t work’ (2000: 60-82). Most Japanese prefer ‘the lost decade’ – bleak enough, but at least offering the possibility that Japan may eventually ‘find itself’ again.

Explaining why it is called the lost decade, Sahoko Kaji, professor of economics at Keio University in Tokyo, one of Japan’s leading universities, says:

Up until around 1997, the whole country was in a state of denial. We simply could not believe that the world’s most successful economy could fail so miserably, that property prices could continue to decline, that the many fiscal packages could be so ineffective. Importantly, the policy authorities, who were supposed to take the lead and solve the problem, were bewildered, along with the rest of the public, who were also bewildered and beginning to lose faith in the authorities. We simply did not realize that we were at a stage where we had to transform ourselves, and tried all the old tricks that used to work in the regime that had already ended. (Kaji, 2000: 3-4)

She identifies the turning point as the failure of three major financial institutions (Sanyo, Hokkaido-Takushoku and Yamaichi) in 1997, followed by the decision to allow the Long-Term Credit Bank of Japan to go into receivership a year later. As a result, Kaji argues, the Japanese are now aware of the need to change; and one of those sources of change is FDI, which she says Japan needs for three reasons:

- To maintain employment

## **Chapter 4 – Why the FDI environment in Japan has changed**

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- To learn new ideas and methods
- To increase competition

This argument bears a remarkable similarity to those being used by the Thatcher government in the 1980s, when Japanese investment and ways of doing business (particularly the handling of trade unions and other labour issues) were regarded as essential to drag Britain out of its old, bad habits. Peter Woods agrees that a close similarity does exist, but with one major exception. He argues that the British economy was on its knees in the 1980s, whereas the Japanese economy – in spite of all its current problems – is fundamentally very strong. Woods believes this makes a powerful argument for foreign investors to enter Japan now in order to benefit from renewed growth.<sup>8</sup>

### **4.3 FDI as a substitute source of risk capital**

Research by two economists at the Bank of Japan, Ryoko Takahashi and Tsuyoshi Oyama (2000a, b), lends support to Professor Kaji's argument, and suggests that FDI and structural change are locked in a mutually reinforcing spiral. They note that mergers and acquisitions (M&As) are now the dominant form of inward FDI<sup>9</sup>; and attribute this to the inability of the Japanese main banks to continue to provide their customers with the traditional safety net for corporate finance, thereby causing the domestic supply of risk capital to shrink. They contend that foreign companies have stepped into the breach as suppliers of risk capital through FDI. While this is no doubt true in

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<sup>8</sup> Personal interview referred to earlier.

<sup>9</sup> According to UNCTAD, Japan became the ninth largest M&A target country in the world in 1999 (UNCTAD, 2000a: 120).

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the sense that any investment represents risk, the motivations behind foreign entrants are often very different. Rather than providing capital for Japanese entrepreneurs to develop new businesses, foreign investors are pursuing their own global agendas and thus changing the nature of the Japanese economic environment.

### **4.3.1 Principal motivations for entry**

Takahashi and Oyama classify the latest wave of investment into five categories:

1. **Rescue-type M&As** (mainly in the finance, wholesale and retail industries) – foreign companies have taken an ‘important role as sponsor or primary supporter in the revitalization’ of several large firms that have failed, including Yamaichi Securities, the Long-Term Credit Bank, and the Nagasakiya supermarket chain. Under the old *keiretsu* relationships, such rescues were often carried out on a loss-sharing basis. With most *keiretsu* now labouring under a heavy debt burden, that is no longer possible. The *keiretsu* are unloading their unprofitable subsidiaries, and the foreign companies that move in are seeking a high rate of return on their investments.
2. **Restructuring-oriented M&As** (mainly in the electronics, machinery and chemical industries) – Japanese firms in the process of divesting non-strategic business units have sold off assets to foreign companies eager to gain access to technology and/or distribution channels.
3. **Deregulation-driven M&As** (mainly in the finance, retail, electronics and telecommunications industries) – business opportunities opened up by regulatory change.

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4. **Industry consolidation/business integration-seeking M&As** (mainly in the automotive, telecommunications and electronics industries) – not necessarily Japan-specific in origin, but stemming from the globalization of particular industries. The takeover of IDC by Cable & Wireless and Vodafone's part acquisition of Japan Telecom would fall into both this and category 3.
5. **IT-led greenfield investments** (mainly in the information services, software, finance and retail industries) – roughly 50 per cent of all greenfield investments in 1998 and 1999 have been IT-related, not just software developers and internet providers, but companies that utilize IT to develop new business models, such as 'category-killer' discount stores, business and investment consultants, and internet business developers. A notable British entrant in this area is RS Components, a wholly-owned subsidiary of Electrocomponents plc that provides a rapid and highly customized distribution service of electronic, electrical and industrial supplies. Although it only began operations in March 1999, it achieved a turnover of £3.6 million in March-September 2000, and expects to break even by 2004 (Electrocomponents, 2000).

All this adds up to a significant change in one of the key inhibitors identified by the Bradford team. Foreign investors no longer have to build their presence in Japan from scratch. They can now inherit a ready-made workforce, customer base and distribution system. Attractive as this might seem, UNCTAD points out that globally half of all M&As do not live up to expectations in terms of shareholder value. Also, host country concerns about cross-border M&As reach into the social, political and

## **Chapter 4 – Why the FDI environment in Japan has changed**

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cultural realms, when the transfer of important enterprises may seem to erode national sovereignty. Such concerns are intensified when acquisitions involve sales of companies in distress, often at prices considered abnormally low (UNCTAD, 2000a: xxiii).

Japan's reaction to these issues has so far been relatively subdued. Although the media reacted with horror to the takeover of the telecommunications company, IDC, by Cable & Wireless in 1999, the author received a much calmer response from one of the most senior officials in the Ministry of Posts and Telecommunications<sup>10</sup>. He emphatically welcomed a British company taking a leading role in the development of what Japan regards as a sector vital to the future of the economy. The media reaction swiftly calmed down, possibly because Cable & Wireless had paid more than rival Japanese bidders, and also because the company was an insider, involved in the establishment of IDC from the outset. The reaction to Renault taking control of Nissan has also been more one of resignation than outright revolt. A retired senior banker told a private conference in Oxford in 1999<sup>11</sup> that Japan was secretly happy Renault had brought in Carlos Ghosn because, as a foreigner, he would be able to fire people and cut costs in a way that no Japanese could. The impression he gave was that Ghosn would do the dirty work, and then withdraw so the Japanese could come back to resume business as usual. If his view is typical, the atmosphere could change once people realize that foreign companies plan to stay.

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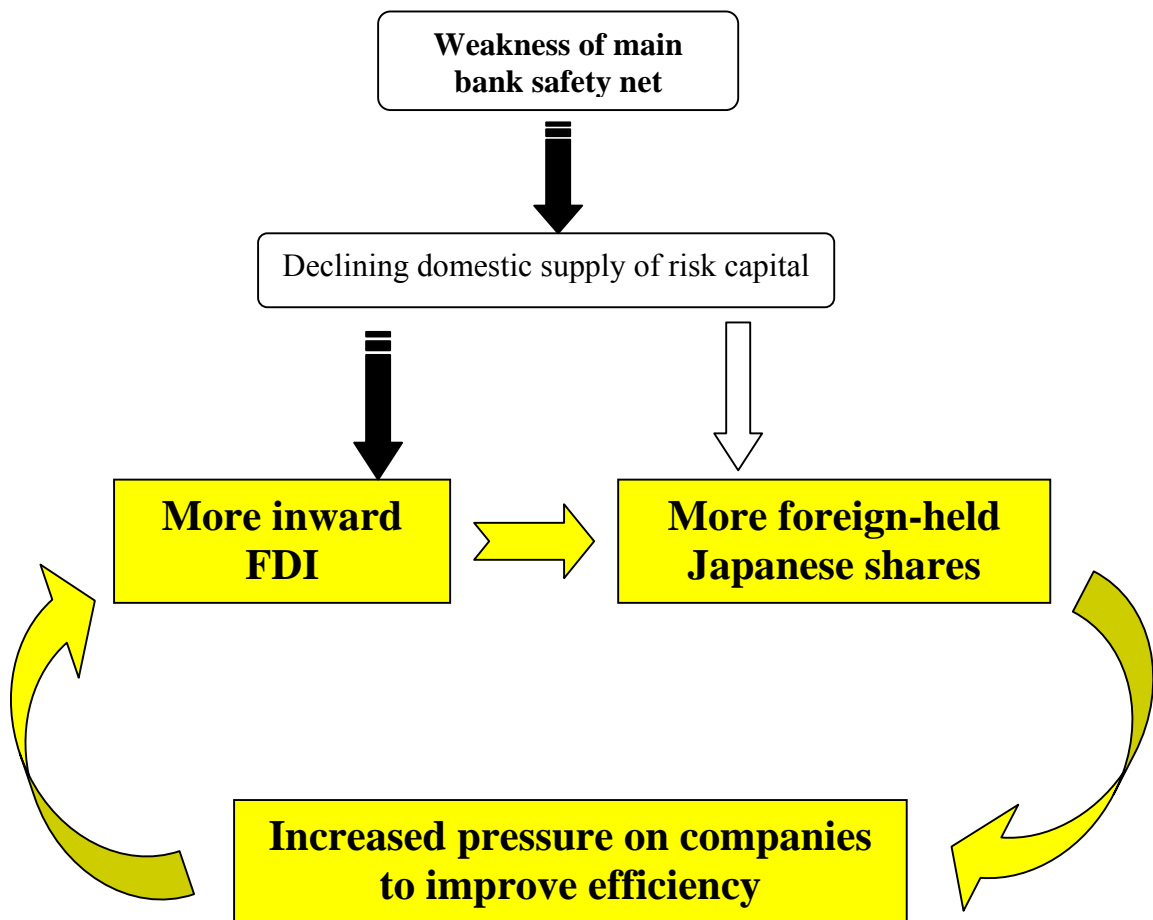
<sup>10</sup> Personal interview in Tokyo the day after the successful C&W bid was announced in May 1999.

<sup>11</sup> At which the author was present.

### 4.3.2 A mutually reinforcing spiral?

Indeed, Takahashi and Oyama acknowledge there could be a backlash against foreign companies, but they believe any slowdown in the growth of FDI would be only temporary (2000b: 15). This is because they consider the inflow of FDI and other risk capital from abroad to have become locked into a mutually reinforcing spiral with structural change in the way the Japanese economy operates (see Figure 4.2).

Figure 4.2: Mutually reinforcing spiral of FDI and structural change



Source: adapted from Takahashi & Oyama (2000a, b)

## **Chapter 4 – Why the FDI environment in Japan has changed**

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In their view, increasing inflows of foreign capital through the stock market have heightened the required rate of return for Japanese companies, forcing them to restructure. Many firms have addressed this issue by seeking capital affiliation with foreign companies to learn their managerial know-how. The more FDI there is, the more Japan changes, and vice-versa. It is a seductive argument, particularly for a country mired in a prolonged slump. It also owes much to a common belief in Japan (shared by many foreigners) that large-scale systemic reform cannot be achieved without foreign pressure (see e.g. Eisuke Sakakibara, quoted in Wood, 1994: 26; Clark, 2000).

Although foreign capital and business practices are undoubtedly changing the Japanese environment, particularly in finance and automobiles (where Toyota and Honda are now the only companies still under Japanese control), Takahashi and Oyama overlook the fact that virtuous circles – like growth – eventually lose momentum; and their model takes no account of the interventionist instincts of the LDP-led government. But if they are right about the power of the changes sweeping through the economy, although government intervention may slow the process down, pressure from business – both Japanese and foreign – will almost certainly make it irreversible.

## 5 IS NOW THE RIGHT TIME TO INVEST?

### 5.1 Contradictory evidence

The answer – or rather two diametrically opposed answers – to the question posed by the title of this chapter can be found in the July/August 2000 edition of *Foreign Affairs*. One very upbeat article under the title ‘Japan: A Rising Sun?’ asserts that the stage is quietly being set for an economic revolution in Japan:

Although rebuilding the Japanese economy will be no easier now than it was during the Meiji Restoration<sup>12</sup> or after World War II, the present changes are more fundamental than anything the country has ever seen. Japan’s revolutionary path will utterly transform it from the state-run industrial powerhouse of the twentieth century toward an innovation-driven, globalized economy of the twenty-first. (Helweg, 2000: 26)

Another article, ‘Japan: A Setting Sun?’, paints a dismal picture of a country, where:

The modest injection of dynamism into the economy effected by corporate restructuring, the information-technology boom, the explosion in e-commerce, and the dissolution of traditional *keiretsu* corporate groups – legacies of the *zaibatsu* conglomerates that were broken up after World War II – is not enough to offset the drag of vested interests and myopic, self-serving bureaucrats and politicians. (Mulgan, 2000: 50-51)

Both articles are by respected experts on Japan, who base their very different opinions through observation of essentially the same set of facts. Helweg’s optimism stems from the belief that ‘The government is not driving the current revolution; business is’ (p38); and that FDI is playing an important role in changing Japan. Her view is very

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<sup>12</sup> The period of rapid economic, political and social change that Japan underwent after it emerged from more than two-and-a-half centuries of self-imposed isolation in 1868. The Meiji Restoration transformed the country from a feudal society into a modern industrial state in three decades.

## Chapter 5 – Is now the right time to invest?

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much in line with the analysis by Takahashi and Oyama (see Section 4.3), whereas Mulgan believes that, in spite of the changes sweeping the country, vested interests will prevent them having the desired effect.

Equally contradictory evidence comes from the business press. A survey of 12 leading economists in Tokyo, conducted by *The Nikkei Weekly* in January 2001, produced a wide range of predictions of annualized GDP growth in the first quarter of the calendar year – from minus 2 per cent to plus 8 per cent. The paper concluded: ‘The only consensus seems to be that the current administration led by Prime Minister Yoshiro Mori has almost no economic policy and lacks a clear vision on how to revitalize the nation’s fragile recovery’ (Ikeya, 2001). Two months later, Finance Minister Kiichi Miyazawa seemed to give credence to that verdict by declaring government finances on the verge of collapse, a statement he hurriedly amended the following day by adding ‘if nothing is done’.

However apocalyptic this pronouncement seems, as Krugman points out, countries do not go out of business (1996: 6). Japan is not the first country to find itself in such a situation, nor is it likely to be the last. The Japanese government’s inability to revive the economy has been brought about by fear of action that might induce short-term pain. Although there is no guarantee the government will get things right, at least Miyazawa’s outburst signals a clear recognition of the problem. British and American experience shows that tough measures, however painful in the short term, eventually produce a stronger economy.

The crucial question for business is to separate short-term operational decisions from long-term strategy. Because of the complexity and risks involved, FDI is strategic in nature, relating to the direction and scope of a company over the *long term* (Johnson & Scholes, 1999: 10). By concentrating too much on Japan's problems, companies run the risk of failing to grasp emerging opportunities, some of which may, in fact, arise precisely because of the current difficulties and the changes they are forcing on the Japanese economy.

