AN ANALYSIS OF JAPANESE DIRECT INVESTMENT OVERSEAS IN POSTWAR YEARS

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JAPAN'S DIRECT INVESTMENT overseas presents a number of unique features. Unlike most direct investment from advanced countries, Japan's investment has been motivated largely by hoped-for trade gains. This in turn may have affected the growth and profitability, and many other aspects of its postwar direct investment.

Estimates of the growth of Japanese direct investment depend on the source of the statistics used. According to the Bank of Japan's statistics, the net annual outflow of direct investment from Japan has grown at a surprisingly slow rate—not much faster than Japan's gross national product. In 1961 outflow was $94 million. By 1968 it had reached $220 million only to fall to $206 million in the following year. It recovered to $350 million in 1970 ($391 million in fiscal 1970), but even at this level the rate of growth seems well below that which many have assumed Japan to have enjoyed.

MITI (Ministry of International Trade and Industry) statistics show a much greater investment outflow. In its annual report on "The State and Problems of Economics Aid," and in the statistics it supplies the OECD, MITI lists what it describes as "approved overseas investment." There is a gap between what is approved and what actually leaves Japan for investment overseas. More importantly, there is a wide gap between the definitions of "overseas investment" and "direct investment."

MITI statistics show "overseas investment" to the end of fiscal 1969 (March 31, 1970) as totalling $2,600 million, with $648 million approved in the last year. On my own calculations, postwar direct investment as shown in the Bank of Japan and earlier statistics totalled $1,374 million at the same date.

The MITI figure includes large amounts of credits which could not be included in any strict definition of direct investment. Some of these credits—approximately $100 million—were for production sharing ventures in Indonesia before 1965. They involved no Japanese equity, though they bore characteristics of equity investment enterprises. Some credits were for the financing of extractive enterprises which had guaranteed to sell their output to Japan. And some were simply commercial credits.

A further point is that approved "overseas investment" takes no account of capital either repatriated from or reinvested by Japanese overseas affiliates.

The Bank of Japan's balance of payments statistics are a more accurate guide to direct investment outflow. These show the actual outflow of investment capital

to overseas enterprises in which the Japanese equity is 25 per cent or greater. But while net of repatriations, they do not include reinvestment.

A feature of Japanese direct investment is the apparently low rate of repatriated income from overseas subsidiaries. Direct investment income (interest, dividends, and branch profits) credited to Japan's balance of payments in fiscal 1969 was no more than $46 million (in fiscal 1970, however, it jumped to $84 million). This represents only 3.3 per cent of my estimate of direct investment outflow to 1969, and the rate of return would be even less if reinvestments were included in investment total. It compares with the 9.8 per cent return, royalties included, from U.S. direct investments in 1968.

Several explanations for this low rate of income return are possible. In the first place, Japanese investment is relatively new and a gestation period of several years could be expected before dividends are issued. Even so, the rate of return when direct investment income in 1969 is compared with the investment outflow to the end of 1966 ($755 million) is still low.

It may also be that Japanese entrepreneurs invest overseas less prudently than other investors. The results of an Export-Import Bank questionnaire survey conducted in 1964 [2] suggested that some investors had been overoptimistic in planning investments. The Bank's 1968 survey [1] showed a high proportion of projects were operating unprofitably, and the preliminary results of its 1970 survey show that 34 per cent of all projects still had operating losses. Only 32 per cent were paying dividends.

But the major reason for low income return is probably the fact that many direct investors see the return from their investments in the form of securing exports of manufactured goods from Japan or imports of raw materials and processed goods to Japan. In the Export-Import Bank survey of 1968, only 4 per cent of "productive" investors (i.e., excluding commercial and financial investors) gave dividends as the primary aim of their investment. The main aims stated by manufacturing investors were, in order of frequency, the development of markets, the protection of markets, export of components and materials, exports to third countries, and export of machinery. The Bank's 1970 survey showed 71 per cent of investors imported most of their main materials from Japan. Of extractive investors (agriculture, fisheries, and mining) 71 per cent gave import to Japan as their main aim in 1968, and this had risen to 78 per cent in 1970.

