Foreign-affiliated Companies In Japan

By Tatsuya Ohmori

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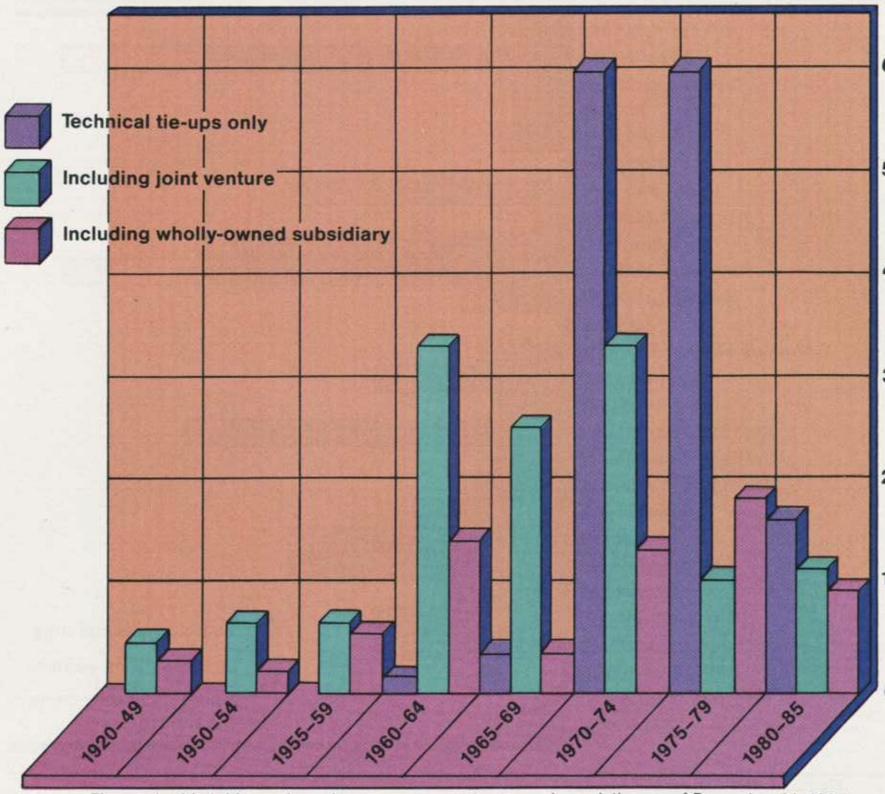
A new era has opened for foreign-affiliated companies (FACs) in Japan. Although there have been some ups and downs in annual volumes of direct foreign investment in Japan reflecting the economic fluctuations since the first oil crisis of the early 1970s, the overall trend has been one of steady growth. By March 1986, the cumulative total of such direct investment was approximately $6.2 billion (on an approvals and notification basis). The United States, which has traditionally accounted for over 30% of the investment flow on an annual basis, accounted for about half of this total. Next were the European countries led by Britain, West Germany and Switzerland at a little over 20%. Of the other countries investing in Japan, Hong Kong comes surprisingly high on the list. In addition, reinvestment in Japan by FACs (companies with 50% or more foreign equity ownership) accounts for about 20% of the total, ranking right alongside the European countries. Looking at investment in Japan over the past 10 years by half-decade periods, the total of $330 million for the years 1981–85 was more than double the total for the years 1976–80.

By further opening the Japanese market, the Foreign Exchange and Foreign Trade Control Law in 1980 was a major reason for this increase in FAC activity. In this sense, the increase in FAC activity in Japan is part and parcel of the progress the government is making in capital liberalization. Until the completion of capital liberalization in 1973, the government's priority was on protecting and nurturing domestic industry, and it looked askance

Fig. 1 **The 1985 Fortune 200 in Japan: Year and Form of Entry**



Note: Figures in this table are based upon a survey of companies existing as of December 31, 1985.
Source: *Survey of Foreign Investment in Japan: Data on American Firms 1985*, Keizai Chosa Kyokai

at foreign-capitalized interlopers. It is not surprising that the Japanese market thus appeared closed to outsiders. However, the major U.S. companies, the most active overseas investors in the postwar years, were only perfunctorily interested in Japan at the time, since their home market was so vast and since entry into Europe was so much easier. As a result, the impression developed, which continues widespread even today both overseas and in Japan, that there is not much FAC activity in Japan.