In essence, the problems facing Japan are sporadic growth, stagnant consumer demand, a high rate of bankruptcies, fear of deflation, and high unemployment<sup>13</sup>. As *Euromoney* put it in March 2000, 'An economy that isn't growing, with a population that isn't spending, where regulations are often onerous and arbitrary and where the cost of employing workers remains high, would not seem a particularly attractive destination for foreign companies to set up operations' (Lee, 2000). Yet, as *Euro-money* noted, FDI into Japan was growing at a healthy rate – and still is.

### 5.2 The UK government's positive long-term view

In spite of all the bad news, the British government department responsible for promoting trade and investment in Japan is unequivocally positive about the long-term environment in Japan. In October 2000, it stated: 'This is probably the best time

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<sup>13</sup> Official statistics put the unemployment rate at 4.9 per cent in January 2001 (Statistics Bureau, 2001a). Although low by international standards, Japanese unemployment is at a post-war high, and has hovered around this level since February 2000. However, research by the Bank of Japan calculates that the rate is probably in the region of 10 per cent, if those 'discouraged' from seeking work are included (Tachibanaki et al, 2000: 26-27).

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therefore in 50 years to start exporting to or investing/reinvesting – in Japan' (Trade Partners UK, 2000a: 3). It lists the following reasons for its optimism:

- Japan continues to be very strong and is the second largest economy behind the United States accounting for 13 per cent of the world's GNP in 1998
- Japan has the highest GNP per head in the G7 – \$32,230 per person
- Japan's 126 million people control 25 per cent of the world's personal savings
- Consumers are demanding, but very open to new ideas, products and services
- Land and property costs are as much as 75 per cent lower than their peak in the 90s, and back to 1986 levels in Tokyo and Osaka
- High quality staff are available because domestic companies are restructuring
- Factory labour costs are at mid-European levels
- Inefficiencies, costs and regulations are reducing
- There is an increasing air of liberalization
- Tax advantages for new companies have been improved
- Funding costs are at their lowest ever, e.g. long term at 2 per cent
- New growth areas abound, e.g. the ageing society, medical care, quality of life, urban renewal, and biotechnology

The government's Senior Investment Adviser on Japan, Peter Woods, enthusiastically supports this long-term view. His colleague, Mike Ingle, Adviser to the British Industry Centre in Yokohama, agrees with the underlying analysis, but admits that 'nobody really knows' whether now is the best time to invest in Japan. His caution is based on

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uncertainty about when the Japanese economy will get back to sustainable growth<sup>14</sup>. Woods says it can be done in five years, and the key is liquidation of bad debt left over from the bubble economy – a process he believes 50 per cent complete.

Again, the evidence about the debt problem is contradictory. An article in *The World in 2001*, published by *The Economist*, presents a positive interpretation:

Over the past few years the Japanese political establishment has flip-flopped between reformist zeal and a desire to protect powerful interest groups from unfettered financial competition. But the presence of foreigners in key areas of the financial system will mean that the move to capital efficiency is irreversible... There is now no looking back. (Tasker, 2000)

Yet in early 2001, *The Economist* ran a special report laden with doom about the state of the Japanese banks and worries about bad loans being listed as good on the banks' books (Economist, 2001). Some people fear this could lead to a meltdown of the Japanese financial system, affecting the economy as a whole. However, in spite of the pessimistic tone of the article, *The Economist* notes that the promise of a massive government safety net greatly raises the collective stability of Japan's banks to a level comparable with the UK or the United States. It also notes that while bad companies in Japan remain weak, good ones are getting stronger.

JETRO's promotional brochure *Japan: A Golden Opportunity for Investment* tends to gloss over the extent of Japan's problems by commenting that, although the economy 'remains stagnant, it is getting back onto a self-sustaining recovery track, and the

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<sup>14</sup> Personal interview in London (24 January 2001).

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business climate has been improving gradually' (JETRO, 2000: 4). It declares 'the cost of investing in Japan has decreased considerably over the past several years', quoting much cheaper share prices down from their 1989 peak (p8). While this makes M&A much cheaper, it ignores the threat posed to Japan's fragile recovery by weak share prices, which may reduce the ability of the financial sector to deal with bad loans by squeezing the capital base of Japanese banks (OECD, 2000, 49-50).

Much to its credit, the UK government's literature makes no attempt to draw a veil over the problems:

A firm economic recovery is not going to be achieved easily. Growth is likely to be tentative, as boosting public confidence in current conditions is no mean feat... In any event, the next two to three years will be a somewhat bumpy ride, because some of the changes that are occurring will inevitably disturb the economy. (BTI, 2000: 8)

It also notes that sustainable growth, once achieved, is likely to be around 2 or 3 per cent a year. This is much lower than the double-digit growth rate achieved in the 1950s and 60s, or even the levels reached in the following two decades (Asahi Shimbun, 1998: 288-289). However, the UK government literature adds a telling statistic: 2 per cent growth in Japan for just four years equals the size of the South Korean economy, the second largest in the Asia-Pacific region (BTI, 2000: 8-9). Both Woods and Ingle stress there is an important market waiting to be exploited, but the actual decision as to whether Japan is the right market and now is the right time can only be made by each individual company; and the official literature urges potential investors to 'check, check and check again' (Trade Partners UK, 2000a: 8).

Even though the environment is very different from the mid-1980s, the current message from the British government echoes the conclusion drawn by the Bradford team as long ago as 1985:

The strategic arguments for a presence in Japan are compelling for global companies: the costs and drawbacks must be balanced against the dangers of not being there (Buckley et al, 1985).

### 5.3 Japan's negative image

Various models and methods exist to help companies reach decisions about strategy in general and FDI in particular (e.g. Buckley & Casson, 1985; Luffman et al, 1996; Madura, 2000; Porter, 1980). Once a company decides it has sufficient internal strength and competitive capability to embark on FDI, it needs to assess the risks associated with the proposed host country.

A survey of country risk experts conducted by *Euromoney* in September 1995 (quoted in Madura, 2000: 454-456) accorded Japan a rating of 97/100, exactly the same as the USA, where the UK has located most of its FDI stock (see Figure 3.8). Yet, although Japan and the USA were rated equal risks, Britain had invested more than 25 times as much in America as in Japan. Since then, the ratio has more than doubled. Moreover, nearly all members of the EU, where Britain has located most of the rest of its FDI stock, ranked lower than Japan.

In the most recent *Euromoney* survey (Geiger, 2000: 216), Japan's rating has fallen to 90.7, but the ratings for the USA and most EU countries are also down. If tiny Luxembourg is left aside, there is a spread of just 2.2 points between Japan and the

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eight most highly rated EU countries. Significantly, Japan's rating for economic performance puts it less than one point behind the USA, and ahead of 11 members of the EU (see Table 5.1). Japan's highly publicized economic problems have not resulted in a significantly lower rating than Britain's two main FDI targets.

**Table 5.1: Euromoney country risk rankings – USA, Japan & EU (Sept 2000)**

World ranking		Total score (max 100)	Political risk (max 25)	Economic performance (max 25)
1	Luxembourg	99.02	24.38	25.00
3	United States	94.25	24.94	19.30
5	Netherlands	92.90	24.66	18.27
6	Denmark	92.77	23.09	19.95
7	Germany	92.77	24.52	18.27
8	France	92.33	24.34	18.01
9	Austria	92.29	23.69	18.63
10	UK	91.54	24.63	16.92
11	Finland	91.38	23.52	18.23
12	Sweden	91.12	23.65	18.65
13	Japan	90.70	23.51	18.41
15	Ireland	89.71	23.42	16.53
16	Belgium	89.63	23.07	17.84
19	Spain	87.29	23.03	14.93
20	Italy	87.11	22.61	16.14
23	Portugal	83.25	22.21	13.72
25	Greece	78.66	20.13	13.35

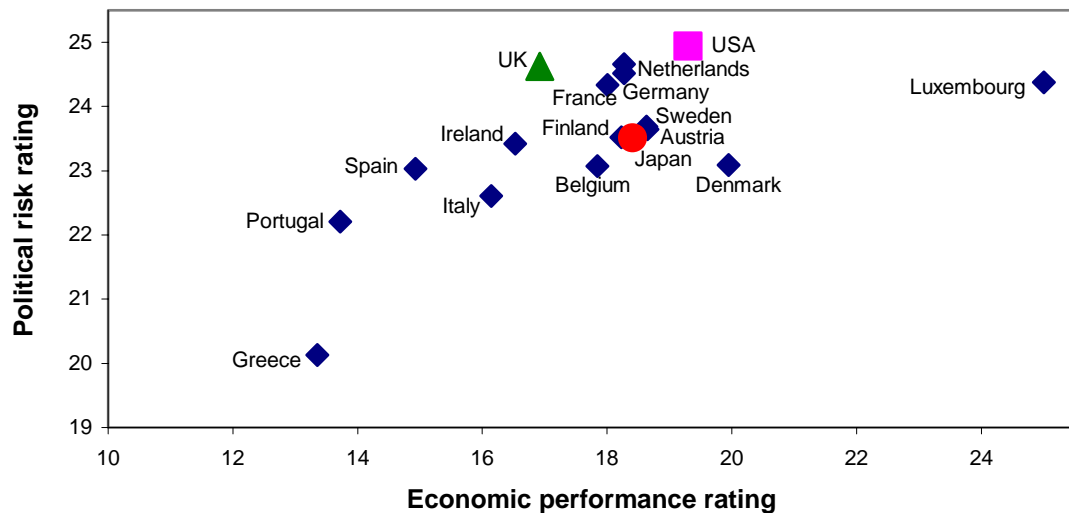
Source: (Geiger, 2000: 216)

In fact, the *Euromoney* survey indicates that Japan's economic performance is expected to improve marginally over the next two years, while the USA and most of the EU are expected to worsen slightly. GNP growth for 2001 is projected at 2.1 per cent, and 2002 at 2.5 per cent (Geiger, 2000: 223). As noted earlier (Section 5.2), growth at this rate for a further two years would create wealth equivalent to the entire South Korean economy.

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Figure 5.1 shows just how closely together Japan, the USA and the most dynamic economies in the EU are all bunched together in terms of economic and political risk.

**Figure 5.1: Comparison of economic performance and political risk**



Source: Geiger, 2000:216

This suggests the following possibilities:

- Either business decision makers are still as indifferent and ignorant about Japan as Abegglen & Stalk asserted in 1987 (see p4) – a view shared by Woods and Ingle, who lay much of the blame on hostile press coverage
- Or the risks involved in investing in Japan require interpreting in a different way from other countries – essentially recognizing the existence of the last major inhibitor: that Japan is a ‘culturally difficult’ place to do business
- Or a combination of both.

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Overcoming indifference and ignorance will not be easy. Some people harbour a lingering prejudice against Japan unconnected with business. Mike Ingle quotes a company that refuses to sell a highly marketable product to Japan because the MD still holds bad feelings about the war – which ended 56 years ago.

In the average month, just over 200 articles about Japan appear in the British press. More than half appear in *The Financial Times*, a newspaper credited by Woods and Ingle – and by senior Japanese diplomats – as fair and accurate in its coverage. Even so, Ingle is frustrated by what he regards as ‘the great delight [the media] seem to take in making entertainment out of the current state of the economy in Japan’. Referring to a particularly critical article in *The Financial Times*, he wrote:

I do not question what it says, but rather what it fails to say – that now is the time for British companies to get in there if they have the right product or service with a high quality or standard. Other countries are doing so and we should be encouraged to do the same, rather than send out messages that Japan’s economy is in a mess and by implication that the country should be avoided (Ingle, 2001).

Woods and Japanese diplomats believe that even non-business coverage in the rest of the press is overwhelmingly hostile or negative. During the summer of 2000, there was a sudden surge of articles – almost all of them critical – mainly about the abduction of a young British woman in Tokyo and the Japanese government’s lavish expenditure on the Okinawa Summit.<sup>15</sup> It could be argued that France and Germany

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<sup>15</sup> Information supplied by Alan Pinnell of Optima Public Relations, who carries out a monthly survey of UK press coverage of Japan for JETRO.

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also receive hostile treatment in the mainly Eurosceptic British press. However, geographic distance, language and a totally unfamiliar culture almost certainly help perpetuate Japan's negative image.

In a speech to British businessmen in Tokyo, a senior Japanese diplomat admitted that 'One of the perception problems that afflict Japan is that the changes taking place in its politics, economy and society are not easily discernible to external observers' (Numata, 1999: 2). Even those not actively hostile to Japan find it difficult to understand – and often simply give up. This is a major barrier to investment because Japanese business places high importance on relationships of trust with customers and suppliers. Peter Woods believes the recent changes in the Japanese business environment have reduced the learning curve, but says it still takes many years longer to establish a foreign company than it does in Europe or the United States.

Many of the cultural problems of operating in Japan – such as the slower pace of decision-making, the need for consensus, commitment, personal relationships, and a strong aversion to a legalistic interpretation of contracts – are well documented in the established literature (e.g. Bartlett & Ghoshal, 1991; Hofstede, 1994; Rao & Hashimoto, 1996; Trompenaars & Hampden-Turner, 1997), as well as in UK government literature (e.g. BTI, 2000; Trade Partners UK, 2000a). What is missing is a clear road map to the pitfalls and opportunities presented by the current changing environment in Japan.

## 6 CURRENT RISKS AND OPPORTUNITIES IN JAPAN

The problem with trying to assess whether now is the right time to invest in Japan is that few, if any, of the risk factors involved in FDI are statistically quantifiable. Not only is each investment unique, the environment is changing rapidly. While such uncertainty makes the analytical process more similar to a soft art than a hard science (Meldrum, 2000: 33), it is through the successful management of uncertainty or speculative risks that companies gain enhanced overall utility or benefit (Waring & Glendon, 1998: 4). On their home territory or one they feel reasonably comfortable with, successful business people can often do this through a combination of sound financial analysis and gut feeling.

For a country like Japan, instinct based on the wrong cultural inputs can lead to expensive mistakes. Peter Woods remembers the case of an otherwise successful Dutch businessman who attempted running his company's Japan branch along European lines. The entire staff eventually walked out.

Meldrum (2000: 36) classifies FDI risk according to the traditional country risk categories: economic, transfer, exchange, location, sovereign and political. All are rated as high, with the exception of transfer risk (moderate) and sovereign risk (low). Three of the high-risk categories – economic, exchange and location – are greatly influenced by the fourth: political risk. Waring & Glendon offer a more general checklist for difficult territories (see Figure 6.1).

Figure 6.1: Checklist for identifying hazards and threats in difficult territories

- General state of the economy
- General and product-specific demand factors
- Sources of investment and product supply
- Government economic and trade policies
- Government legislation
- Cultural, social and political factors
- Foreign policy and foreign relations
- Security and safety

Source: Waring & Glendon (1998: 331)

Both lists boil down to a basic tool of strategy – assessment of political, economic, social and technological factors (PEST analysis). Any investment decision must be based on a proper understanding of these factors as they apply to Japan. Consideration must also be given to the consequences of earthquake or volcanic eruption.

