

# Foreign Affiliates' Business Activities in Japan As Seen from Statistics

By Naoyuki HARAOKA

## Asians: Main Players in Silicon Valley

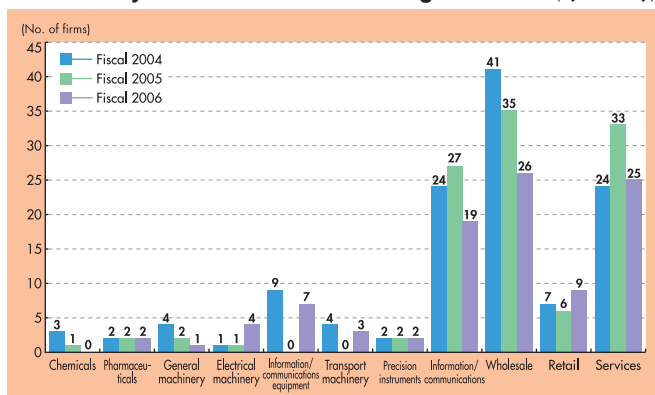
At a time when businesses are stepping up their globalization efforts, it is widely said that the future of a country's international competitiveness depends upon whether it can attract as many foreign firms as possible and whether it can offer an attractive investment environment for them. Incoming investments are particularly beneficial in that they contribute to the promotion of innovation. Even if incoming investments do not take the form of business activities, the recipient country can accelerate its pace of innovation if it is successful in attracting researchers and engineers rich in originality.

A typical example for this is found in Silicon Valley in the United States. Silicon Valley is really a melting pot of different ethnic groups. Asians account for 33% of the area's population, almost rivaling Caucasians who occupy 40%. Moreover, China and India show an overwhelming presence, with their nationals combined accounting for 60% of all foreign specialists active in Silicon Valley. Most of those specialists are computer software engineers. This means Asians are shouldering the bulk of creative activities in Silicon Valley, which is known as a center of intellectual industry.

## Creative Individuals/Small Firms

How are foreign-affiliated firms' business activities in Japan supporting innovation efforts in the country, in a similar sense as in Silicon Valley? Although not necessarily offering any direct answer to this question, data in the "Survey of Trends in Business Activities of Foreign Affiliates," released annually by the Ministry of Economy, Trade and Industry, provide some inspiring indications of favorable effects on Japan from foreign-affiliated firms. I would like to show data in the survey for fiscal 2006 through March 2007, the latest available statistics. Foreign affiliates covered here are mainly companies owned one-third or more by foreign investors, excluding financial, insurance and real estate firms.

CHART 1  
No. of newly established/funded foreign affiliates (by industry)



Source : Survey of Trends in Business Activities of Foreign Affiliates, Ministry of Economy, Trade & Industry

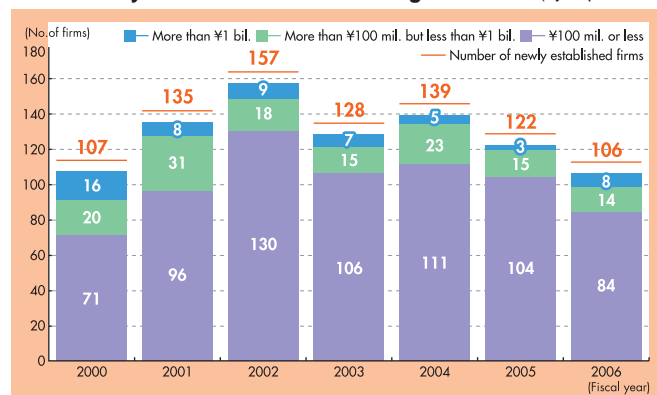
First of all, let's take a look at the number of function-wise offices of foreign affiliates in Japan. The data show that the number of their offices for research and development is small, averaging only 0.5 per company for the manufacturing sector. Most of the offices are for sales and marketing. However, foreign affiliates having one R & D office in Japan account for 88% of the companies surveyed. *Chart 1* shows the number of industry-wise newly established or newly funded foreign affiliates. This finds the information and communication industry, which is regarded closely linked with high technology, representing a relatively large share, the third largest after those of the wholesale and services industries. Small and midsize firms assume a high proportion of start-up businesses in terms of capitalization, as shown in the year-by-year trend in the number of capital-wise newly founded and newly funded foreign affiliates (*Chart 2*). Seen from the nationality of their parents, Asian firms raised their share to 24% in fiscal 2006 from 15% in fiscal 2000. A quantitative increase in incoming investments does not necessarily accelerate the pace of innovation. What is interesting in this connection is the finding that there are many individuals or minor firms with creative technologies, even though the amount of their investments is small.