My own survey based on information supplied for 560, or 96 per cent, of productive investment projects with Japanese equity participation approved by the MITI to the end of fiscal 1967 shows that in 67 per cent of all projects the export of components and materials or the import of foodstuffs and raw materials was given as one of the "merits" of the investment. A number of manufacturing investors also mentioned the export of machinery as an investment aim.

Other available data confirm this "trade orientation" of most Japanese and extractive investments overseas. In Table I, even allowing for the fact that the data for Japanese manufacturing projects surveyed is three years after establishment when imports from the parent company would be at a peak, the comparison

TABLE I
PARENT COUNTRY EXPORTS OF CAPITAL GOODS AND CURRENT INPUTS TO MANUFACTURING AFFILIATES OVERSEAS RELATIVE TO PARENT COUNTRY INVESTMENT

	Japan	U.S.	U.K.
Parent country investment	100	100	100
Net operating assets	n.a.	131	136
Annual value of capital goods exports	9	1	1
Annual expenditure on fixed assets	n.a.	14	13
Annual value of current inputs exported	142	9	6
Annual sales	n.a.	210	201

Sources: Japan: Ryōichi Takagi, *Nippon kigyō no kaigai shinshutsu* [Overseas investment of Japanese enterprises], Nihon kokusai mondai kenkyū-sho, 1967, p. 86.
U.S.: S. Pizer, and F. Cutler, "Foreign Investment—Summary and Analysis of Recent Census: Current Trends and Economic Effects," *Survey of Current Business*, Vol. 40, No. 9 (September 1960).
U.K.: W.B. Reddaway, *Effects of U.K. Direct Investment Overseas*, London, Cambridge University Press, 1967.

with U.S. and U.K. manufacturing investments projects overseas is striking.

A similar situation could be presumed with extractive investments. Comparative statistical data are not available, but both Reddaway's and U.S. Survey of Current Business statistics suggest that only a small proportion (considerably less than 50 per cent) of the output of U.K. and U.S. investments is imported by parent companies. In the case of Japan, this proportion would rise to 80–90 per cent.

It can be concluded, therefore, that profits from overseas investments are realized indirectly by the investor, in the form of greater security and/or price differences in the exports or imports secured. A large proportion of extractive investors surveyed by the Export-Import Bank in 1968 mentioned both price and security gains through investments. However, the high proportion of joint ventures (as shown later) among Japanese direct investment projects overseas sets a limit on the extent to which price gains can be realized—unless the partner in the venture can be compensated by some form of return other than what he would normally expect to receive from the profits and dividends of the project.

The trade orientation of Japanese direct investments overseas has an important consequence. U.S., and to some extent U.K., direct investors overseas could be described as seeking a financial (dividend) return from the capital and/or skills they provide. They are, understandably, reluctant to share this return with others, which helps to explain the high proportion of equity they hold in their overseas investment projects. (See Table II.)

The Japanese share in the equity of their investment projects tends to be comparatively low. Part, but not all, of the reason in the fact that much Japanese investment is located in underdeveloped countries which restrict foreign ownership. Table III reflects this, but at the same time indicates clearly the Japanese preference for joint ventures even in countries where equity ownership

TABLE II

COMPARISON OF U.S. AND JAPANESE EQUITY OWNERSHIP OF DIFECT INVESTMENT PRODUCTIVE ENTERPRISES OVERSEAS

United States			Japan		
Equity Ownership	Number of Enterprises(%)	Value $mil.(%)	Equity Ownership	Number of Enterprises(%)	Value $mil.(%)
95% and over	937 (62)	1,081 (69)	75% and over	146 (29)	257 (58)
50%-95%	381 (25)	346 (21)	50%-75%	170 (34)	103 (23)
less than 50%	192 (13)	156 (10)	less than 50%	186 (37)	86 (19)
Total	1,510(100)	1,575(100)		502(100)	446(100)

Source: U.S.: W.G. Friedmann, and G. Kalmanoff ed., *Joint International Business Ventures*, New York, Columbia University Press, 1961.