### 6.1 Political factors

In the most recent *Euromoney* country risk survey, Japan scored 23.51 on political risk, very close to the USA and most of the EU. However, this rating covers only a narrow range,<sup>16</sup> and takes no account of such important issues as company and employment law, taxation policy, regulation, corruption, and political stability. The need for a clear understanding of Japan's political scene is illustrated in a hyperbolic editorial in *The Economist* (10 February 2001) entitled 'Why Japan's Mori Must Go', which warned:

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<sup>16</sup> The *Euromoney* rating covers risk of non-payment or non-servicing of payment for goods or services, loans, trade-related finance and dividends, and the non-repatriation of capital (Geiger, 2000: 222).

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For a decade, the political establishment has failed to find a way to pull the country out of its economic treacle. In such circumstances, all it would take to open the way to demagogues and other sorts of political faith-healer would be a fresh economic crisis, one harsh enough to make voters fear that treacle was turning into quicksand. And, if the worst really did come to the worst on Wall Street and in the American economy this year, such a crisis would be only months away. Yet Japanese politics stumbles on, in its usual corrupt, complacent and ineffectual way. (p 20)

The editorial ends with the ominous conclusion that, so far, everything in Japan is ‘all within the normal range of democratic politics and policy discussions. But the risk is rising that Japan will not stay normal for ever.’

It is not possible to say whether this assessment will prove any more accurate than the conflicting views presented in the previous chapter. Investors should, however, be aware that serious political problems exist in Japan. At the time of writing, Prime Minister Yoshiro Mori had indicated that he would soon resign, making 27 changes of prime minister since 1945 (the UK has had just 11). What makes the situation difficult for outsiders to understand is that the parties are not divided along ideological or policy lines. The Liberal Democratic Party, which has dominated the political scene almost continuously since 1955, is a loose coalition of factions based on personal allegiances. Often members of the same faction will hold diametrically opposed positions on the same issue. For instance, Mori wants to slow down the pace of deregulation, whereas the chairman of his faction (and potential future prime minister), Junichiro Koizumi, advocates speeding it up and extending its reach.

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The OECD (1999: 9) believes ‘the lack of a coherent concept of the role of the state in a period of market-led growth has left regulatory intervention fragmented, incoherent, and vulnerable to a host of special interests.’ A powerful example can be found in a recent draft bill, limiting the sale of alcohol to when a registered supervisor is present. This is seen as an attempt to protect small shopkeepers when alcohol licensing is deregulated in 2003, and has drawn vigorous protests from major convenience store and supermarket operators (Nikkei, 2001). The essential point is that Japanese business regards this regulation as highly damaging to its own interests, and is determined to fight it.

Another example of internal Japanese pressure to shake off regulatory restrictions comes from the medical sector. Japan’s strict regulations on foreign drugs are gradually being relaxed, with the results of foreign clinical trials now accepted on condition they are backed by a small ‘bridging’ study to demonstrate their applicability to Japan. Although this is something the United States has long pressed for, it is unlikely to have happened without Japanese doctors wanting access to more innovative and cost-effective medicines, which tend to be produced by western companies. One British beneficiary of this is expected to be AstraZeneca, which is seeking to double its 1.5 per cent share of the Japanese market (Piling, 2001).

Like AstraZeneca, Boots decided to enter Japan ahead of deregulation, and may also benefit from these changes. Boots has opened four retail outlets in the Tokyo area since 1999. Before it could do so, it had to reformulate many of its toiletries and

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cosmetics to meet Japanese standards (Hutton, 2000). According to industry sources, many of the Japanese regulations do not represent higher standards, but are the result of bureaucratic delays in approving modern ingredients. Nevertheless, Boots decided it was worth going to the expense of creating products just for Japan because of the size of the market.

The OECD (2000: 16) also identifies political weakness as a key problem in public works, the main route through which the government has tried to revive the economy. It says local interest groups exercise undue influence over resource allocation, resulting in ‘considerable waste and corruption’. In 1995 Taichi Sakaiya described the bloated nature of the Japanese construction industry and bid rigging as a prime cause of distortion in the economy (Sakaiya, 1995: 82-83). Yet, as Director of the Economic Planning Agency from 1998 to 2000, he proved incapable of weaning the government away from lavish spending on construction projects – mainly because of the incestuous relations between construction companies and politicians. The British government does not recommend construction as an investment target, and at least one large UK construction company has made a conscious decision not to enter Japan.

Long-term observers of the Japanese political scene such as Curtis (1999) and Stockwin (1999) acknowledge the potential for crisis, but conclude that Japan’s democratic process – imperfect though it is – will prevail. Curtis asserts that any major political party advocating only the interests of those seeking protection against imports and continued access to government subsidies ‘would consign itself to marginal political

status' (p 238). Their message, though couched in more cautious terms than Tasker (see Section 5.2), is that 'there is no looking back'.

What this means to the foreign direct investor is that neither there should be naïve belief in Japan sweeping away all the institutional inhibitors to international business, nor should there be stubborn conviction that Japan is incapable of addressing its economic problems. Moreover, government delay in tackling the country's problems creates opportunities for efficient foreign companies to outperform Japanese rivals.

### **6.2 Economic factors**

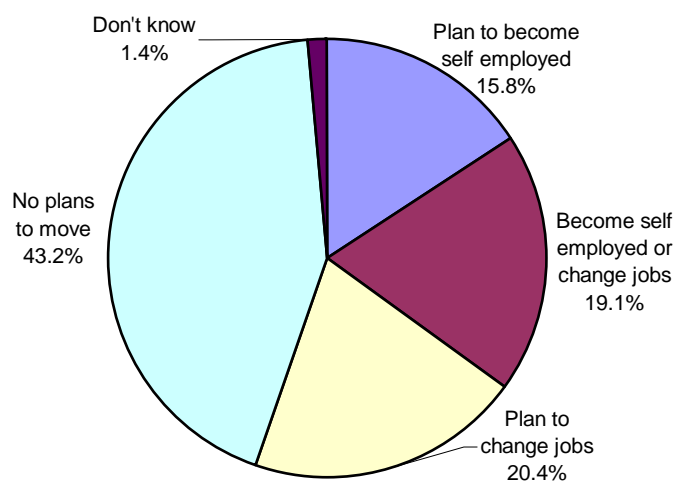
Japan's economic downturn has continued for so long, consideration of one of the main factors in assessing economic risk – where the country is on the business cycle – seems almost academic. The consensus is that – barring a meltdown – Japan has probably hit the bottom, and must therefore go up. The question nobody seems able to answer is: when and how far? The *Euromoney* survey quoted in Section 5.3 gave projections of 2.1 per cent GDP growth for 2001 and 2.5 per cent for 2002. These may be over-optimistic in view of the expected slowdown in the USA, and the Japanese government's subsequent downgrading of its own projection for 2001 to 1.7 per cent (Naikakufu, 2001).

The size of Japanese economy and the important opportunities this offers have already been outlined in Section 5.2, but an economic risk analysis should also take into account labour issues, disposable income, inflation, and exchange rates.

### 6.2.1 Labour issues

Greater flexibility in the labour market is confirmed by a recent, detailed study by a private research institute, which revealed that more than half of all men and women surveyed either wanted to change jobs or to become self employed (see Figure 6.2).

Figure 6.2: Future intentions of employees



Source: Works Institute (2000a: 7)

Moreover, it discovered that 50.2 per cent had experience of moving to a different company, and that on average they had moved twice (Works Institute, 2000a: 10). Unlike previous surveys of attitudes towards work, which concentrated solely on men in full-time employment, this study breaks away from the stereotypical image of Japanese ‘*sarariman*’ remaining in the same company for life, by covering part-timers, freelancers, and perhaps most importantly – women<sup>17</sup> (Works Institute, 2000b).

<sup>17</sup> The only criterion for inclusion was that participants should have worked for at least one day during the final week of July 2000.

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When asked why they wanted to move, the most common reply was ‘to get more money’ (35.1%). Although this is no different from most other countries, the other main reasons<sup>18</sup> reveal the extent of the problems facing the Japanese economy: concern about the future of their company (31.9%), the work is too physically demanding or stressful (27.8%), unhappiness with work conditions (26.8%), under-utilization of their skills and ability (18.8%), lack of future prospects (17.9%), lack of faith in the company’s philosophy or management style (15.4%) (Works Institute, 2000a: 8). This suggests that foreign companies coming into Japan with fresh ideas and new products or services should be able to find staff of all ages and abilities.

Although the principal motive for moving was to get more money, the average increase achieved by both men and women in the past five years was just 1.8 per cent. Nearly half took a cut in salary. The main losers were older men (see Table 6.1).

**Table 6.1: Average change in salary after moving jobs (men 18-59)**

	Change
Average for both men and women	1.8%
Men – average	3.2%
18 – 24	16.8%
25 – 29	9.7%
30 – 34	5.7%
35 – 39	1.7%
40 – 44	2.2%
45 – 49	-4.7%
50 – 54	-15.5%
55 – 59	-24.4%

Source: Works Institute (2000a: 17)

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<sup>18</sup> Multiple answers were permitted.

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Also likely to be of importance to potential UK employers is English ability. Only 3.6 per cent claim their English is good enough to conduct business negotiations or act as an interpreter. A further 18.6 per cent say they can hold a conversation, but nearly four out of every five say they have virtually no ability at all (Works Institute, 2000a: 18). For jobs that do not involve dealing with expatriate staff or head office, this is not a major problem, but many Japanese companies are now making minimum grades in TOEFL or TOEIC a precondition for promotion. This may eventually raise standards, but could also provoke strong competition for high-quality English speakers, thereby raising costs.

Mike Ingle of Trade Partners UK says recruitment has become a major concern for British companies planning to set up in Japan. He regards it as a bigger barrier than the cost of premises, because salaries often come to a lot more than the annual rent. As a result, the British government is planning to put more effort into helping companies find the right staff. The practical experience of recent British direct investors will be discussed further in the next chapter.

### **6.2.2 Disposable income and inflation**

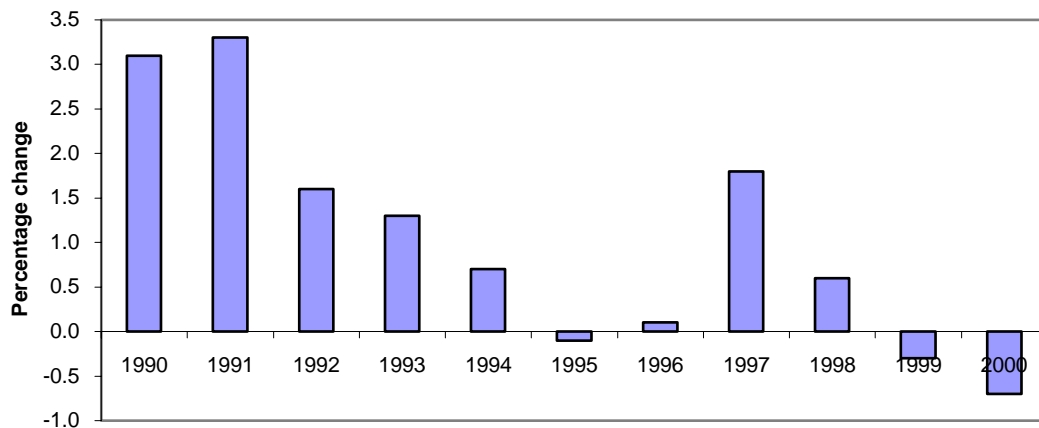
As noted in Section 5.2, Japan's 126 million people control 25 per cent of the world's personal savings, so in theory they should have plenty to spend. That is what they did during the 1980s, but since the collapse of the bubble economy savings rates have gone up again. Not surprisingly, this is because people are worried about the state of the economy, albeit for different reasons:

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The motivation to save among individual segments has been rising due to different perceptions of risk: 1) the middle-aged and elderly low-income households feel anxiety regarding employment conditions, 2) the young households feel anxiety regarding pension systems, and 3) the elderly households feel anxiety regarding nursing care (Nakagawa, 1999: iv).

The key to unlocking Japan's massive reserves of personal savings lies in removing these causes of anxiety – a task that has eluded successive governments over the past decade. One highly controversial view is that Japan needs a period of 'expected inflation... to convince people that the yen they are tempted to hoard will buy less a month or a year from now that they do today' (Krugman, 1999: 78). Japan has enjoyed low inflation for many years, and the consumer price index has been edging down (see Figure 6.3). Opinions are deeply divided as to whether this represents a benign reduction in Japan's high prices or the threat of a deflationary spiral.

**Figure 6.3: Changes in Japan's Consumer Price Index since 1990**



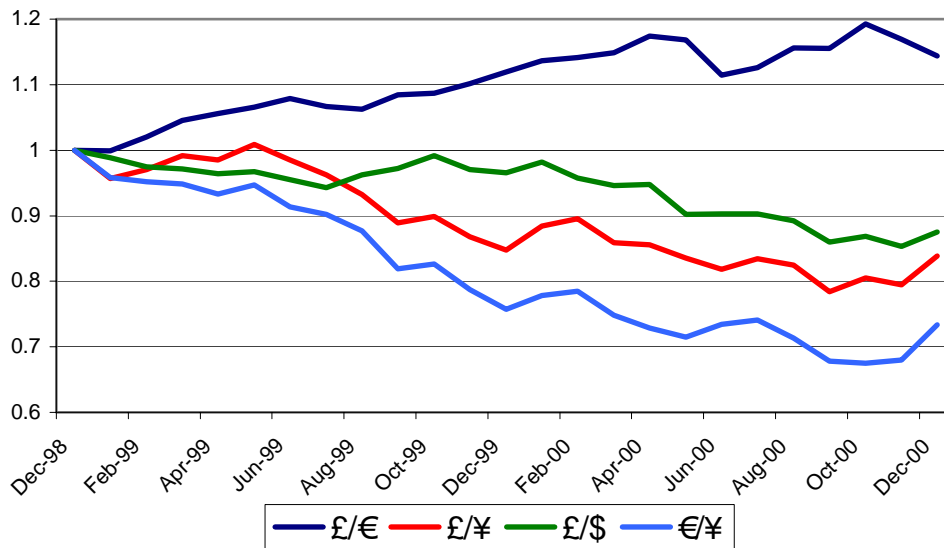
**Source: Statistics Bureau (2001b)**

Inflation, therefore, is not a major concern – and could actually be beneficial in encouraging people to spend, but the possibility of deflation cannot be ignored.

### 6.2.3 Exchange rate movements

The factors that affect exchange rates are complex, as too are the way they affect individual businesses (Madura: 2000). The difficulties experienced by British exporters to the euro zone since the launch of the single European currency on 1 January 1999 have been well publicized. As Figure 6.4 shows, the yen moved in the opposite direction against sterling, rising at one point by more than 20 per cent.

Figure 6.4: Relative movements of sterling, yen and euro since launch of euro



Source: Bank of England (2001)<sup>19</sup>

The rise in the value of the yen has a positive impact on any profits repatriated to the parent company. Just how important this can be is illustrated by Bargas (2000: 59-60), who attributes much of the 13 per cent rise in worldwide earnings by US overseas affiliates in 1999 to the high value of the yen, although only 4.2 per cent of American

<sup>19</sup> The data for the euro/yen exchange rate have been obtained by calculating the cross exchange rate with sterling.