## Profit, Capital Spending, R & D

Next, let's compare the ratio of pretax profit to sales of foreign affiliates — an indicator of business performance — with that of all businesses in Japan. As indicated in *Chart 3*, foreign affiliates have achieved better profitability. This shows the possibility of foreign affiliates' entry not only prompting innovation in the country but also revitalizing the national economy as a whole. A nationality-wise comparison finds the profit-to-sales ratio ranging from 5% to 7% for European and US firms, higher than the average 3.5% for all businesses in Japan. But the ratio for Asian companies is much lower at 0.9%.

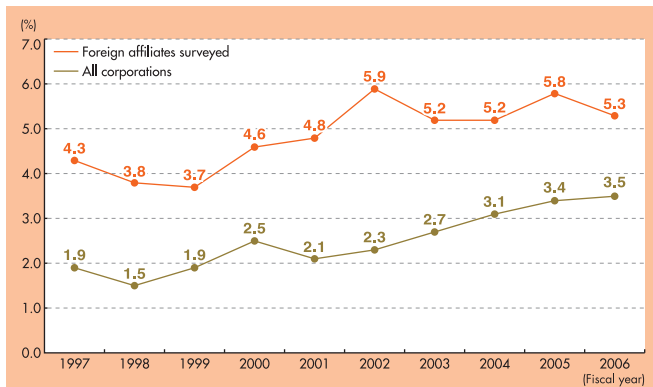
Capital spending by foreign affiliates also contributes to economic revitalization as their entry promotes innovation efforts. In fiscal 2006, capital investments by all foreign affiliates hit an all-time high of ¥1.15

CHART 2  
No. of newly established/funded foreign affiliates (by capital size)



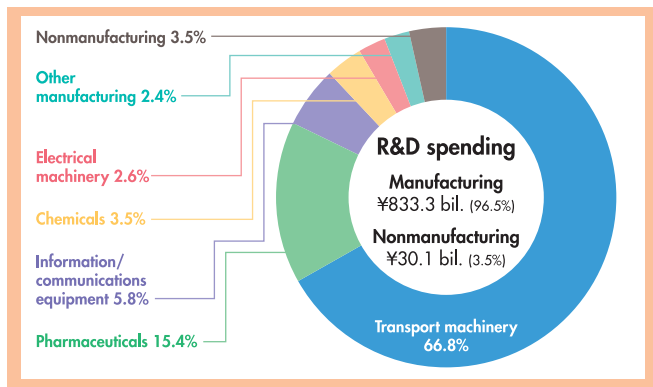
Source : Survey of Trends in Business Activities of Foreign Affiliates, Ministry of Economy, Trade & Industry

**CHART 3**  
Trend in ratio of pretax profit to sales (all industries)



Note: Ratio of pretax profit to sales = pretax profit/sales × 100. Both profit and sales figures are based only on data from firms that responded to the survey.  
Source: Data for "All Corporations" from Financial Statement Statistics of Corporations by Industry, Ministry of Finance

**CHART 5**  
Industry-wise shares in R&D spending



Source: Survey of Trends in Business Activities of Foreign Affiliates, Ministry of Economy, Trade & Industry

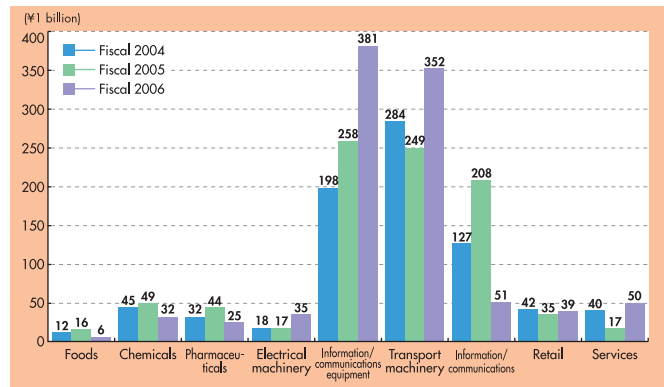
trillion, up 9.5% from the previous fiscal year. But combined capital investments by all businesses in Japan increased 13.5%. This means the share of capital spending by foreign affiliates in the national total shrank slightly. However, their share in the total capital investments in Japan was generally on the rise in the past several years. Notably, as indicated in *Chart 4*, leading the rise were high technology-linked information/communications equipment and transport machinery that achieved remarkable increases in their capital investments.