Yet contrary to this impression, many of the leading foreign companies set up shop in Japan soon after the war. The major U.S. companies, for example, have been in Japan since the 1950s, either in joint ventures or with independent Japanese subsidiaries. Of the *Fortune* 200, 121 have joint ventures or subsidiaries in Japan, and another 41 have technical agreements with Japanese companies. Given their lines of business, the market situation and their corporate strategies, it is unlikely that the remaining 38 companies will enter Japan soon. The same trends hold for European companies: Many have been in Japan since before the war, and the companies that are going to come to Japan are already here.

There are several distinct eras in FAC entry into Japan from the 1950s through the early 1980s. In the 1950s and 1960s, most of the new FACs in Japan were in technical tie-up agreements with Japanese companies or joint ventures premised upon technical tie-ups in line with the Japanese government's policies on foreign capital entry. In 1964, Japan joined the OECD and substantial liberalization was begun, culminating with complete liberalization in line with OECD guidelines in 1973. There was, therefore, a rapid increase in the number of non-joint-venture technical tie-ups in the 1970s. Around this same time, the pattern of FAC establishment in Japan shifted from joint ventures to wholly-owned subsidiaries. This was especially true as U.S. and European giants shifted their global strategies in the 1980s to place new emphasis on Japan (Fig. 1).

Today, there are over 1,300 U.S. and about 900 European companies doing business in Japan. Of course, not all of these FACs are doing well, and about 30 withdraw from the Japanese market every year. While some of these companies withdraw because the market is surfeited and the competition keeps getting stiffer, others pull out as the result of strategic decisions such as Du Pont's decision to sell off its general-use resins joint venture and to move upscale into the fine chemicals field. Looking at the business results for the FACs in Japan, their total sales in fiscal 1983 were ¥13,586.3 billion, giving them 1.5% of the total for all corporations in Japan. While this is overall a rather low percentage, the FACs have about 30% of the petroleum and petroleum products manufacturing industry, about 4% of chemicals, including pharmaceuticals, and 3% of electrical equipment. Still, there are FACs with very strong market shares in such products as foodstuffs, paper products and computers, and it would be a mistake to characterize FACs as underrepresented in the Japanese market. In terms of operating profit ratio, the average for all Japanese companies is only 1.8%, but that for the FACs is nearly double that at 3.5%. In manufacturing the average is 4.3%, which jumps to 6.8% when petroleum is excluded (Fig. 3). In the electrical machinery and precision machinery field, the profit ratio is very high, at 10% or more. There are also a number of FACs that have better profit ratios than their Japanese counterparts.

Recent trends

There has been a strong and steady stream of foreign companies coming into Japan (both foreign companies coming in anew and foreign capital buying into existing companies). As shown by the data on notifications, the largest numbers of companies are in commerce and services, yet the largest investments are in manufacturing, especially in machinery and chemicals. The liberalization of Japanese capital markets has attracted National Westminster Bank and other large European financial institutions and there has been a recent surge in FAC entry into electronics and computer software, telecommunications and information processing, new materials, biotechnology and other areas born of technological innovation.