FDI stock is in Japan. The impact would be even greater for profits converted into sterling or euro. However, the yen has begun to weaken against all three currencies, increasing the risk of translation exposure, as yen earnings fall in value. The current value of the yen also means that it has become more expensive to fund development from the UK. For some companies, this may mean exports are a preferable alternative to FDI, as the high yen makes them cheaper for customers in Japan.

### 6.3 Sociocultural factors

Cultural barriers – both in society and business practice – remain a serious inhibitor to successful direct investment and trade with Japan. The following section considers briefly some of the main issues emerging in this area.

#### 6.3.1 Demographic change

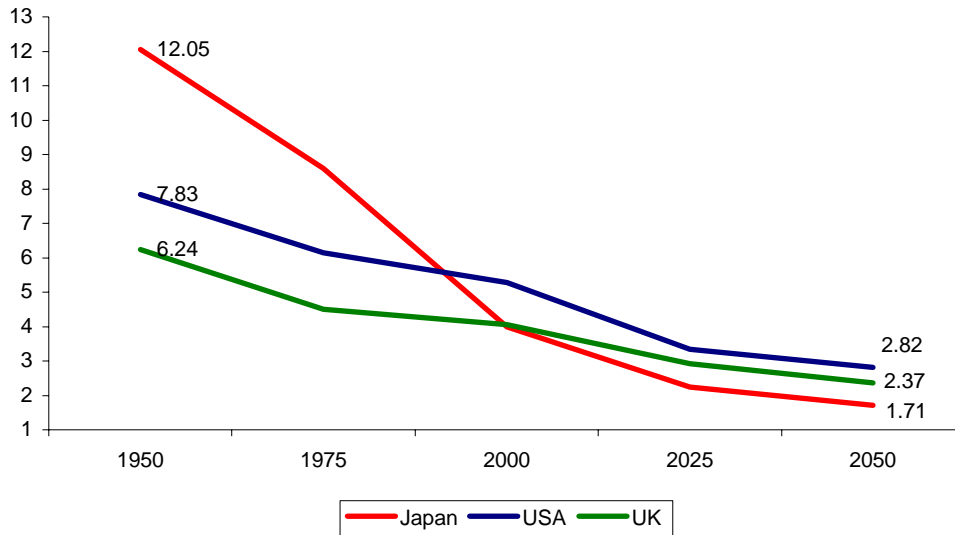
Throughout the developed world, people are having fewer babies and living much longer. The result is a rapidly ageing population. Although this demographic change is by no means unique to Japan, Figure 6.5 shows it is happening much faster than in any other developed country (UNPD, 2000: 50). Each line shows the potential support ratio (PSR) – the ratio of the working-age population<sup>20</sup> to the old-age population over 65. Whereas there were more than 12 people of working age to every elderly person in Japan in 1950, there are now just 4 (roughly the same as the UK). The UN assumes that the birth rate will start to rise again in Japan, but unless other action is taken, there will be fewer than two people of working age by 2050 for every person over 65.

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<sup>20</sup> The UN defines this for all countries as ages 15 to 64. Since a very high proportion of Japanese remain in full time education until the age of 18 or 22, the actual PSR is lower.

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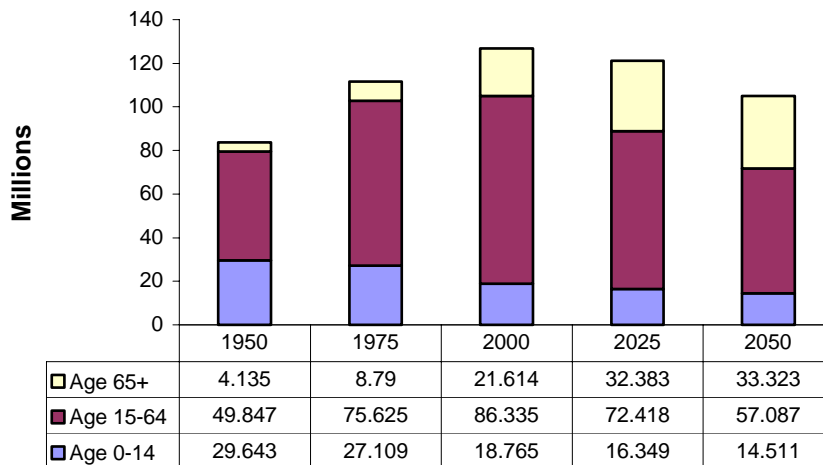
**Figure 6.5: Comparison of potential support ratios for Japan, UK and USA**



Source: UNPD (2000)

After peaking at 127.5 million in 2005, Japan’s population will gradually decline, but the proportion of over-65s will almost double to nearly 32 per cent (see Figure 6.6).

**Figure 6.6: Changing age profile of Japanese population (1950-2050)**



Source: UNPD (2000: 51)

## Chapter 6 – Current risks and opportunities in Japan

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Much has been made in the British media about the prediction that Japan will need to accept more than 600,000 immigrants a year until 2050 in order to maintain the size of its working population. This estimate comes from the same report as the data for Figure 6.5 and Figure 6.6 – *Replacement Migration: Is it a Solution to Declining and Ageing Populations?* – which calculates that Japan would need even more immigrants to maintain its current PSR, a staggering 10 million a year. Under such a scenario, the population of Japan would rise to 818 million by 2050, and 87 per cent of them would be immigrants and their descendants!

For the EU to maintain its PSR would require an equally staggering 13 million immigrants a year. From these figures, it is clear that the question contained in the report's title is largely rhetorical; and it concludes that social, economic and political circumstances will determine whether governments will be able to accept so many migrants. One option for Japan to maintain its current PSR of 4.8 would be to raise the upper limit of working age to 77. It is important to note that a similar trend is taking place in the UK and the USA, although at a slower pace. The UK would have to raise retirement age to 72 to maintain its current PSR of 4.1.

The implications will be far reaching, impacting on recruitment, retirement, pension rights, sickness benefit, productivity, taxation, etc. Since Japan will experience the impact before other countries, companies based there will need to devise appropriate solutions. As well as the risks this poses, it opens up a wide range of opportunities,

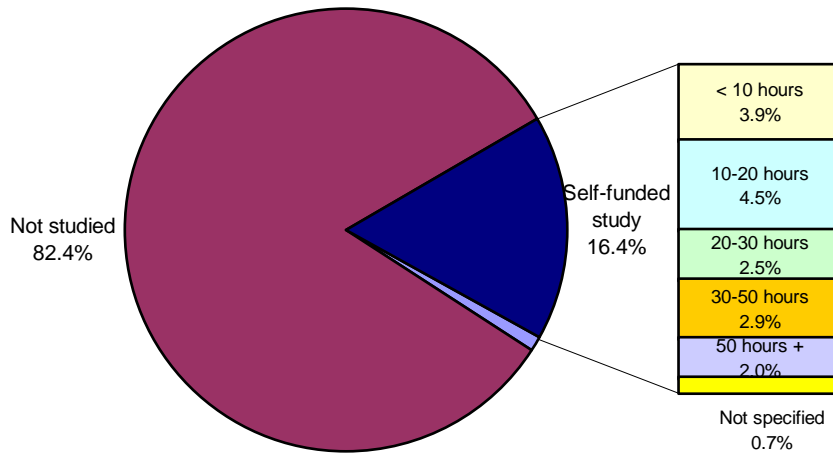
not only in being at the forefront of new human resources strategies, but also in providing services for one of the wealthiest elderly populations in the world.

### 6.3.2 Education

Education is often credited as a key factor in Japan's rapid post-war growth. Schools and universities have produced a highly literate and numerate workforce, but are equally criticized for stifling creativity and originality (Horsley & Buckley, 1990; Tasker, 1987; van Wolferen, 1989). Japanese schools have been slow to introduce computers, resulting in such a severe shortage of IT skills that visa regulations have been relaxed for Indian software engineers (MoFA, 2001). This shortage could create a bidding war between companies seeking suitable staff, although it may also open opportunities to gain cost advantages by locating staff offshore and connecting them to Japan by broadband circuits.

There is a similar shortage of transferable managerial skills, as Japanese companies have traditionally relied on company-specific training. As a result some enterprising young Japanese are resigning, and paying for themselves to go to the UK or the USA to acquire a business degree. The labour survey referred to in Section 6.2.1 revealed that 16.4 per cent of those surveyed had paid for work-related study at their own expense during the previous month (see Figure 6.7). The average expenditure was ¥20,500 (approximately £117) – 3.7 per cent had spent at least five times that amount.

Figure 6.7: Self-funded work-related education



Source: Works Institute, 2000a: 21

### 6.3.3 Attitudes towards foreign companies

It is by no means clear how Japanese employees and customers will react to the surge of foreign companies into the country. On the superficial level, there should be no problem; many companies – such as Coca-Cola, Nestlé and Lever – have established a strong presence. At the same time, it has already been noted (see Section 4.3) that UNCTAD warns that cross-border M&As can lead to resentment, particularly when it involves rescuing companies in distress. As Morrison and Floyd (2000: 271) point out, Japanese corporate control is opening up to market forces, but western investors must build up relational trust in their new alliances if they are to be successful.

### 6.3.4 Consumerism

Consumer attitudes towards prices appear to be polarizing. Cut-price clothing stores like Uniqlo are so popular that occasionally admission has to be restricted; and shops

## **Chapter 6 – Current risks and opportunities in Japan**

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where everything is priced at ¥100 (about 57p) are doing a roaring trade (Kawai, 2000). Non-Japanese companies may be able to gain price advantage if they have more efficient distribution chains, or if they have access to parallel imports avoiding the multi-tiered Japanese distribution system.

On the other hand, expensive foreign brand-name goods are also selling well. Louis Vuitton, for instance, felt confident enough to raise prices by 9 per cent in February 2001, and now charges 40 per cent more than in France (FPC, 2001). The implication for marketing would appear to be that, whereas only quality used to matter to the Japanese consumer, it is now a far more complex balance between quality and price – but the right combination of quality and image can still command premium pricing.

### **6.4 Technological factors**

Most technological factors are specific to particular companies or industries, but Johnson and Scholes (1999: 105) recommend considering issues such as government spending on research, and government and industry focus on technological effort. The widely held view is that Japan's economic strength has been built through government sponsorship and targeting of key industries (e.g. Johnson, 1982; Prestowitz, 1988). This interpretation of events was strongly disputed in interviews the author had in the early 1990s with senior members of Keidanren – Japan's equivalent of the CBI – such as Kazuo Nukazawa. Keidanren's position has now been backed up by research (Porter et al, 2000), which shows that sectors singled out by the government for special promotion or protection have, in fact, turned out to be the least competitive.

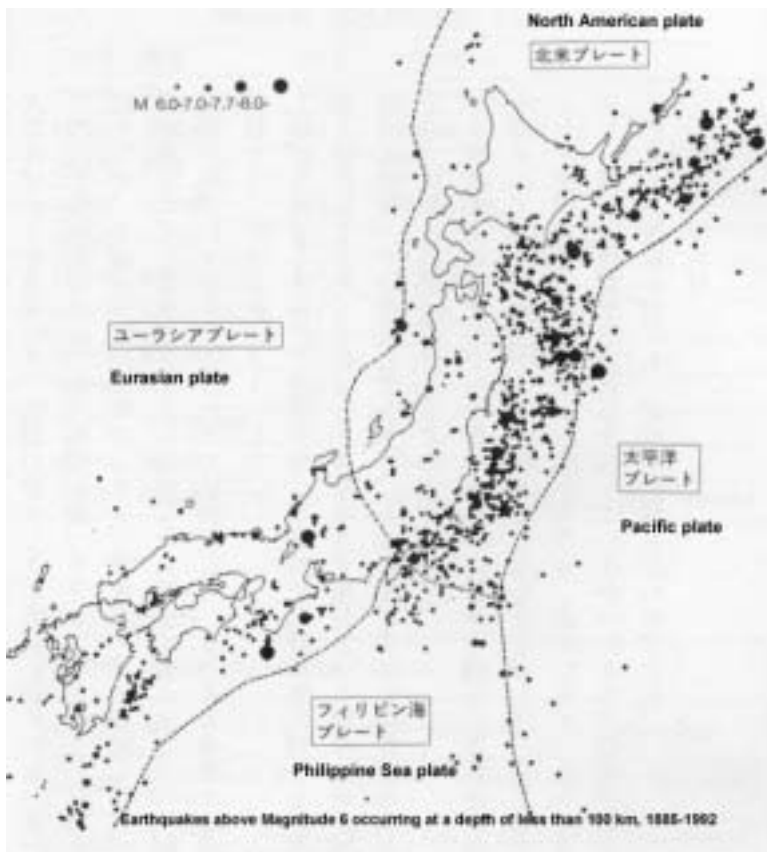
## Chapter 6 – Current risks and opportunities in Japan

The Japanese government has designated IT as its next main priority. An important part of this will entail the creation of a national fibre-optic network. It remains to be seen whether issues of access will distort competition. Although not toothless, Japan's Fair Trade Commission is less vigorous than its equivalents in the UK or the USA.

### 6.5 Earthquake and volcanic eruption

Nearly 10 per cent of all the seismic energy released in the world every year is concentrated around Japan (Hadfield, 1991: 18). As Figure 6.8 shows, most activity occurs along the east coast from Tokyo and Yokohama to Hokkaido.

Figure 6.8: Seismic activity around Japan



Source: Adapted from Mizoue (1993: 10)

## **Chapter 6 – Current risks and opportunities in Japan**

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Earthquake-resistant construction methods have succeeded in making most of the tremors that hit Tokyo – even violent ones – little more than an unpleasant passing sensation. However, the man responsible for tightening building regulations in the 1980s, Makoto Watabe, admits that an earthquake of similar magnitude to the one that struck Tokyo in 1923<sup>21</sup> would kill 3,000 people directly, and up to 330,000 others would die or be injured as a result of fire (Powers, 1989). The Kobe earthquake of 1995 was a reminder that nowhere in Japan is safe. Japan also has more than 80 active volcanoes (Asahi Shimbun, 2001).

Waring and Glendon categorize earthquakes as a ‘pure risk’ – something controllable only by avoiding exposure altogether (1998: 4). There are ways, however, of reducing potential damage, such as choosing offices away from fire hazards, ensuring that backup files are kept at a different location, and so on. Investors need to adopt an earthquake risk strategy. At the same time, it is important to note how quickly Japan recovered from the Kobe earthquake. The author arrived in the city less than four months later on the bullet train. Even though large sections of the overhead track had been destroyed in the earthquake, they had already been rebuilt and were operational. Most of the city’s basic infrastructure had been restored, and virtually all the homeless rehoused in prefabricated buildings with individual water and gas supply.

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<sup>21</sup> The Great Kanto Earthquake on 1<sup>st</sup> September 1923 is estimated to have measured 7.8 on the Japanese earthquake scale (which differs from the Richter scale by approximately  $\pm 0.3$ ). It resulted in the deaths of more than 100,000 people in Tokyo and Yokohama (Itasaka et al, 1983, vol 2: 138-140).