TABLE III

AREA VARIATIONS IN JAPANESE OWNERSHIP OF DIRECT-INVESTMENT MANUFACTURING PROJECTS

	Direct-Investment Projects No.	Japanese Interest over 50%		100% Japanese Owned	
		No.	%	No.	%
Asia	278	125	45	34	12
Thailand	52	36	69	10	19
Hong Kong	40	26	65	11	27
Taiwan	64	40	63	11	17
Ryukyus	40	6	15	—	—
South Asia	29	1	3	—	—
Latin America	80	52	65	23	29
Brazil	39	32	82	14	36
Advanced countries	36	20	56	13	36
All areas	415	206	50	71	17

Source: Data from my own survey.

is not restricted.

Export-Import Bank data, while less complete, confirm the Japanese preference for joint ventures. The Bank's 1970 survey showed only 18 per cent of projects were fully Japanese owned. In 41 per cent of cases the Japanese share of equity was less than 50 per cent.

The fact that Japanese investors seek much of the return from their investment through exports or imports helps to explain the preference for joint ventures shown in Tables II and III. Provided the share of the Japanese investor in the project is sufficient to give him control over the project's purchasing and/or sales policies, he hopes through trade gains to draw a return for his contribution to the venture. And it is in the nature of this contribution that the essential difference between Japanese and the more traditional forms of direct investment can be found.

One approach to the analysis of direct investment overseas is to regard investment as the result of the investor enjoying a degree of command (or monopoly)

over one or other of the factors required in a particular production process.

The assumption of command over the factor is important since otherwise local capitalists would be expected to utilize the same factor to gain the same profit. Indeed, not having the additional risk and expense involved in investing overseas, the local capitalist should be able to operate more profitably than the foreign investor.

It was suggested earlier that command over capital and/or skills was usually the contribution of U.K. and U.S. investor. The advantage of command over the other main factors—land and labour—usually, though not always, lies with the local capitalist.

Where the values of both contributions are comparable, a joint venture enterprise is suggested. Where, as is often the case, the foreign investor insists on complete ownership, it can be assumed that he values his command over capital and skill well above any disadvantage in obtaining other factors.

The generally small scale of Japanese investment projects suggests that command over capital is not an important factor with most Japanese investors. Of the 560 productive investment projects surveyed (see above) the average Japanese equity investment approved was $620,000. The Bank of Japan's 1970 survey showed the average investment in manufacturing projects was $800,000. In extractive projects it was $4 million.

Command over skill would be more important, at least for manufacturing investments in the underdeveloped countries. Here, presumably, the return is received less in the form of royalties or profits, and more in whatever markup is available for the export of parts and materials to the overseas enterprise. With extractive investments, however, few Japanese firms are in a position to contribute skill since in many cases the scale or type of the overseas operation is unknown in Japan. A frequent pattern, particularly in Australia and Canada, is for Japanese investors to join with another foreign or local investor who handles management of the project, while the Japanese partner guarantees sales outlets in Japan.

If the definition of skill could be expanded to include skill in the sale of the product of the investment, then an important Japanese contribution to investment projects emerges. Among extractive and processing investments, the Japanese contribution lies in the ability to find and guarantee sales outlets in the difficult Japanese domestic markets. Few overseas entrepreneurs have such skill.

A similar situation could be suggested for the rising proportion of manufacturing investments undertaken to take advantage of low labour costs (34 per cent of projects in 1970 according to the Export-Import Bank), or low materials costs overseas. Here the output is usually sold in Japan or third countries where the Japanese investor has already established sales outlets—outlets which would possibly be lost without cost-reducing overseas production.

Where the output is sold locally, then the sales skill is more likely to be found with local entrepreneurs—a frequently stated reason for their inclusion in joint ventures. Here the Japanese sales contribution usually lies in providing a known brandname.

However, establishing the nature of the Japanese contribution still does not explain why the investment has come about. In theory, the investor should see a higher return in the overseas deployment of whatever capital and skills are required that is available domestically. This is an important assumption in the case of Japan, since the domestic return on capital has been high during the postwar years. To this return should be added a margin as compensation for the risk and expense of deploying resources overseas rather than in Japan. In any rational calculation of risk, this margin should be set at a high level for Japanese investors lacking experience of overseas conditions and whose resources cannot easily be transferred from domestic to overseas use.