Yet the trend in recent years is one of scaling down foreign investment in Japan for the following three reasons:

Fig. 2 **The 1985 Fortune 200 in Japan: Industry and Form of Entry**

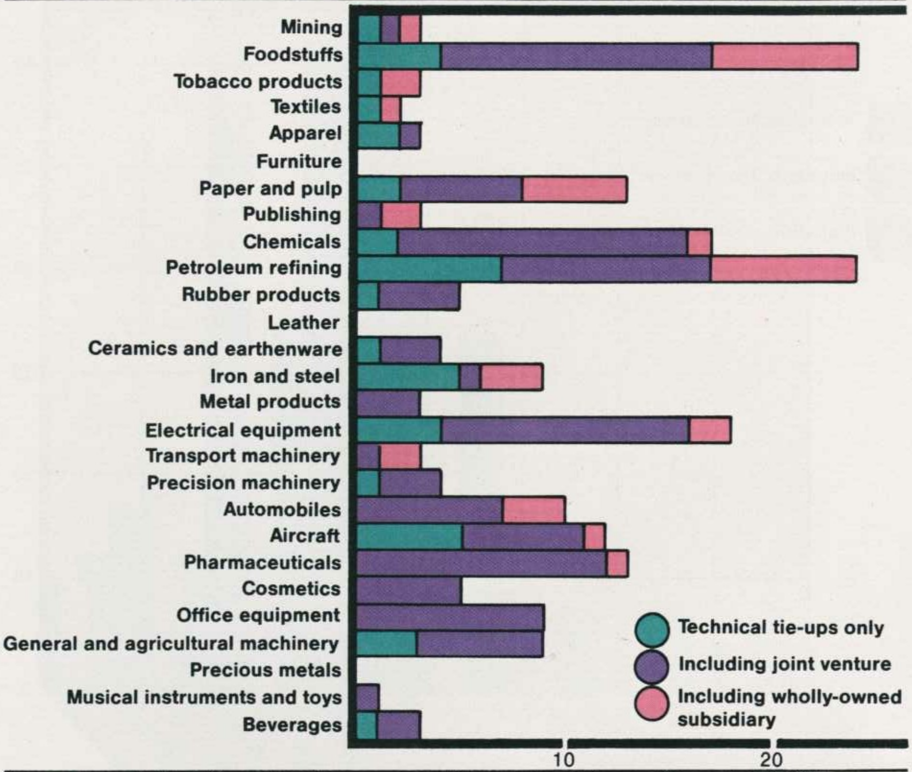


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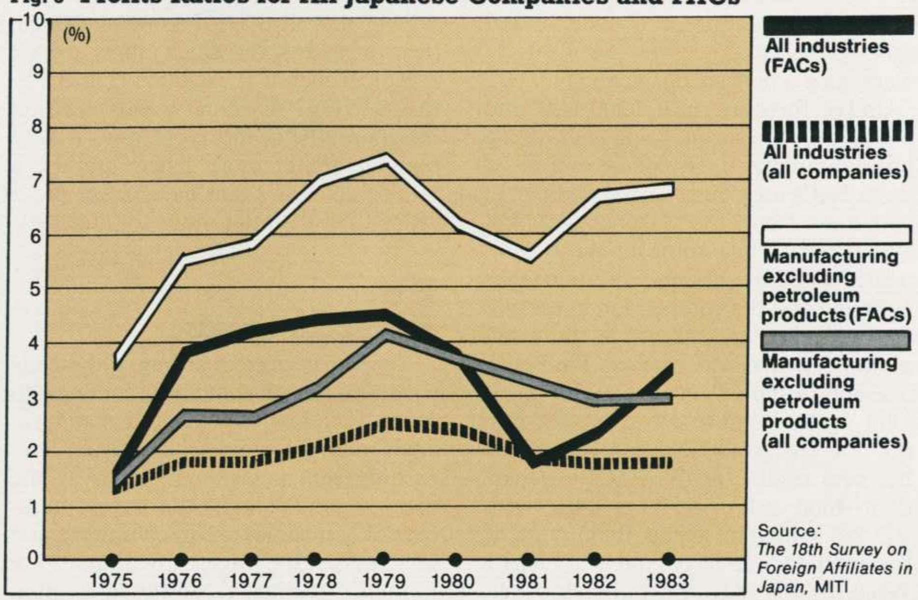
Fig. 3 **Profits Ratios for All Japanese Companies and FACs**



1) As noted above, most of the major U.S. and European companies are already represented in Japan in one form or another, and reinvestment by FACs in Japan is now equivalent to the total new investment from Europe.