## **7 RECENT BRITISH EXPERIENCE**

### **7.1 The survey**

To test the validity of the earlier Bradford research in today's investment climate, a questionnaire (Appendix D) was formulated covering the same areas: organizational setup, motivations, levels of commitment, difficulties and obstacles, personnel policy, and measures of success. Comparability was ensured by retaining or combining many of the questions from the most recent survey of European manufacturers in Japan (1993). One of the main differences was to ask a wider variety of questions about recruitment and personnel policies (Questions 4.6 to 4.10), in view of the importance attached to this by Trade Partners UK (see section 6.2.1). Also, the survey sought to ascertain whether companies were taking cultural and language issues seriously.

Initially, four companies operating in different sectors – industrial manufacturing, consumer goods, software development, and distribution – indicated willingness to participate in the survey. Unfortunately, one company pulled out, limiting its reply to saying it had relocated its operation in Japan due to high costs. Of the remaining companies, senior executives from two answered the full questionnaire and follow-up questions. The third gave direct access to the President of the Japanese subsidiary, who answered an abbreviated questionnaire (Appendix E) and discussed the main issues – investment inhibitors, critical success factors, and personnel.

## **7.2 Summary of results**

### **7.2.1 Organizational setup**

One company entered Japan in 1996, with the other two following in 1999. One stood out particularly for the time devoted to preparation before actual entry – a total of six years – at least three times longer than the others. The same company also had a bigger preparation team than usual because it anticipated a cumulative loss double that of a similar investment elsewhere due to the high cost of operating in Japan. It was not only determined to get things right once it entered Japan, but also strongly believed Japan was the right place to go.

The methods of entry they chose were also different – one took the traditional route of a 50:50 joint venture, another established a wholly-owned subsidiary, while the third adopted the highly tax-efficient arrangement of a branch office selling services to a wholly-owned subsidiary. Of the two companies that participated in the full survey, neither plans to change its form of organization, and operations in Japan so far represent about one per cent or less of global business. Both operate elsewhere in the Asia-Pacific region, but treat their Japan operations completely separately.

### **7.2.2 Difficulties and obstacles**

In 1993, the high cost of doing business in Japan was cited as the biggest difficulty. It remains so today, even though land prices, rents, wages and other costs have fallen or remained stable (two companies listed it as number 1, the other at number 2). As one

company put it, 'it costs more to transport our goods across Japan than it does to get them there in the first place.' Consequently, the time needed to reach corporate profit levels was regarded as a major inhibitor of greater investment.

The second biggest problem in 1993 was finding and retaining suitable staff. Again, it remains a big obstacle (for one company it was the main problem, the other two put it third). Despite greater labour mobility, all companies spoke at length about staffing problems. Although this was partly due to a shortage of people with IT qualifications, the real difficulty lay in getting staff to work the way the company wanted them to – something they ascribed mainly to culture. Issues mentioned were lack of spontaneity, inertia, and unwillingness to do things out of fear of making a mistake in front of others. One executive remarked: 'It's not a lack of knowledge or qualifications. The Japanese excel in task-driven areas like manufacturing, but we require initiative.' Another company was trying to train its staff to be more pro-active, but found most felt uncomfortable doing things without clear guidelines or precedent.

The question of empowerment – or lack of it – affected one company in a different way. It commented that the benefits of its business model were difficult to utilize because potential customers within Japanese organizations were not sufficiently empowered to make independent purchase decisions. The joint venture company mentioned its partner was constantly urging it to 'Japanize' its way of doing business. While understanding the need to adapt, it was wary of seeing its business model subsumed, and thereby losing the advantage it hoped to gain.

## Chapter 7 – Recent British experience

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Other cultural issues raised were the complexity of doing business, the lack of corporate management's understanding of Japan, and exclusionary business practices. Two companies listed non-market pricing among the top three issues restricting their ability to do more business. One said Japanese rivals had responded to their arrival with predatory pricing.

As in 1993, Japanese government restrictions were regarded as only a minor obstacle. In one case, a company had come across such strict regulations in Germany that Japanese requirements posed no problem. Petty bureaucracy – and the home office's failure to appreciate how simple the solution was – did cause one company difficulty. It found that customs officials were rejecting consignments marked 'x-type goods', but invoiced as 'goods, x-type'. All it required was for the home office to draw up invoices accurately in the first place, but lack of attention to such apparently trivial details cost the Japanese subsidiary time and money.

All companies agreed that the major home side restriction on investment in Japan was the longer timescale than permitted under normal corporate strategy. This was also the main issue in 1993, although phrased slightly differently.<sup>22</sup> One other issue chosen by the majority in 1993 – quality requirements for Japan – remained in the top three; but moving up to second place was the home company's lack of knowledge of Japan –

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<sup>22</sup> The earlier research interviewed both Japanese affiliates and parent companies. Since only the parents were approached on this occasion, it was felt they might be less frank if asked whether 'short-term management outlook' – the expression used in 1993 – was a problem.

only the fifth most important issue in 1993. Another significant change concerned attitudes towards exchange rate variability, which ranked bottom in 1993.

Although only one company listed exchange rate variability among its top three obstacles to doing more business, all had strong views. For one, it was a major determinant of when profitability was likely to be achieved. Another, which has already moved into profit, was also highly sensitive to exchange rates, but due to the nature of its business, regarded the key rate as not against sterling, but against the dollar. The third company was prepared to ignore it until the Japan venture moved into profit, commenting that ‘the prize at the end of the day – the size of the Japanese market – is so big, the exchange rate will not become important until then’.

Questioned about problems between the Japanese and British sides of their investment in Japan, the two companies that participated in the full survey singled out difficulties in communication, and the different speeds of decision-making. One noted that the parent company was quite probing, which the Japanese side resented. There was also a feeling that the Japanese side did not fully appreciate the value of the foreign staff.

### **7.2.3 Personnel policy**

Considerable differences emerged in the appointment of senior management. Two companies had placed staff from both countries in senior positions, with expatriates from the home company as chief executive. One said its ultimate goal was to replace the expatriates with Japanese, but not in the foreseeable future. The other felt it was

essential to have home company control during the critical phase, even beyond break-even point. In contrast, the third company withdrew its last expatriate less than two years after beginning operations; and said being able to hand over entirely to Japanese management had been one of its main measures of success.

Personnel policy for Japanese staff also differed considerably. One operates entirely along Japanese lines, whereas the others have adopted more western approach, but adapted to local conditions. For example, because the Japanese pension industry is in a state of flux, one company gives its Japanese staff cash and financial advice; and eventually plans to introduce a share-related savings scheme.

Everyone interviewed placed great importance on language and cultural awareness training, but only two of the companies actually offered it. The person who did not receive such training before being sent to Japan was in no doubt that it was ‘essential’. One company also ensures its Japanese management gets English training.

### **7.2.4 Objectives and success factors**

Three measures of success – sales and financial targets, as well as brand/name recognition in Japan – were common to all companies. The first two were also the most commonly applied measures in 1993, whereas brand/name recognition was little used. This almost certainly reflects the marked shift towards investment in the service

sector since the earlier survey. One company also counts worldwide sales to Japanese customers<sup>23</sup> – another measure little used in 1993.

The emphasis on service was again revealed by a company measuring performance in such areas as ability to fulfil orders, levels of customer acquisition and repeat purchasing. All claimed to be reaching their targets, although one sounded less emphatic than the others.

Critical success factors were listed by two companies as:

- Good products
- The right presentation
- A strong commitment backed by plenty of funds
- A strong, effective team
- Knowing the market

Although phrased differently, these were very similar to those most frequently quoted in 1993.

The third company, however, offered a completely different list:

- Not working with a distributor
- Using government trade boards for introduction purposes
- Training your own staff to build needed skills

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<sup>23</sup> It was not revealed whether these were customers gained as a result of entering Japan or whether a previous relationship existed.

By going it alone, the company has been able to set its own agenda and avoided the cost of ‘two-stage’ entry (see Section 2.3.3) in the event of any disagreement with a Japanese partner. Moreover, its use of government trade boards indicates that – in its experience at least – the offer of Japanese government help to foreign investors is not an empty promise.<sup>24</sup> The third critical success factor reinforces the earlier discussion about staffing problems (see Section 7.2.2).

Widely varying estimates were given for the time regarded as necessary to break even and reach average corporate profit levels, the shortest being three years for a wholly-owned subsidiary to break even (actually achieved by one company), and the longest 15 years for a joint venture to make a satisfactory profit. In all cases, the view was that it would take longer than in other markets. More importantly, the two companies that took part in the full survey agreed it would be possible to exceed average corporate profit levels in Japan. It was striking how they both said, ‘once in profit, the graph goes like that’, indicating a sharp upward movement.

### **7.2.5 Motivations for investment<sup>25</sup>**

Both companies’ principal motives for locating in Japan were identical:

- To take advantage of the size and potential of the Japanese market
- The importance of Japan to their global strategy

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<sup>24</sup> Another company, based in Yokohama, commented that the city authorities had been ‘fantastic’ at helping with networking.

<sup>25</sup> This and the following two subsections refer to issues covered only in the full survey (two companies).

- To monitor the market and gather information

These coincide exactly with the findings of the 1993 Bradford survey. What has changed, though, is the response to other questions about motivation. Both companies said they were there to take advantage of deregulation and market opening measures – something barely mentioned in 1993, suggesting a major shift in perceptions about the openness of Japan. Another significant change was that neither company cited the desire to support international or Japanese clients in Japan or to support Japanese clients overseas – all of which had been important motivations for service operations in 1993. This indicates they view Japan as a new market opportunity. A further motivation was to diversify their company's sources of revenue, a question not asked in the previous survey.

### **7.2.6 Commitment to Japan**

One company characterized the parent company's commitment to Japan as 'very strong'. The other appeared slightly less enthusiastic, describing the parent's commitment to testing the market as 'strong', but as 'neutral' overall. In other words, it is prepared to pull out if things do not go according to plan. There are no signs yet of second thoughts, as both companies have increased their investment by more than 100 per cent since first entry. One has more than doubled its staff in Japan; the other has increased it by 50 per cent.

### 7.2.7 Influence of *keiretsu* on business

In 1993 half the companies surveyed reported positive or negative influences on their business through being directly linked into a *keiretsu* or having to deal across such groups. This time the question was recast to reflect the weakening of *keiretsu* relationships as a result of the unwinding of cross-shareholdings. One company reported no obvious effect; while the other was positively enthusiastic about the competitive advantage it had gained through the breakdown of the *keiretsu*, describing it as a ‘win-win situation for customers and manufacturers’.

## 7.3 Government support

### 7.3.1 British Industry Centre

The British government set up the British Industry Centre in Yokohama in 1997 in direct recognition of the problems companies face in trying to set up in Japan, and of the massive opportunities waiting for those who succeed. Operating on a self-financing, non-profit basis, it offers high-quality, but relatively low-cost office accommodation in a prestigious office development, bilingual secretarial assistance and help with settling-in formalities, as well as a conference room and reception facilities. BIC tenants are also eligible for low-interest loans and other financial support from the City of Yokohama (Trade Partners UK, 2000b: 4).

Japan is the only country where the British government has set up such an incubator for new businesses, and there are currently no restrictions on the type or size of com-

pany that can apply for space. Mike Ingle, the BIC adviser, describes it as ‘a leg up’ for British companies to overcome the cultural problems and high start up costs in Japan. For three years the BIC remained only half full, but rapidly filled up in 2000. Twenty more companies are actively talking to the government about the availability of space, and the idea of opening a similar facility in Tokyo is under consideration.

One of the earliest tenants, RS Components, has already ‘graduated’ and taken over another floor in the same building; and Ingle describes another company as growing so fast, it will almost certainly move out soon. Of the 15 other tenants so far, 12 are still there, but three others have fared less well. One was forced to pull out because of problems in the UK. The remaining two are reported to be operating on a less ambitious scale. It is too early to declare the BIC an outright success, but the initial indications look very positive.

### **7.3.2 Other assistance**

A wide range of help – both tailor-made and off-the-shelf – is available to companies from British and Japanese official sources. JETRO has created a series of detailed market sector reports (50 so far), freely available for download from its website<sup>26</sup>. The British government also offers market reports, and will compile customized sector reports at one-third of the normal commercial cost. In addition, it runs subsidized trade missions and hundreds of trade-related events a year. There is no shortage of help for companies interested in both FDI and exporting to Japan.

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<sup>26</sup> [www.jetro.go.jp](http://www.jetro.go.jp)

## 8 CONCLUSIONS AND RECOMMENDATIONS

Japan's direct investment climate has undoubtedly changed since the 1993 Bradford survey. Many fixed costs are cheaper, labour is more mobile, *keiretsu* relationships are breaking down to the advantage of newcomers, and M&As are not only no longer taboo, they have become the predominant trend. The changes have also opened up greenfield investment, particularly in IT-related businesses. An attractive, yet difficult market has become easier to penetrate. Instead of turning their backs on foreign companies, many Japanese are welcoming them, seeing their business methods as essential to reinvigorate the economy. Help is also freely available from the British and Japanese governments. Yet Japan does not represent an unqualified golden opportunity.

It is still a high-cost country. Culture still presents outsiders with many obstacles, even in everyday things such as food. One of the executives put it graphically: 'Japan is just like sushi – cold, wet and fishy. Yet taste it once, and you can't have enough of it.' It is a message repeated over the years by companies that have been successful there – Japan *is* difficult, but the potential rewards are so great, it is worth the effort.

It would be unwise to try to draw universal conclusions from a survey covering just three companies, but their similarity of views was striking. Although it is understandable that the fourth company might have been reluctant to reveal its difficulties, a clearer picture of its problems would have made an invaluable comparison.

## Chapter 8 – Conclusions and recommendations

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Nevertheless, certain broad conclusions can be drawn:

- **The high cost of doing business in Japan remains the principal obstacle to FDI** – higher overheads lengthen profitability horizons. As one executive said, ‘Japan is not a country to cut your teeth on if you have no experience of FDI’.
- **Staffing problems remain the second biggest obstacle, but for different reasons** – the main complaint is no longer recruitment (except in specialist IT skills), but inertia and lack of initiative. This poses a threat to the effectiveness of foreign business models.
- **Lack of understanding of Japan is one of the most significant home-side barriers** – according to Peter Woods of Trade Partners UK, to be successful, the chief executive of a Japan-based operation needs to spend almost as much time, if not more, dealing with the home office as attending to customers in Japan. Hostile media coverage and articles concentrating solely on Japan’s economic and political problems contribute greatly to misunderstanding.
- **Language and cultural awareness training are essential for staff dealing directly with Japan, including back-office operations where appropriate.** Differences in the speed and style of decision-making are a potential source of conflict, as are hidden cultural meanings. When a Japanese says ‘I’ll deal with it’ (*zensho shimasu*), other Japanese immediately understand this is a polite refusal, the exact opposite of what most foreigners would expect. Getting the back office to understand the need for exact documentation would avoid unnecessary expense and frustration.