R & D expenditures by all foreign affiliates showed an 11.2% surge in fiscal 2006 from the previous year. By industry, high technology-related electrical machinery, information/communications equipment and pharmaceuticals achieved hefty gains of more than 20%. (For reference, *Chart 5* shows industry-wise shares in R & D expenses.) In recent years, some foreign firms moved their R & D bases to Japan in the fields of home information appliances and information technology, attracted by Japan's strong R & D capabilities (high levels of research and the presence of many excellent researchers). The survey results appear to back up this trend in general.

### Japan: Good Place to Test Marketing

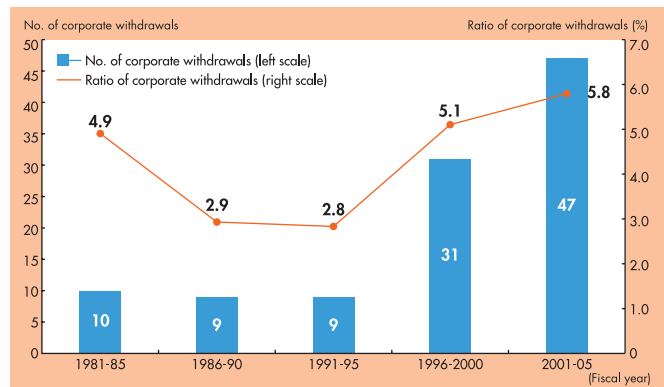
Japan has taken various trade policies, such as those for import promotion, in response to the advance of globalization and to the level of its economic development. Now the promotion of incoming investments poses a major policy challenge for the country. Incoming investments in Japan accounts for only 2% of its gross domestic product, much smaller than the 20-30% levels achieved by other major advanced countries. Needless to say, a quantitative increase is important. At the same time,

**CHART 4**  
Capital investment trend (main industries)



Source: Survey of Trends in Business Activities of Foreign Affiliates, Ministry of Economy, Trade & Industry

**CHART 6**  
No./ratio of corporate withdrawals from Japan in fiscal 2006 (by time of establishment/capital acquisition)



Note: Ratio of corporate withdrawals = No. of withdrawals in fiscal 2006 / (No. of companies covered by fiscal 2006 survey + No. of withdrawals in fiscal 2006) × 100. Calculations were made according to the time of establishment & capital acquisition.

Source: Survey of Trends in Business Activities of Foreign Affiliates, Ministry of Economy, Trade & Industry

however, the matter of quality is also important if Japan is to aim at becoming a center for creative technological development, like Silicon Valley as mentioned at the outset. Japan needs to put importance on the quality aspect, even in the case of smaller firms' advance into the country, and see if it could help contribute to the promotion of innovation.

Meanwhile, the ratio of foreign firms withdrawing is on the rise recently as indicated in *Chart 6*. Japan not only needs to solicit investments by foreign companies but also is required to consider how to prevent them from withdrawing. Japan needs to provide aftercare for them as part of its efforts to promote incoming investments by foreign firms. In addition, it is necessary to conduct a more comprehensive statistical survey on foreign affiliates, including those in the financial services, insurance and real-estate sectors not covered in the current annual survey.

As a matter of course, it is important to publicize Japan's selling points in soliciting investments by foreign businesses. This author would like to point out that Japan has high-quality R & D capabilities, as mentioned earlier, and at the same time has high-level consumers who want to purchase high-quality products. It is said that a corporation able to satisfy consumers in the Japanese market is assured of a success in any country. In that sense, Japan also excels as a test marketplace.

Japan has already launched policy efforts in this direction. In the not-so-distant future, a number of foreign corporations that have many advantages as hybrid enterprises are expected to play an active role in the Japanese market.

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