2) Much of the investment from the U.S. and Europe has been in the miniaturization fields represented by electronics, where Japanese technology is already world class, and in biotechnology, where the West has a lead.

3) Most of the major U.S. semiconductor manufacturers have already invested in Japan, and they are being followed by smaller peripheral and subcontracting companies with annual sales of only about $50 million.

Along with this downturn in the scale of foreign investment in Japan, there has been a shift in form of investment, including a new emphasis on wholly-owned subsidiaries. There are two main reasons for this. First, the very rapid progress made by Japanese companies and joint ventures building upon technology licensing agreements has enabled these companies to develop into formidable competitors. Especially in the case of joint ventures, it is not uncommon for the Japanese parent to buy out the foreign partner completely, and more and more U.S. companies are opting for 100% ownership from the very beginning to protect against precisely this possibility. Second, related to this tendency to 100% ownership, more and more U.S. and European companies are starting to use Japan as a test market or production center to take advantage of Japanese production and quality control technologies to compete with Japanese companies internationally.

With this desire on the part of the major U.S. and European companies for test marketing in Japan, a number of the major U.S. companies either have or plan to set up research laboratories in Japan, including 3M (1985), IBM (1985), Du Pont (1986) and Kodak (1988). While the tendency in the U.S. and Europe is to do basic research and product development in different places, the tendency in Japan is to do R&D fairly close to the market in anticipation of customer requirements. As a result, Japan has more experience in market-oriented R&D than the U.S. and Europe do. At the same time, the Japanese market is very sensitive to new products or near-products, is quick to respond, yet is also very exacting and demanding. As a result, people have started to feel that a product that does well in Japan will do well anywhere.

There is also considerable progress being made in building production facilities in Japan for electronics products, with a rush of new factories built by U.S. and European companies anxious to take advantage of Japan's quality engineering and skilled labor. There has been especially active plant construction by FACs already in Japan in semiconductor-related fields. Motorola, for example, decided to build its second plant for VLSIs (very large-scale integrated circuits) last

March, Texas Instruments is planning a research laboratory-cum-production facility for ultra-LSIs with megabit DRAM (dynamic random access memory) capacities, and Fairchild is also expanding facilities at its plant for 64 kb SRAM (static RAM) integrated production. Nor are these companies alone.

Like it or not, this trend by the FACs to build production centers in Japan in semiconductors and other high-technology fields will inevitably raise these industries' export ratios. In fact, exports accounted for ¥220 billion or about 30% of IBM's 1984 sales of ¥770 billion, and for about 20% of Texas Instruments' approximately ¥100 billion in semiconductor sales. According to a JETRO study, exports to the United States by American FACs in Japan totaled $2 billion in 1984. However, Japanese industry is very competitive with vast numbers of companies active in everything from parts supply to assembly. Given this, there is also a tendency for foreign companies to try to take advantage of Japan's quality control technology and skilled labor not by setting up their own factories, hiring employees and adopting the technology but rather by the OEM (original equipment manufacturer) route. Yet whether this is direct investment or OEM production, it is clear that Japan ranks high in U.S. and European companies' global strategies as a production center.

According to MITI's *18th Survey on Foreign Affiliates in Japan*, U.S. FACs in electrical machinery manufacturing had exports of ¥200.8 billion and imports of ¥224.9 billion in fiscal 1983, for a net trade deficit of ¥24 billion.