## Chapter 8 – Conclusions and recommendations

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- **Cultural sensitivity is also important to prevent a possible backlash against the recent surge of foreign investment and takeovers.**
- **Government regulation is not regarded by companies already in Japan as a major issue** – they say the problem lies mainly in *perceived* restrictions.
- **The breakdown of *keiretsu* relationships offers new competitive opportunities, and has swept away traditional resistance to M&As.** There remains, however, a deeply ingrained cultural preference for building relationships of personal trust.
- **Consumers are becoming more price sensitive** – but the right combination of image and quality still commands premium pricing.
- **Selectivity is a key success factor** – companies adopting a ‘me-too’ approach lay themselves open to predatory pricing and excessive competition
- **Success in Japan demands a higher level of commitment than usual.** On the other hand, the returns are likely to be higher.
- **Japan is going through a difficult period of economic adjustment, which will bring both risks and opportunities.** Individual companies must assess how to extract those opportunities. This is rarely easy, even in familiar markets. Cost and culture make it more difficult in Japan. It is worth recalling, though, that Coca-Cola entered Japan when there was no guarantee of ever being able to repatriate profits. Coca-Cola now controls nearly 20 per cent of the non-alcoholic ready-to-drink beverage market, and derives 19 per cent of its global net operating revenue from Japan (Coca-Cola, 2000).

## **Chapter 8 – Conclusions and recommendations**

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As a minimum, government and business need to put more efforts, both collectively and independently, into removing misconceptions and ignorance about Japan. More comprehensive, independent research into the rapid changes affecting FDI in Japan needs to be undertaken as a matter of urgency to help provide a clearer road map to the opportunities and pitfalls, with particular emphasis on staffing issues and how appropriate foreign business models remain in this complex and dynamic environment.

## **APPENDIX A ORIGINAL PROJECT PROPOSAL**

**Name:** David Powers

**Project Title:** The impact of deregulation and the changing economic environment on British direct investment in Japan

**Supervisor:** Professor Hafiz Mirza

**Company:** Not applicable (research project)

**Submission:** March 2001

### **1. Scope/Rationale of Project**

Japanese government statistics show a marked increase in the flow of inward direct investment from the UK during the second half of the 1990s, rising to peak of ¥89.8 billion in FY 1999 (to the end of March 2000), more than treble the average of the previous decade. Although still tiny in comparison with the flow of Japanese direct investment into Britain, this reflects an international trend of companies displaying a greater willingness to invest in Japan, a country traditionally regarded as particularly difficult territory for foreign direct investment (FDI) to succeed in. This change in attitude is likely to have been brought about by a number of factors, as the country continues to fight off the effects of the collapse of the bubble economy of the late 1980s and early 1990s and the longest post-war slump in Japan. These include government deregulation, cheaper land and property prices, and greater employment flexibility resulting from Japanese corporate restructuring. Positive encouragement by government agencies in both countries is also likely to have made a contribution to the increased flow of British FDI into Japan.

This project will review the recent pattern of investment and compare it with previous studies, in an attempt to identify just how much these changes have affected the main factors motivating British companies to move into Japan. It will seek to establish whether different types of company are being attracted to Japan, or whether the increase in FDI is the result of the same or similar companies simply increasing their stake or bringing forward previously planned projects. The project will also inquire into the reasons behind the overwhelming majority of British FDI projects being concentrated in the non-manufacturing sector, except in 1991 and 1997, and ask whether this is likely to continue.

Although official literature describes Japan as a 'golden opportunity', there is a danger that ill-prepared companies will make hasty or unwise decisions. Among the problems likely to be encountered are not only exchange rate fluctuations, but also considerable cultural differences in trade and employment practices. The project will

review the level of support available from official and non-official sources, and try to draw lessons that may be valuable to future potential direct investors.

### 2. Methodology

The objective is to provide a general overview of the environment of value to those actively involved in or contemplating FDI in Japan, rather than to attempt a detailed analysis sector by sector. An important aspect of the literature review will be to survey the range of material made available to companies by government agencies in both the UK and Japan, and to assess how useful it is and whether it gives an accurate picture of the FDI environment. This will be tested by seeking the views of companies that already have a presence in Japan. The literature review will also encompass social and demographic changes, such as the rapid ageing of the population, which are likely to affect the dynamics of the Japanese market through their impact on employment and spending patterns.

FDI is an expensive, long-term undertaking, and an important consideration for investors is whether Japan's recent official enthusiasm for inward direct investment is motivated by a genuine desire to welcome foreign companies, or whether it is an expedient measure to help the country overcome its economic difficulties. It is intended to interview senior officials from both Japan and the UK to try to gain a richer insight than that offered by published documents, as well as to obtain first-hand information about the latest investment trends and progress on deregulation.

Particular attention will be paid to the size and scope of investment projects. More than 60 per cent of the FY 1999 total was accounted for by a single project, indicating that most UK FDI in Japan is actually quite small in scale. It will be important to try to identify why this is the case; and establish whether it is as a result of obstacles, over-cautiousness, and limited sales potential, or simply companies taking an incremental approach by investing small amounts over a long period. It is intended to examine how successful the British Industry Centre in Yokohama has been since it was set up as an incubator for small business start-ups in 1997, and compare it with the German experience.

The research will be backed up by conducting a survey of companies involved in or planning FDI in Japan, followed up by interviews either in person or on the telephone. The survey will also focus on problems encountered, and attempt to identify what obstacles – either real or perceived – have contributed to companies deciding against Japan as a target for FDI. To ensure comparability of data, the questionnaire will be structured along lines of established research carried out by Bradford Management Centre since the 1980s, and adapted to the requirements of the current project.

### **3. Data Sources**

#### **Primary information**

- Interviews with senior officials at British Trade International
- Interviews with senior officials at JETRO
- Survey of companies involved in or contemplating FDI in Japan
- Follow-up interviews with companies and tenants of British Industry Centre

#### **Secondary information**

- Published FDI statistics, e.g. JETRO White Paper on Foreign Direct Investment, Japanese Ministry of Finance statistical data, UNCTAD World Investment Report
- British and Japanese official publications on direct investment, e.g. *Working With Action Japan* (Komatsu, K, 1999, London: JETRO), *Climate: The Investment Journal for Japan* (London: British Trade International)
- Publications on the Japanese economy, e.g. *The Bubble Economy* (Wood, C, 1992, London: Sidgwick & Jackson), OECD Economic Surveys of Japan, *Can Japan Compete?* (Porter, ME et al, 2000, Basingstoke: Macmillan)
- Publications on population change, e.g. *Replacement Migration* (UN Population Division, 2000)
- Publications on international trade and FDI, e.g. *International Business* (Rugman, MA and Hodgetts, RM, 2000, Harlow: Financial Times/Prentice Hall)
- Publications on international human resource management and cultural issues, e.g. *International Human Resource Management* (Dowling, PJ et al, 1999, Cincinnati, OH: South-Western Publishing), *Cultures and Organizations* (Hofstede, G, 1994, London: HarperCollins)
- Newspaper and media reports on current state of Japanese economy
- Wherever possible, reference will be made to original material published in Japanese

### **4. Aspects of MBA Syllabus Used**

The project will involve aspects of the core course in Strategic Management and the electives in International Business, International Human Resource Management and International Financial Management.

### **5. Proposed Chapter Headings and Sub-Headings**

#### **1. Introduction**

- 1.1. Overview of foreign direct investment in Japan
- 1.2. Terms of reference
- 1.3. Project methodology

- 2. The Japanese Economy**
  - 2.1. The collapse of the ‘bubble’
  - 2.2. Deregulation
  - 2.3. The effect of restructuring
  - 2.4. The impact of demographic change
  
- 3. Foreign Direct Investment in Japan**
  - 3.1. General patterns of FDI since 1990
  - 3.2. Survey of UK FDI since 1990
  - 3.3. Methods of entry
  
- 4. Support Available to Investors**
  - 4.1. Official Japanese support
  - 4.2. Official UK support
  - 4.3. British Industry Centre in Yokohama
  - 4.4. Other sources of support
  
- 5. The British Experience in Japan**
  - 5.1. Manufacturing sector
  - 5.2. Non-manufacturing sector
  - 5.3. Success stories
  - 5.4. Failures
  - 5.5. Decisions against investment
  
- 6. Conclusions and Recommendations**
  - 6.1. Conclusions
  - 6.2. Recommendations
  
- 7. Appendices and Bibliography**

**6. Work Programme**

Activity	Nov			December				January					February				March			
	13	20	27	4	11	18	25	1	8	15	22	29	5	12	19	26	5	12	15	
Construct survey					Holiday															
Distribute survey																				
Review literature																				
Collate & analyze survey results																				
Interview officials																				
Company i/vs																				
Consult supervisor																				
Write dissertation																				
Submit for binding																				

## APPENDIX B MOF FIGURES

Inward Direct Investment (Industry - U.K.)

(unit: Case, JPY100million)

FY	1989		1990		1991		1992		1993	
	Cases	Value	Cases	Value	Cases	Value	Cases	Value	Cases	Value
Food	11	0	6	1	16	0	1	0	-	-
Textile	1	-	1	6	-	-	-	-	-	-
Rubber&Leather	3	0	-	-	-	-	-	-	-	-
Chemical	19	73	22	0	6	200	-	-	1	0
Metal	22	0	10	0	19	1	-	-	-	-
Machinery	121	2	94	9	65	1	1	20	2	4
Petroleum	-	-	2	0	8	205	3	0	-	-
Glass&Ceramics	1	3	4	0	15	0	-	-	-	-
others	39	1	62	2	32	3	-	-	4	4
<b>Manufacturing Total</b>	<b>217</b>	<b>80</b>	<b>201</b>	<b>19</b>	<b>161</b>	<b>410</b>	<b>5</b>	<b>20</b>	<b>7</b>	<b>7</b>
Telecommunication	1	11	2	4	8	44	6	31	6	10
Construction	47	0	34	0	41	1	4	0	-	-
Trading	137	7	134	13	129	111	19	115	19	42
Finance&Insurance	2	0	11	14	3	9	3	1	2	3
Service	89	5	87	17	62	7	19	30	12	17
Transportation	5	0	3	0	14	0	-	-	-	-
Real Estate	5	0	7	0	2	0	2	139	1	0
others	23	4	10	12	5	1	3	1	1	0
<b>Non-Manufacturing Total</b>	<b>309</b>	<b>27</b>	<b>288</b>	<b>60</b>	<b>264</b>	<b>172</b>	<b>56</b>	<b>317</b>	<b>41</b>	<b>71</b>
<b>TOTAL</b>	<b>526</b>	<b>107</b>	<b>489</b>	<b>79</b>	<b>425</b>	<b>583</b>	<b>61</b>	<b>337</b>	<b>48</b>	<b>79</b>

FY	1994		1995		1996		1997		1998	
	Cases	Value	Cases	Value	Cases	Value	Cases	Value	Cases	Value
Food	-	-	-	-	-	-	-	-	-	-
Textile	-	-	-	-	-	-	-	-	-	-
Rubber&Leather	-	-	-	-	-	-	-	-	-	-
Chemical	1	85	1	37	2	25	2	197	1	6
Metal	-	-	-	-	1	2	-	-	-	-
Machinery	4	14	-	-	1	0	-	-	1	28
Petroleum	-	-	-	-	-	-	-	-	2	68
Glass&Ceramics	-	-	-	-	-	-	-	-	-	-
others	2	1	2	0	1	11	2	153	-	-
<b>Manufacturing Total</b>	<b>7</b>	<b>100</b>	<b>3</b>	<b>37</b>	<b>5</b>	<b>38</b>	<b>4</b>	<b>350</b>	<b>4</b>	<b>102</b>
Telecommunication	3	2	22	12	8	5	2	0	1	0
Construction	-	-	-	-	-	-	-	-	-	-
Trading	11	15	14	50	22	34	21	50	30	256
Finance&Insurance	-	-	2	1	4	10	1	0	5	4
Service	12	10	19	12	19	318	16	46	14	7
Transportation	1	0	3	1	-	-	-	-	5	1
Real Estate	2	3	-	-	-	-	-	-	1	0
others	4	-	1	2	1	-	-	-	-	-
<b>Non-Manufacturing Total</b>	<b>33</b>	<b>29</b>	<b>61</b>	<b>77</b>	<b>54</b>	<b>367</b>	<b>40</b>	<b>96</b>	<b>56</b>	<b>268</b>
<b>TOTAL</b>	<b>40</b>	<b>129</b>	<b>64</b>	<b>114</b>	<b>59</b>	<b>405</b>	<b>44</b>	<b>446</b>	<b>60</b>	<b>370</b>

Note: these figures represent gross investment only, and do not take into account either divestment or reinvestment by local affiliates.

## Appendix B – MoF figures

Inward Direct Investment (Industry - U.K.)

(unit: Case, JPY100million)

FY	1999		2000 (1st half)	
	Cases	Value	Cases	Value
Food	-	-		
Textile	-	-		
Rubber&Leather	-	-		
Chemical	-	-		
Metal	-	-		
Machinery	4	23	<b>No breakdown available</b>	
Petroleum	-	-		
Glass&Ceramics	1	2		
others	1	10		
<b>Manufacturing Total</b>	<b>6</b>	<b>35</b>		
Telecommunication	1	552		
Construction	-	-		
Trading	29	249		
Finance&Insurance	11	41		
Service	18	22		
Transportation	-	-		
Real Estate	-	-		
others	-	-		
<b>Non-Manufacturing Total</b>	<b>59</b>	<b>863</b>		
<b>TOTAL</b>	<b>65</b>	<b>898</b>	<b>45</b>	<b>65</b>

Note: these figures represent gross investment only, and do not take into account either divestment or reinvestment by local affiliates.