Japan provides few examples of the so-called global enterprise—firms which actively seek to employ their resources in foreign countries. This fact was well shown by the comparison of the overseas activities of large U.S. and Japanese firms given in the MITI 1970 Trade White Paper (*Sōron* p. 256).

(One of the few examples of a globally minded Japanese enterprise is the small fishing-net making company of Momoi Seimō which has grown almost exclusively through both production and sale of nets overseas, outside the already adequately supplied Japanese market. Its personnel have been largely trained overseas and are well adapted to overseas employment. Another example is the zipper maker, Yoshida Kōgyō, with factories in twenty-one countries.)

Some industries have, however, passed through periods of domestic over-production, where outlets for surplus machinery and personnel could only be found overseas. Textiles, fishing, and sugar refining are examples.

But in most cases the expansion overseas appears to require the deployment of resources which could be equally well, if not better, used domestically. And as suggested earlier, the monetary return from these resources, regardless of what form it has taken, has been surprisingly small—well below the equivalent return on domestic use of the same resources. This suggests that much of the underlying motivation for the direct investment so far undertaken overseas has been for reasons other than the expectation of a monetary return.

Among most extractive and processing investments, it is not difficult to deduce this motivation. Most Japanese firms importing raw and processed materials feel the need to secure the overseas sources of these materials. In some cases they believe this can only be done through direct investment in overseas production, and the deployment of resources overseas is seen as the price to be paid for the security needed.

Manufacturing investment presents a different picture. Exports are often marginal to a firm's activities and even where they account for more than 20–25 per cent of domestic production, the firm is not always obliged to invest directly to secure these exports. They can also be secured or expanded simply by allocating resources to increased sales promotion. One of Japan's most successful exporters of electrical goods—Sony—has undertaken only one direct investment in overseas production (Ireland), and that has since been closed down. This suggests that deeper analysis is needed to establish the underlying motivation for manufacturing investments.

Japanese surveys of investment often make a distinction between aim (*mokuteki*) and motive (*dōki*). Thus the aim for many manufacturing investors is said to be the securing of export markets. The motives, in order of frequency as they appear in recent surveys (the 1968 Export-Import Bank survey in particular) are (i) tariff barriers, (ii) the need to stay close to export markets, and (iii) low wages or materials costs overseas.

In the case of (i) and (ii), and to some extent (iii), the Japanese investor has undertaken his investment in order to gain or maintain a foothold which he felt was threatened in the overseas market. I would suggest that in many cases, estimation of the worth of such footholds is highly subjective. It may have been influenced unduly by the highly-developed "export consciousness" of Japanese manufacturers in the past, a consciousness developed as a result of past official backing and urging for individual firms to expand exports. To this should be added the competition between Japanese firms within an industry for the prestige and other benefits of expanding market shares and which has spilled over to competition for export markets.

My conclusion, therefore, is that Japanese direct investment overseas has been largely trade oriented, and is the result mainly of the desire of Japanese firms to secure sources of import goods and outlets for export goods. Japan may be unique in this motivation for investment; traditionally, direct investment overseas has been undertaken by investors able to take advantage of their command (monopoly or semi-monopoly) over capital resources or technological skills in the overseas country.

It is doubtful, however, whether this unique situation can continue indefinitely. In the case of extractive and processing investments, Japan faces a different supply position from that a decade ago. Then, few overseas producers were prepared consciously to expand production to take account of an expanding Japanese market. Few Japanese even were convinced the market would expand as rapidly as it has.

Today, many countries and overseas producers are competing to expand production to meet Japan's future estimated demand for materials. The need, therefore, for Japanese firms to invest to expand this production is less than before.

Similarly with manufacturing investments. Official pressure on firms to expand export markets at all costs is now less than before, when Japan feared chronic deficits in her balance of payments.

In other words, if future direct investment overseas is continued to expand, it will require different motivations from the past. The ability of the Japanese investor to exploit and export financial and technological superiority, rather than marketing skill, will become more important.

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