The Japanese market's increasing importance

Generally, foreign companies are not very aware of the situation in Japan, and the same holds true of relations between the parent company and its Japanese subsidiary. This is clearly evident from how few of the top management from subsidiaries in Japan are also on the parent companies' boards of directors. It is a common enough story in locating a new plant in Japan. In the initial stages, there is a great flurry of wanting information and input from Japan, but when it comes time to make a decision, the directors responsible for the project, engineers and other people fly in from the head office, do their siting study and take the matter back for discussion by the board. This is indicative of the low status that Japan has had to date in these multinationals' global strategies.

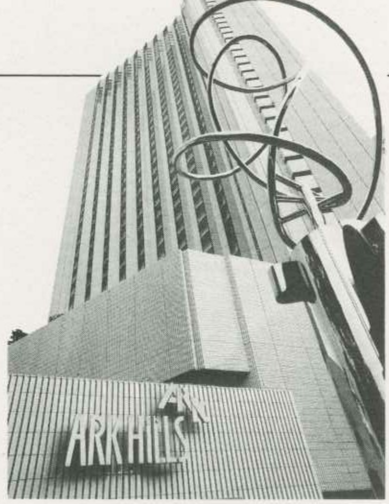
However, the fact that more multinationals are now doing test marketing and production in Japan suggests that Japan is becoming more important in their global strategies. Flustered and anxious in the face of the international threat from Japanese companies, these companies are making a major effort to learn and apply the secrets of Japan's competitive edge. Just as this effort is reflected in moves to introduce quality control and just-in-time production in their home plants, it is also resulting in a greater emphasis on Japan at the head office and the establishment of test marketing, production and even sales centers in Japan. Du Pont, the world's largest chemical company, has embarked upon a very ambitious strategy for a more visible presence in Japan, consolidating its sales and production divisions to form Du Pont Japan in 1983 and moving to give the Du Pont name more prominence by, for example, renaming its joint ventures (e.g., changing from Toyo Products to Du Pont-Toray). Consistent with this policy shift, Du Pont has greatly expanded facilities at its Utsunomiya plant and has started work on a new research facility—slated to be Du Pont's largest outside the United States—in Yokohama.

IBM is the same. Drastically revamping its organization, world-leader Big Blue has given the Asian-Pacific Group (APG) greater autonomy and operational responsibility for the Far East and Australia and has embarked upon market development better suited to this fast-growing market. The APG is headquartered in Japan, and a staff of 200, including one vice president, has been sent to Tokyo to take charge.

Despite this improvement in Japan's standing with foreign companies, it is commonly said that Western companies coming into Japan will have trouble recruiting capable local staff within the Japanese practice of lifetime employment. The reason is that most Japanese are assumed to look down on FACs because of their reputation for being independent profit centers with managers from the head office who, being primarily concerned with how well the company does while they are here, go outside the company for sales and technical experts.

Even if a Japanese is appointed president of an FAC, the company is usually managed consistent with the way things are done at the head office. As a result, because the top executives have considerable say in how the company operates and things are strongly performance oriented, little consideration is given to nurturing people the Japanese way and building an organization that can get the job done as a group. One Japanese who is also the top executive at an FAC says that these foreign companies need to be more international in their outlook. Although it may seem strange to call on these companies with their years of international experience to be more international-minded, the old way of doing things by the American book and trying to manage and sell the Western way just does not work in Japan. Even though the head office may be interested in its Japanese operation, that does not mean it should kibitz, since ill-informed advice is often detrimental to the company's long-term interests.

Even FACs, once their operations in



The number of foreign-affiliated companies in Japan has burgeoned since the early 1970s. Over 50% of the office tenants in the recently completed Ark Hills complex are FACs.