Source: MoF (2000a, b)

## APPENDIX C UK OFFICIAL STATISTICS

### 1 Net outward direct investment by UK companies analysed by area and main country<sup>1 2</sup>

		£ million				
		1995	1996	1997	1998	1999
<b>Europe</b>	<b>QGBX</b>	9 184	13 321	19 964	22 899 <sup>†</sup>	43 625
<b>EU</b>	<b>CAUV</b>	9 457	13 432	17 368	11 459 <sup>†</sup>	38 031
Austria	CBJD	90	102	16	22 <sup>†</sup>	9
Belgium & Luxembourg	CAUV	438	991	1 536	-147 <sup>†</sup>	56
Denmark	CAUW	416	-176	47	-114 <sup>†</sup>	122
Finland	CBJE	112	28	-5	96 <sup>†</sup>	307
France	CAUX	1 515	2 375	2 380	-101 <sup>†</sup>	2 322
Germany	CAUY	1 478	1 184	1 078	1 418 <sup>†</sup>	1 389
Greece	CAUZ	163	106	302	221 <sup>†</sup>	-34
Irish Republic	CAVA	776	755	450	1 057 <sup>†</sup>	..
Italy	CAVB	406	421	447	548 <sup>†</sup>	240
Netherlands	CAVC	2 953	6 577	9 804	7 750 <sup>†</sup>	5 565
Portugal	CAVD	159	56	112	-11 <sup>†</sup>	92
Spain	CAVE	431	735	864	197 <sup>†</sup>	525
Sweden	CBJG	522	277	335	527 <sup>†</sup>	..
<b>EFTA</b>	<b>CAVG</b>	-594	-12	2 195	8 794 <sup>†</sup>	3 634
of which						
Norway	CBJF	-255	96	1 997	773 <sup>†</sup>	84
Switzerland	CBJH	-338	-110	197	8 013 <sup>†</sup>	3 548
<b>Other European Countries</b>	<b>QGBY</b>	322	-97	402	2 646 <sup>†</sup>	1 960
of which						
Russia	GLAA	39	132	448	-170	257
UK offshore islands	GLAC	-	-	-933	2 445 <sup>†</sup>	890
<b>America</b>	<b>QGBZ</b>	13 460	3 277	13 953	48 863 <sup>†</sup>	76 379
of which						
Bermuda	CBKZ	291	142	-43	469 <sup>†</sup>	1 443
Brazil	CBLA	473	692	337	323 <sup>†</sup>	942
Canada	CAVK	244	-159	823	393 <sup>†</sup>	933
Chile	QCCA	220	89	168	168 <sup>†</sup>	-672
Colombia	QCCB	123	100	241	346 <sup>†</sup>	332
Mexico	GLAD	79	110	760	151 <sup>†</sup>	113
Panama	GLAE	75	103	..	310 <sup>†</sup>	-18
USA	CAVJ	11 840	1 837	10 509	46 066 <sup>†</sup>	70 759
<b>Asia</b>	<b>QQCI</b>	1 657	2 823	2 251	1 671 <sup>†</sup>	5 005
<b>Near and Middle East Countries</b>	<b>CBKF</b>	154	28	350	1 678 <sup>†</sup>	-864
of which						
Gulf Arabian countries <sup>3</sup>	QQCC	116	30	260	1 622 <sup>†</sup>	-595
<b>Other Asian Countries</b>	<b>QQCD</b>	1 503	2 794	1 901	-6 <sup>†</sup>	5 870
of which						
Hong Kong	CAVN	734	730	-359	1 537 <sup>†</sup>	626
India	GLAF	61	110	171	206 <sup>†</sup>	155
Indonesia	GLAG	-28	155	170	93 <sup>†</sup>	1
Japan	CAVM	169	378	383	10 <sup>†</sup>	1 996
Malaysia	CBKN	28	184	731	819 <sup>†</sup>	201
Singapore	CBKQ	-48	535	352	-2 479 <sup>†</sup>	1 340
South Korea	GLAH	47	32	-26	279 <sup>†</sup>	130
Thailand	GLAI	245	194	103	87 <sup>†</sup>	94
<b>Australasia &amp; Oceania</b>	<b>QQCE</b>	2 596	1 843	827	202 <sup>†</sup>	925
of which						
Australia	CBJO	2 258	1 472	737	216 <sup>†</sup>	814
New Zealand	CBJP	67	244	255	-112 <sup>†</sup>	177
<b>Africa</b>	<b>QQCF</b>	707	561	623	-95 <sup>†</sup>	1 267
of which						
Kenya	GLAJ	67	24	73	38 <sup>†</sup>	59
Nigeria	CBJY	-271	-94	234	-144 <sup>†</sup>	159
South Africa	CAVO	466	-25	401	-212 <sup>†</sup>	405
Zimbabwe	CBKD	16	25	1	36 <sup>†</sup>	74
<b>World Total</b>	<b>CDQD</b>	27 604	21 823	37 619	73 539 <sup>†</sup>	127 202
OECD	QQCG	23 686	17 545	33 212	67 758 <sup>†</sup>	116 518
Central and Eastern Europe <sup>4</sup>	QQCH	194	201	214	457 <sup>†</sup>	219

<sup>1</sup> Net investment includes unremitted profits.

<sup>2</sup> Minus sign indicates net disinvestment overseas.

<sup>3</sup> Includes Abu Dhabi, Bahrain, Dubai, Iraq, Kuwait, Oman, Other Gulf States, Qatar, Saudi Arabia and Yemen.

<sup>4</sup> Includes Albania, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Serbia and Montenegro, Slovakia, Bosnia & Herzegovina, Macedonia FYR and Slovenia.

<sup>5</sup> .. Indicates data are disclosive.

<sup>6</sup> - Indicates nil returns.

Sources: ONS Overseas Direct Investment Inquiries; Bank of England

## Appendix C – UK official statistics

### 2 Level of UK outward direct investment - book value of net assets analysed by area and main country at year end

£ million

		1995	1996	1997	1998	1999
<b>Europe</b>	<b>GQCT</b>	<b>76 434</b>	<b>87 582</b>	<b>99 263</b>	<b>115 142<sup>†</sup></b>	<b>169 002</b>
<b>EU</b>	<b>CDLN</b>	<b>72 808</b>	<b>83 902</b>	<b>92 072</b>	<b>94 894<sup>†</sup></b>	<b>150 158</b>
Austria	CDLZ	734	578	461	492 <sup>†</sup>	745
Belgium & Luxembourg	CDLO	3 172	5 326	5 701	5 421 <sup>†</sup>	10 933
Denmark	CDLP	2 803	2 273	2 123	2 258 <sup>†</sup>	3 075
Finland	CDMA	271	215	217	255 <sup>†</sup>	541
France	CDLQ	12 913	13 128	11 368	9 889 <sup>†</sup>	12 904
Germany	CDLR	9 215	8 943	8 328	9 956 <sup>†</sup>	10 860
Greece	CDLS	500	465	366	506 <sup>†</sup>	425
Irish Republic	CDLT	4 587	6 282	6 182	7 517 <sup>†</sup>	27 164
Italy	CDLU	2 698	3 196	3 064	3 092 <sup>†</sup>	3 069
Netherlands	CDLV	29 906	37 676	48 240	49 678 <sup>†</sup>	69 033
Portugal	CDLW	1 210	1 190	1 023	1 020 <sup>†</sup>	985
Spain	CDLX	3 389	3 477	3 748	3 149 <sup>†</sup>	3 593
Sweden	CDMD	1 401	1 154	1 250	1 663 <sup>†</sup>	6 831
<b>EFTA</b>	<b>CDLY</b>	<b>2 522</b>	<b>2 161</b>	<b>1 533</b>	<b>10 506<sup>†</sup></b>	<b>7 144</b>
of which						
Norway	CDMC	1 244	1 171	1 116	428 <sup>†</sup>	1 391
Switzerland	CDME	1 279	988	415	10 073 <sup>†</sup>	5 750
<b>Other European Countries</b>	<b>GQCK</b>	<b>1 103</b>	<b>1 520</b>	<b>5 658</b>	<b>9 742<sup>†</sup></b>	<b>11 700</b>
of which						
Russia	GQAA	120	238	401	200 <sup>†</sup>	282
UK offshore islands	GQAB	-	-	2 690	6 940 <sup>†</sup>	8 520
<b>America</b>	<b>GQCU</b>	<b>83 275</b>	<b>67 592</b>	<b>80 324</b>	<b>137 860<sup>†</sup></b>	<b>207 212</b>
of which						
Bermuda	CDQA	5 504	5 295	4 942	4 688 <sup>†</sup>	6 669
Brazil	CDQB	2 323	2 421	2 214	1 604 <sup>†</sup>	2 633
Canada	CDML	5 395	4 563	5 748	4 889 <sup>†</sup>	5 687
Chile	GQCT	666	670	970	1 099 <sup>†</sup>	1 075
Colombia	GQCS	1 207	1 274	1 197	558 <sup>†</sup>	977
Mexico	GQAC	350	553	1 327	797 <sup>†</sup>	1 035
Panama	GQAD	467	744	..	..	121
USA	CDMM	62 159	49 170	59 083	120 382 <sup>†</sup>	185 363
<b>Asia</b>	<b>GQCL</b>	<b>18 038</b>	<b>19 916</b>	<b>19 389</b>	<b>20 777<sup>†</sup></b>	<b>25 319</b>
<b>Near &amp; Middle East Countries</b>	<b>CDNE</b>	<b>788</b>	<b>676</b>	<b>917</b>	<b>2 646<sup>†</sup></b>	<b>1 064</b>
of which						
Gulf Arabian countries <sup>1</sup>	GQCM	704	586	658	2 375 <sup>†</sup>	660
<b>Other Asian Countries</b>	<b>GQCR</b>	<b>17 250</b>	<b>19 239</b>	<b>18 472</b>	<b>18 131<sup>†</sup></b>	<b>24 254</b>
of which						
Hong Kong	CDNN	4 033	4 636	4 406	5 271 <sup>†</sup>	6 334
India	GQAE	498	532	703	700 <sup>†</sup>	868
Indonesia	GQAF	418	391	801	638 <sup>†</sup>	747
Japan	CDMP	2 397	2 437	1 605	1 844 <sup>†</sup>	3 679
Malaysia	CDNQ	1 813	2 164	2 411	1 900 <sup>†</sup>	2 076
Singapore	CDNT	5 287	5 822	5 186	5 600 <sup>†</sup>	5 964
South Korea	GQAG	250	238	154	218 <sup>†</sup>	555
Thailand	GQAH	920	1 053	1 009	621 <sup>†</sup>	564
<b>Australasia &amp; Oceania</b>	<b>GQCN</b>	<b>13 985</b>	<b>14 636</b>	<b>13 312</b>	<b>12 117<sup>†</sup></b>	<b>11 928</b>
of which						
Australia	CDMO	11 365	12 213	10 598	9 017 <sup>†</sup>	9 387
New Zealand	CDMQ	1 670	1 640	1 663	1 617 <sup>†</sup>	1 749
<b>Africa</b>	<b>GQCQ</b>	<b>4 955</b>	<b>4 876</b>	<b>5 873</b>	<b>4 254<sup>†</sup></b>	<b>9 884</b>
of which						
Kenya	GQAI	276	237	361	414 <sup>†</sup>	454
Nigeria	CDNA	335	321	1 060	462 <sup>†</sup>	505
South Africa	CDMR	2 827	2 429	2 527	1 693 <sup>†</sup>	6 552
Zimbabwe	CDNF	262	200	192	114 <sup>†</sup>	154
<b>World Total</b>	<b>CDOO</b>	<b>196 687</b>	<b>194 601</b>	<b>218 162</b>	<b>290 150<sup>†</sup></b>	<b>423 343</b>
<b>OECD</b>	<b>GQCO</b>	<b>159 476</b>	<b>157 652</b>	<b>175 434</b>	<b>246 158<sup>†</sup></b>	<b>366 007</b>
<b>Central &amp; Eastern Europe<sup>2</sup></b>	<b>GQCP</b>	<b>427</b>	<b>622</b>	<b>1 782</b>	<b>2 129<sup>†</sup></b>	<b>1 521</b>

<sup>1</sup> Includes Abu Dhabi, Bahrain, Dubai, Iraq, Kuwait, Oman, Other Gulf States, Qatar, Saudi Arabia and Yemen.

<sup>2</sup> Includes Albania, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Serbia and Montenegro, Slovakia, Bosnia & Herzegovina, Macedonia FYR and Slovenia.

<sup>3</sup> .. Indicates data are disclosive.

<sup>4</sup> - Indicates nil returns.

Sources: ONS Overseas Direct Investment Inquiries; Bank of England

### 3 Net earnings from direct investment overseas by UK companies analysed by area and main country<sup>1 2</sup>

		£ million				
		1995	1996	1997	1998	1999
<b>Europe</b>	<b>GDV</b>	<b>8 288</b>	<b>8 700</b>	<b>10 440</b>	<b>10 938<sup>†</sup></b>	<b>14 118</b>
<b>EU</b>	<b>GDW</b>	<b>7 251</b>	<b>8 557</b>	<b>8 994</b>	<b>9 448<sup>†</sup></b>	<b>11 230</b>
Austria	GDG	73	82	65	45 <sup>†</sup>	57
Belgium & Luxembourg	GDH	308	358	297	606 <sup>†</sup>	362
Denmark	GDJ	286	206	191	207 <sup>†</sup>	227
Finland	GDK	43	-	36	56 <sup>†</sup>	98
France	GDN	819	999	1 036	934 <sup>†</sup>	1 245
Germany	GDQ	1 032	951	844	755 <sup>†</sup>	1 235
Greece	GDW	-106	172	122	76 <sup>†</sup>	167
Irish Republic	GDY	635	547	1 112	1 155 <sup>†</sup>	1 367
Italy	GDZ	272	327	268	319 <sup>†</sup>	411
Netherlands	GD0	3 245	3 748	4 143	4 351 <sup>†</sup>	5 207
Portugal	GD1	185	154	95	154	155
Spain	GD2	335	493	581	425 <sup>†</sup>	391
Sweden	GD3	310	188	234	285 <sup>†</sup>	310
<b>EFTA</b>	<b>GD8</b>	<b>896</b>	<b>963</b>	<b>991</b>	<b>835<sup>†</sup></b>	<b>1 426</b>
of which						
Norway	GD4	224	311	242	123	245
Switzerland	GD5	675	652	747	703 <sup>†</sup>	1 180
<b>Other European Countries</b>	<b>GD6</b>	<b>136</b>	<b>180</b>	<b>454</b>	<b>655<sup>†</sup></b>	<b>1 461</b>
of which						
Russia	GD7	12	24	-30	-214 <sup>†</sup>	4
UK offshore islands	GD8	-	-	225	661 <sup>†</sup>	979
<b>America</b>	<b>GD9</b>	<b>10 254</b>	<b>10 686</b>	<b>11 867</b>	<b>11 620<sup>†</sup></b>	<b>12 964</b>
of which						
Bermuda	GD9	509	506	70	440 <sup>†</sup>	464
Brazil	GD0	432	650	380	321 <sup>†</sup>	120
Canada	GD1	374	571	913	832 <sup>†</sup>	879
Chile	GD2	263	285	236	146	141
Colombia	GD3	28	23	53	2	78
Mexico	GD4	52	74	145	55 <sup>†</sup>	175
Paraguay	GD5	45	67	-	150	25
USA	GD6	7 853	8 034	9 338	9 534 <sup>†</sup>	9 968
<b>Asia</b>	<b>GD7</b>	<b>2 501</b>	<b>3 776</b>	<b>3 248</b>	<b>4 066<sup>†</sup></b>	<b>2 741</b>
<b>Near &amp; Middle East Countries</b>	<b>GD8</b>	<b>262</b>	<b>241</b>	<b>475</b>	<b>520<sup>†</sup></b>	<b>493</b>
of which						
Gulf Arabian countries <sup>3</sup>	GD9	260	212	424	675 <sup>†</sup>	444
<b>Other Asian Countries</b>	<b>GD0</b>	<b>2 239</b>	<b>3 536</b>	<b>2 774</b>	<b>3 186<sup>†</sup></b>	<b>2 248</b>
of which						
Hong Kong	GD1	1 362	1 463	623	632 <sup>†</sup>	689
India	GD2	100	81	124	192	189
Indonesia	GD3	71	87	143	110 <sup>†</sup>	111
Japan	GD4	212	281	213	164 <sup>†</sup>	443
Malaysia	GD5	246	332	360	246 <sup>†</sup>	344
Singapore	GD6	-144	883	796	1 286 <sup>†</sup>	72
South Korea	GD7	40	34	17	33 <sup>†</sup>	10
Thailand	GD8	75	101	95	17 <sup>†</sup>	134
<b>Australasia &amp; Oceania</b>	<b>GD9</b>	<b>2 044</b>	<b>2 289</b>	<b>1 950</b>	<b>1 516<sup>†</sup></b>	<b>1 500</b>
of which						
Australia	GD0	1 567	1 747	1 503	1 079 <sup>†</sup>	1 152
New Zealand	GD1	322	319	278	145 <sup>†</sup>	283
<b>Africa</b>	<b>GD2</b>	<b>607</b>	<b>1 055</b>	<b>965</b>	<b>654<sup>†</sup></b>	<b>1 067</b>
of which						
Kenya	GD3	46	25	94	75 <sup>†</sup>	53
Nigeria	GD4	-35	81	46	49	54
South Africa	GD5	438	503	521	395 <sup>†</sup>	641
Zimbabwe	GD6	56	50	56	53 <sup>†</sup>	73
<b>World Total</b>	<b>GD7</b>	<b>23 894</b>	<b>27 498</b>	<b>28 470</b>	<b>29 014<sup>†</sup></b>	<b>32 419</b>
<b>OECD</b>	<b>GD8</b>	<b>18 567</b>	<b>20 621</b>	<b>22 801</b>	<b>22 244<sup>†</sup></b>	<b>25 857</b>
<b>Central &amp; Eastern Europe<sup>4</sup></b>	<b>GD9</b>	<b>16</b>	<b>15</b>	<b>118</b>	<b>70<sup>†</sup></b>	<b>294</b>

1 A minus sign indicates net losses.

2 Net earnings equal profits of overseas branches plus UK companies' receipts of interest and their share of profits of overseas subsidiaries and associates. Earnings are after deducting provisions for depreciation and overseas tax on profits, dividends and interest.

