# U.S. Direct Investment In Japan

By Masayuki Hara

Foreign direct investment may be defined as the cross-border transfer of managerial resources. A catchall term for the various resources of a company, managerial resources consist mainly of human resources, real capital and money capital, but are very difficult to quantify in numerical terms. As a result, the scale of foreign direct investment is commonly measured as the amount of capital transferred internationally, and the standard reference for foreign direct investment is the U.S. Commerce Department's *Survey of Current Business.*

As seen in Table 1, there is a steadily increasing cross-flow of direct investment between the United States and Japan. Japanese direct investment in the U.S., for example, has grown dramatically with the yen's appreciation in the latter half of the 1980s and the intensification of trade friction as a result of Japan's massive trade surplus. Going the other way, direct investment from the U.S. in Japan, while increasing steadily in manufacturing, is not growing as fast. As a result, the amount of Japanese direct investment outstanding in the U.S. has recently sharply exceeded the U.S. direct investment outstanding in Japan.

By industry, Japanese direct investment in the United States has been less and less in manufacturing investment and more and more in commerce, real estate and finance. U.S. direct investment in Japan has held steady with about 50% in manufacturing and the rest in commerce, real estate and finance, with the result that nonmanufacturing investment is a much smaller percentage of the total than is the case with Japanese investment in the U.S.

## High returns

Table 2 compares U.S. direct investment in Japan and Japanese direct investment in the U.S. in terms of profitability. The figures show that the profitability of U.S. investment in Japan, both for all industries and for manufacturing industries only, is much higher than the profitability of Japanese investment in the U.S. In fact, U.S. direct investments in Japan are more profitable than U.S. domestic investments. In such an environment, U.S. direct investment in Japan contributes to the optional redistribution of U.S. managerial resources and it seems clear that the U.S. should vigorously expand its direct investments in Japan in order to promote an even more effective use of resources. The profitability of all U.S. direct investment worldwide was 15.2% in 1988.

Table 3 offers a comparison of the trade patterns of American subsidiaries in Japan and Japanese subsidiaries in the U.S. The 1987 figures for American subsidiaries in Japan show that their exports to the U.S. were worth \$9.2 billion and their imports from the U.S. \$4.9 billion. In terms of U.S.-Japan trade, this added \$4.3 billion to Japan's trade surplus or the same amount to the U.S. trade deficit. Trade by American subsidiaries in Japan is clearly only a very small portion of U.S.-Japan trade.

Such is not true for Japanese subsidiaries in the U.S. Also in 1987, Japanese subsidiaries in the U.S. recorded imports of \$71.1 billion and exports of \$20.8 billion, resulting in a \$50.3 billion deficit for the U.S. Clearly the trade by Japanese subsidiaries in the U.S. accounts for most of the massive U.S. trade deficit in its trade with Japan, and the trade generated by Japanese subsidiaries in the U.S. makes up a large percentage of overall U.S.-Japan trade. This is not peculiar to 1987 but shows up in the figures for other years as well.

Looking at trade by American subsidiaries in Japan by industry, close to 80% of their imports to Japan are oil-related, mainly petroleum products from the Middle East, Asia and Latin America.

Table 1 **Total Direct Investment**

($ million)

| | Japanese investment in the U.S. | | | | | | U.S. investment in Japan | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Manu-facturing | Commerce | Finance | Real estate | Others | Total | Manu-facturing | Commerce | Banking | Oil | Others | Total |
| 1980 | 1,033 | 3,255 | 645 | 264 | 270 | 4,723 | 2,971 | 1,115 | n.a. | 1,570 | 186 | 6,243 |
| 1985 | 2,460 | 11,822 | 3,008 | 1,054 | 575 | 19,116 | 4,584 | 1,581 | 178 | 2,184 | 707 | 9,235 |
| 1986 | 3,578 | 13,977 | 4,791 | 2,941 | 1,306 | 26,824 | 5,443 | 2,179 | 192 | 2,612 | 905 | 11,332 |
| 1987 | 5,232 | 14,987 | 6,045 | 4,431 | 2,367 | 33,361 | 7,073 | 2,934 | 343 | 2,561 | 1,359 | 14,270 |
| 1988 | 12,222 | 18,736 | 6,758 | 10,017 | 5,374 | 53,354 | 7,876 | 3,473 | 262 | 3,468 | 1,789 | 16,868 |

Source: *Survey of Current Business*, U.S. Department of Commerce

Exports from Japan, most of them bound for the home market, account for 10% of the total sales of the American subsidiaries in Japan. Thus the typical pattern of trade by American subsidiaries in Japan can be summarized as one of importing oil products from third countries (i.e. not from the U.S.) and exporting their products to the U.S. If these companies were seriously interested in helping to reduce the trade imbalance, one place to start would be to import crude oil from Alaska instead of the Middle East.