Japan get going, turn away from mid-career recruitment and toward hiring new college graduates to start work in April. Although it is difficult for these FACs to compete head-on with Japanese companies for people since they are not as well known and do not have the record of performance that established Japanese companies do, hiring new graduates every year has the advantages for the FACs of building trust with the universities so that the universities will steer good people their way, and giving them people who are more likely to be loyal to the company. The FACs must play by Japanese rules in full heed of Japanese management practices if they want to overcome the handicap of their foreign ownership and attract outstanding people. Yet even though it is imperative that the company adopt Japanese management practices if it wants to grow, this will only enable it to play on a level field, and does not guarantee its success. If the FAC is to win in Japan, it has to have Japanese management techniques plus something as an FAC.

The effects of yen appreciation

Business Week ran a much-talked-about feature this spring on "The Hollow Corporation" detailing the way U.S. business is becoming a planning and marketing entity rather than a manufacturing power. Part and parcel of this hollowing is the way U.S. companies have moved their production to Japan, the ASEAN countries and the newly industrializing countries (NICs). Thus it was that the currency realignments in the wake of last September's G-5 meeting of central bankers and treasury secretaries from France, Japan, Britain, the United States and West Germany were expected to prove effective in rectifying the problems in the economic relationship between Japan and the United States as epitomized by the trade imbalance.

The yen's rapid appreciation has made Japanese wages among the highest in the world and has meant that Japanese production, and hence export, costs are sharply higher. At the same time, it has also made it more difficult for foreign companies to invest in Japan and easier for Japanese companies to invest in overseas production facilities, since, unlike in the United States, land is already very expensive in Japan. Despite this, FACs continue to be as active as ever in Japan.

The yen's appreciation has by no means altered the conditions that make Japan attractive for FACs as either a test market or production center. Rather, the yen's appreciation has forced U.S. companies to reexamine their global strategies and decide what products they really want to produce in Japan and has promoted greater geographical diversification including the Asian NICs.

For Japanese companies, it has spurred new investment in the United States, both as a response to the cost attractions and as one step toward alleviating trade friction. Yet the bulk of Japanese management opinion seems to be that investing in the United States is very much a political rather than a business decision, and it is still advantageous to produce in Japan despite the currency realignment. Nor is this view restricted to Japanese companies. Especially in high-technology fields, U.S. companies are also concluding that cost alone is not the determining factor and that technology and quality control are at least as and perhaps even more important. These companies are opting to produce in Japan.

At the same time, the yen's appreciation may be expected to make Japan a more important market, as well as production center, for Western companies. Western companies that were until now interested only in their domestic markets, for example, are now finding their products much more price competitive in Japan, and finding the Japanese market impossible to ignore. Kohler, an American manufacturer of luxury bathtubs, has recently supplemented its import agency sales with the establishment of a wholly-owned subsidiary and began a full-scale marketing push in Japan. With the progress being made in industrialization in Korea, Taiwan, Singapore and the other Asian NICs, these countries are enjoying sharply higher per capita GNPs and are expected to become more important markets. With an assist from the yen's appreciation, the Asian NICs are rapidly becoming more competitive and poised for even faster growth. Given the very strong economic ties that Japan has with these countries, more and more Western companies are finding it imperative that they establish Asian headquarters in Japan as a way of positioning themselves in this vast Pacific market.

On the financial side, Japan is now, as a result of its massive trade surpluses and high savings rate, the world's largest exporter of capital, and Tokyo is rapidly becoming one of the three central foci in the 24-hour global money market. As financial deregulation proceeds, the major Western financial institutions have to set up listening posts and gird for market expansion. Thus it is assumed that international financial institutions will become increasingly active in Japan in the years ahead.

Although I have tried to outline the situation facing FACs in Japan, it should be noted that, despite these companies' aggressive stances, foreign investment in Japan still only totals \$6.2 billion—less than one-tenth of what Japanese companies have invested overseas. Which is why the *Outlook for Japan's Industrial Society toward the 21st Century* released by MITI this June stressed the importance of balanced cross-investment. The Japanese government has long provided information and financial support for FACs, and it is hoped that these FACs will become even more numerous and more active in Japan in the years ahead.●