3 Includes Abu Dhabi, Bahrain, Dubai, Iraq, Kuwait, Oman, Other Gulf States, Qatar, Saudi Arabia and Yemen.

4 Includes Albania, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Serbia & Montenegro, Slovakia, Bosnia & Herzegovina, Macedonia FYR and Slovenia.

5 - Indicates data are decisive.

6 - Indicates nil returns.

Sources: ONS Overseas Direct Investment Inquiries; Bank of England

Source: National Statistics (2000)

## APPENDIX D QUESTIONNAIRE

### 1. Company information

1.1. When did you begin operations in Japan?

1.2. How long was the research and preparation period before operations actually started?

1.3. With which form of organization did your company enter Japan? (Check only one in each column)

<b>A. Mode of Entry</b>	
Imports through third party, including trading company or agent	
Imports through sales subsidiary/ representative or branch office	
Technology agreement/licence/ franchise with local firm	
Manufacturing subsidiary	
Retail subsidiary	
Other (please specify)	

<b>B. Ownership</b>	
Wholly owned	
Majority owned joint venture	
50:50 joint venture	
Minority owned joint venture	
Equity ownership in Japanese corporation	
Other (please specify)	

1.4. Is 1.3 still your current form of organization?

YES      NO

If NO, what is your current form of organization?

In what year(s) did your company change organizational form?

1.5. Have you any plans to change your current organizational form?

YES      NO

*If YES, what to?*

1.6. What percentage of your global business is in Japan?

1.7. What is your current scale in Japan in terms of:

Sales

Net investment

Employment

Profits

Any other relevant details

## Appendix D - Questionnaire

1.8. Why has your company decided to locate in Japan?  
(Please tick the relevant box for each item)

	<b>Major factor</b>	<b>Minor factor</b>	<b>Not a factor</b>
Size/potential of Japanese market			
Importance of Japan in the company's global strategy			
To service existing customers in Japan			
To service customers who have moved to Japan			
To monitor the market/gather information			
To access other markets in the Asia/Pacific region			
In response to competition with Japanese companies in home market			
To take advantage of deregulation/market-opening measures			
To lobby the Japanese government to improve market access			
Potential for participating in Japanese-won contracts outside Japan			
To diversify the company's sources of revenue and foreign exchange			
To gain access to new products/processes/technology			
Other (please specify)			

1.9. What role does your Japan operation have with regard to the rest of the Asia/Pacific region?

Company does not operate outside Japan in Asia/Pacific	
Japan is regional HQ for Asia/Pacific (please list main other areas Japan subsidiary is responsible for)	
Company is active elsewhere in region, but operations are controlled from elsewhere (please specify)	

**2. Parent company involvement**

2.1. Please rate the strength of the parent company's commitment to the business in Japan. (Select one)

Very strong	Strong	Moderate	Neutral	Weak	Very weak
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2.2. By what percentage has the parent company increased/decreased its net investment in Japan since first entry?

100%+ increase	51-100% increase	1-50% increase	No change	1-50% decrease	51-100% decrease
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2.3. By what percentage has the total number of employees in your Japanese operations changed since first entry?

100%+ increase	51-100% increase	1-50% increase	No change	1-50% decrease	51-100% decrease
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2.4. To what extent does the parent company intend to pursue equity investments in Japan over the next 5 years? (Select one)

Definite plans	
Seeking opportunities	
If opportunity arises	
No plans	
Not feasible	

Why?

## Appendix D - Questionnaire

2.5. Which of the following factors inhibit greater investment in Japan by the parent company? (Please tick the relevant box for each item)

	<b>Major factor</b>	<b>Minor factor</b>	<b>Not a factor</b>
High cost of doing business in Japan			
Complexity of doing business in Japan			
Getting the right staff locally			
Difficulties finding appropriate expatriate staff			
Time required to reach corporate profit levels			
Lack of corporate management's understanding of Japan			
Japanese government regulations			
Lack of market opportunities			
Tariffs and quotas (please specify)			
Non-tariff barriers (please specify)			
Unable to acquire Japanese companies			
Lack of financing			
Other (please specify)			

2.6. Which of the following factors inhibit greater trade with Japan by the parent company? (Please tick the relevant box for each item)

	<b>Major factor</b>	<b>Minor factor</b>	<b>Not a factor</b>
Controlled distribution channels			
Government regulations			
Non market-driven pricing			
Intellectual property protection			
Uneven enforcement of regulations			
Product testing regulations			
Government procurement practices			
Tariffs and quotas			
Non-tariff barriers (please specify)			
Lack of financing			
Other (please specify)			

**3. Current trade and investment issues**

3.1. Please number the top three issues (1 = most important, 2 = next most important, etc) restricting your ability to do business (or more business) in Japan.

<b>Japan-side issues</b>	
High land costs/rents	
Staffing problems	
Keiretsu relationships	
Exclusionary business practices	
Legal/regulatory restrictions	
Complex distribution system	
Ministry guidelines/industry policies	
Non-market pricing	
Other (please specify)	

<b>Home-side issues</b>	
Investment in Japan requires longer timescale than permitted under normal corporate strategy	
Product quality requirements in Japan	
Product modification requirements for Japan	
Lack of knowledge of Japan	
Exchange rate variability	
Frequent strategy changes	
Frequent personnel changes	
Tax issues	
Other (please specify)	

Why are these the most important issues for your company?

**Appendix D - Questionnaire**

3.2. Are there local restrictions on the types of goods/services that your company can provide in Japan compared with the home market?

YES

NO

If YES, please give examples

To what extent do these restrictions apply to

	Not at all	Somewhat	About the same	Slightly more	A lot more
Japanese firms already in the sector					
Potential Japanese new entrants					
Foreign firms already in the sector					
Potential new foreign entrants					

3.3. What impact, if any, has the unwinding of Japanese cross-shareholdings and the consequent weakening of *keiretsu* relationships had on trade and investment in your industry sector?

Positive	No effect	Negative
----------	-----------	----------

If positive or negative, please give specific examples

**Appendix D - Questionnaire**

3.4. Is your company's ability to do business in Japan adversely affected by restrictions on the extent to which patent/copyright/trademark protection is available in Japan?

YES

NO

If YES, please give examples

To what extent do these restrictions apply to

	Not at all	Somewhat	About the same	Slightly more	A lot more
Japanese firms already in the sector					
Potential Japanese new entrants					
Foreign firms already in the sector					
Potential new foreign entrants					

3.5. Are there any testing procedures/guidelines that significantly impede the market entry of your products?

YES

NO

If YES, please give examples

To what extent do these restrictions apply to

	Not at all	Somewhat	About the same	Slightly more	A lot more
Japanese firms already in the sector					
Potential Japanese new entrants					
Foreign firms already in the sector					
Potential new foreign entrants					

**Appendix D - Questionnaire**

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3.6. Are Japanese firms in your sector given tax benefits or other subsidies that are not available to your firm because it is foreign?

YES

NO

If YES, please give examples

3.7. Do Japanese government procurement practices affect the competitive ability of your products/services in Japan?

YES

NO

If YES, please give examples

3.8. Which of the following are reasons for companies in your sector (not necessarily your own company) being unable to penetrate the Japanese market better?

	<b>Major factor</b>	<b>Minor factor</b>	<b>Not a factor</b>
High fixed costs			
Difficulty in finding/keeping personnel			
General complexity of doing business			
They make too many mistakes			
They are not trying hard enough			
Complexity of the distribution system			
Japanese business blocking competition			
Japanese government not encouraging trade			
Japanese government restricting trade			
Home government not encouraging trade			
Other (please specify)			

## Appendix D - Questionnaire

3.9. Please assess the current climate for foreign direct investment in Japan in your sector.

Favourable	Neutral	Not favourable
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3.10. What is your impression of the degree of restrictions hindering foreign direct investment in your sector in Japan?

Major restrictions exist	Some restrictions exist	No restrictions
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If you believe restrictions exist, please give examples

3.11. Please assess the degree to which the climate for foreign direct investment in Japan has changed over the past 10 years, and how it can be expected to change in the next 10 years.

Last 10 years		Next 10 years
	Significant improvement	
	Some improvement	
	No change	
	Some deterioration	
	Significant deterioration	

What do you think the major factors are accounting for this change (or lack of it)?

4. **Company's current operations in Japan**

4.1. What are your objectives in Japan, and do these differ from those elsewhere?

4.2. Who are your main customers in Japan?

4.3. How, if at all, do you adapt your operations to Japanese conditions?

Products, range, quality

Sales, marketing, promotion

Prices

Distribution

Any other way

4.4. Does your presence in the Japanese market stimulate the home company to make/offer better and more competitive products?

## Appendix D - Questionnaire

4.5. Have new processes/technology been transferred to or from Japan?

4.6. How easy is it for your company to find suitable staff in Japan?

	Difficult	Same as UK	Easy	N/A
Senior management				
Middle management				
Rank & file				

4.7. Where are staff recruited and what nationality are they?

	Locally recruited Japanese	Japanese already within company	UK staff from home company	Locally recruited expats*
Senior management				
Middle management				
Rank & file				

\*Any nationality other than Japanese

4.8. What nationality are the following executives?

	Japanese/recruited locally	Japanese already within company	UK staff from home company	Locally recruited expats
Chief executive				
Finance director				
Marketing director				

4.9. If expatriates (of any nationality) currently hold any of these senior positions, are there any plans to replace them with Japanese? If so, within what time frame?

## Appendix D - Questionnaire

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4.10. Does your company give non-Japanese staff any of the following training?

	YES	NO	If YES, how many weeks?
Japanese language training			
Cultural awareness training			

4.11. Does your company's personnel policy differ substantially from that adopted at home or in other countries? If so, how?

4.12. What is the single most important conflict between the UK parent company and the Japanese affiliate?

4.13. What is the single most important conflict between yourself and the Japanese joint venture partner (if any)?

5. **Key success factors**

5.1. How does your company measure ‘success’ and whether your activities in Japan are successful?

Sales targets	
Financial targets	
Growth targets	
Brand/name recognition in Japan	

Market share targets	
Market technology/intelligence acquired	
Worldwide sales to Japanese customers	
Other (please specify)	

Are you currently achieving those targets?

5.2. Please list 3 critical success factors that have enabled you to compete in Japan.

5.3. How many years do you feel are required for companies in your sector to reach break-even point for new investments in Japan?

For a joint venture  
For a wholly-owned subsidiary

Is this longer/shorter than in other markets?

5.4. How many years do you feel are required for companies in your sector to reach average corporate profit levels in Japan?

For a joint venture  
For a wholly-owned subsidiary

Is this longer/shorter than in other markets?

5.5. How many years do you feel are required for companies in your sector to exceed average corporate profit levels in Japan?

For a joint venture  
For a wholly-owned subsidiary

Is this longer/shorter than in other markets?

## APPENDIX E ABBREVIATED QUESTIONNAIRE

1. Please number the top three issues (1 = most important, 2 = next most important, etc) restricting your ability to do business (or more business) in Japan.

Japan-side issues	
High land costs/rents	
Staffing problems	
Keiretsu relationships	
Exclusionary business practices	
Legal/regulatory restrictions	
Complex distribution system	
Ministry guidelines/industry policies	
Non-market pricing	
Other (please specify)	

Home-side issues	
Investment in Japan requires longer timescale than permitted under normal corporate strategy	
Product quality requirements in Japan	
Product modification requirements for Japan	
Lack of knowledge of Japan	
Exchange rate variability	
Frequent strategy changes	
Frequent personnel changes	
Tax issues	
Other (please specify)	

- Name three critical success factors that have enabled you to compete in Japan
- Is recruitment/getting Japanese staff to work the way you want them to a problem?
- How sensitive is your business to changes in the exchange rate?
- How long do you expect it will take before you reach break-even/corporate profit levels, and how does this compare with expectations in other markets?
- How easy is it for your company to find suitable staff in Japan?

	Difficult	Same as UK	Easy	N/A
Senior management				
Middle management				
Rank & file				

## Appendix E – Abbreviated questionnaire

7. Where are staff recruited and what nationality are they?

	Locally recruited Japanese	Japanese already within company	UK staff from home company	Locally recruited expats*
Senior management				
Middle management				
Rank & file				

\*Any nationality other than Japanese

8. What nationality are the following executives?

	Japanese/recruited locally	Japanese already within company	UK staff from home company	Locally recruited expats
Chief executive				
Finance director				
Marketing director				

9. If expatriates (of any nationality) currently hold any of these senior positions, are there any plans to replace them with Japanese? If so, within what time frame?

10. Does your company give non-Japanese staff any of the following training?

	YES	NO	If YES, how many weeks?
Japanese language training			
Cultural awareness training			

11. Does your company's personnel policy differ substantially from that adopted at home or in other countries? If so, how?

## **Appendix E – Abbreviated questionnaire**

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12. When did your company enter Japan?

13. In what organizational form?

14. How long did the preparation period take?

15. When do you expect to/did you break even?

16. Is this longer or shorter than in other markets?

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