**Table 2 Investment Profitability** (%)

| | Japanese direct investment in the U.S. | | U.S. direct investment in Japan | |
|---|---|---|---|---|
| | Manufacturing | Total | Manufacturing | Total |
| 1980 | 2.7 | 14.4 | 13.5 | 13.4 |
| 1985 | –7.6 | 8.9 | 21.4 | 17.5 |
| 1986 | –6.0 | 3.8 | 34.2 | 29.5 |
| 1987 | 3.9 | 3.5 | 27.9 | 25.5 |
| 1988 | –0.5 | 3.3 | 19.9 | 21.0 |

Note: Profitability is defined as net profit for the period divided by average capital during the period.
Source: *Survey of Current Business*, U.S. Department of Commerce

**Table 3 Subsidiaries' Trade Patterns** ($ million)

| | Exports by Japanese subsidiaries in the U.S. | Imports by Japanese subsidiaries in the U.S. | Exports to the U.S. by U.S. subsidiaries in Japan | Imports from the U.S. by U.S. subsidiaries in Japan |
|---|---|---|---|---|
| 1982 | 21,514 | 35,901 | 3,934 | 2,516 |
| 1983 | 22,816 | 36,568 | 3,634 | 2,464 |
| 1984 | 22,655 | 47,275 | 4,212 | 2,912 |
| 1985 | 22,715 | 58,102 | 6,360 | 3,342 |
| 1986 | 22,693 | 63,724 | 7,331 | 3,646 |
| 1987 | 20,838 | 71,092 | 9,209 | 4,897 |

Sources: *Survey of Current Business; Foreign Direct Investment in the United States*

## Curing imbalance

What of trade by Japanese subsidiaries in the U.S.? By industry, 95% of exports by value fall into the wholesale category (defined as manufacturers' sales, purchasing centers and trading companies), with the main products being metals, minerals and agricultural commodities. Wholesale goods also account for more than 90% of imports to the U.S., with most of them being automobiles, automobile parts and other durable goods. The main role of Japanese subsidiaries in the U.S. has been as import and export bases, not as local production operations.

In effect, Japanese subsidiaries function as an important network for promoting exports to the U.S. It should be noted, however, that the recent acceleration of direct investment in the U.S. manufacturing sector represents a concerted effort to switch to local production. By producing import substitutes in the U.S. and increasing local content, this trend has considerable potential for helping to reduce the trade imbalance between the U.S. and Japan.

While much of the Japanese direct investment in the U.S. is in trading and functions to promote exports, U.S. direct investment in Japan in trading is minimal in both relative and absolute terms. The recent explosion in services and information goods, however, has disrupted and discredited the old trade patterns and requires that companies have their own sales and service networks in the local markets. In seeking to promote exports to Japan, it is imperative that U.S. industry increase its direct investment in Japan in the trading sector to provide these sales and service functions.

Viewing Japan-U.S. trade as a single market, it may be said that Japanese subsidiaries in the U.S. have close to monopoly control over this market. It should also be noted that Japanese subsidiaries in the U.S. have a much higher percentage of export and import transactions with a narrowly definable group of companies than other foreign subsidiaries in the U.S. do. This is a pattern that tends to substantiate foreign criticism of the Japanese way of doing business, including its distinctive distribution system, business practices, *keiretsu* transactions and exclusionism.

As the Japanese economy goes more global, it will be increasingly important to harmonize the Japanese economy with the world economy, and this in turn makes it imperative not only that American companies work harder to establish a presence in the Japanese market, but also that the Japanese side make greater efforts to further enhance market access. The policies announced by the Japanese

Table 4 **M&A Involving Japan**

| | 1985 | | 1986 | | 1987 | | 1988 | | 1989 (to June 30) | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Total cases | % | Total cases | % | Total cases | % | Total cases | % | Total cases | % |
| **Japanese company taking over Japanese company** | 163 | 56.4 | 226 | 50.0 | 219 | 46.7 | 223 | 40.2 | 110 | 38.6 |
| **Japanese company taking over foreign company** | 100 (56) | 34.6 | 204 (126) | 45.2 | 228 (120) | 48.6 | 315 (167) | 56.8 | 170 (84) | 59.7 |
| **Foreign company taking over Japanese company** | 26 (21) | 9.0 | 21 (15) | 4.7 | 22 (13) | 4.7 | 17 (11) | 3.1 | 5 (2) | 1.7 |
| **Total** | 289 | 100 | 451 | 100 | 469 | 100 | 555 | 100 | 285 | 100 |

Note: Figures in parentheses are those involving American companies.
Source: Yamaichi Securities Co.

government in its Final Report for the Structural Impediments Initiative (SII) talks are especially significant here.

## Focus on mergers

Recently, foreign M&A (mergers and acquisitions) activity has been a focus of attention in discussions of foreign direct investment. Because they involve absorbing or merging with an existing foreign company, M&A enable companies to enter a foreign market without having to set up a new company. As such, they save time and resources. For example, time is saved in the development of new products or technologies, in the establishment or strengthening of sales networks and material procurement networks, and in the construction of production facilities.

Japanese M&A figures are shown in Table 4. As seen, Japanese M&A overseas have increased rapidly since 1985, with more than half of this activity aimed at the U.S. There has been very little foreign M&A activity in Japan, although almost all of what there is involves American firms. The usual reasons cited for this phenomenon are the strong yen, high stock prices and Japan's extraordinarily high land prices. Other causes are most likely the shortage of information concerning the Japanese market and the opacity of Japanese business practices.


An Indiana-based fast food chain opens its first outlet in Tokyo in a ceremony attended by the vice governor of Indiana State, Frank L. O'Bannon (3rd from left), and his Tokyo Metropolitan Government counterpart Tsutomu Manita (2nd from left).

In its Final Report for the SII talks, the Japanese government referred to direct investment by first describing the beneficial role that direct investment in Japan has for advancing the Japanese economy's internationalization and spurring further growth. It then said it intends to promote foreign direct investment in Japan by expediting the investment process, facilitating the provision of information on the Japanese market, providing financial assistance to encourage more foreign investment, and ensuring the transparency of business practices.

The same report also proposed policies for eliminating exclusionary business practices and *keiretsu* transactions. If these policies can be implemented to improve the investment environment for foreign direct investment in Japan, and if this can be combined with a more vigorous approach to the Japanese market by American companies, there will be a considerable increase in U.S. direct investment in Japan and this will, in turn, alleviate some of the friction between Japan and the United States.

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