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Inbound foreign direct investment in Japan: A typology

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ABSTRACT

While Japan has been attracting far less foreign investment than other mature economies, it could offer insights into FDI decision-making for international firms entering countries with a shrinking domestic market and increased international competition. Using a Delphi methodology with contributions from foreign direct investors and experts, we propose a model of inbound FDI in Japan and identify four types of investors based on the nature of investments and market maturity, namely empire builders, rescuers, niche players, and cherry-pickers. This framework, offering both descriptive and prescriptive components, highlights the importance of the predisposition and motives of local takeover targets and business partners in foreign market entry decisions. This model can help foreign firms take advantage of investment opportunities in Japan, and provide lessons for market entry in other mature economies facing similar conditions.

1. Introduction

The Tohoku crisis, destroying large areas and damaging billions of dollars in infrastructure in Northeast Japan, has disrupted and cast doubts on the country's energy policy and its reliance, albeit very limited, on nuclear power. It has led foreign investors to further question the country's attractiveness after a long period of economic slowdown resulting from the bursting of the speculative bubble in the early 1990s and the global recession triggered by the Lehman shock (Siddiqui, 2009). This succession of crises also affects the economic and social environment confronted to a series of challenges including the largest public debt as a ratio of Gross Domestic Product (GDP) and a demographic problem (Meyer, 2011). Furthermore, Japan must cope with the increasing competition of fast growing economies, especially China, whose GDP growth makes it the de facto regional leader.

While Japan has long been an investment powerhouse abroad, there has been a recent resurgence of inward foreign direct investment. In 2015 alone, there were 162 inbound Japanese deals worth USD 25.4 billion, which is the highest amount in a decade and represents more than 20% of all inbound deals over the same period (JETRO, 2016). Inward foreign investment has been fueled in part by large and high-profile foreign takeovers such as that of electronics group Sharp by Taiwanese technology conglomerate Hong Hai (better known as Foxconn) for USD 3.5 billion in 2015, Toshiba's white goods unit to China's Midea for USD 500 million in 2016, and Hitachi's power tools unit Hitachi Koki to US private equity firm KKR for USD 1.3 billion in 2017. However, when looking at recent cases of inbound M & A, many seem to

be driven by financial buyers or by Japanese subsidiaries of multinational companies, with targeted companies often in financial trouble or hit by corporate governance scandals (Bebenroth, 2015).

At the same time, the Japanese government has been trying to make Japanese companies more attractive to foreign investors. A new corporate governance code championed by Prime Minister Shinzo Abe – aiming to address issues related to low profitability and sometimes questionable management decisions with negative effects on financial performance, thus discouraging foreign investors – will now require companies with no outside directors to explain why to shareholders (Bloomberg, 2014; The Economist, 2014; Wall Street Journal, 2014). Japan still remains the third most important world economy and continues to be a reference for innovation – in products and above all, in process – and for quality.

Although historically, developed countries have been both the source and the host of most foreign direct investment (FDI) (Glass, 2008), their share is on the decline. Developed nations attracted 55% of global FDI inflows in 2015 (USD 962 billion) versus 41% in 2014, 60% in 2008 and 87% in 2000 (OECD, 2011, 2013; UNCTAD, 2016). Among countries from the Organization for Economic Co-operation and Development (OECD), most inflows of FDI are horizontal and located in America and in Europe, suggesting that the motive for FDI is more about market access rather than reducing production costs (Glass, 2008). Inflows to developing and transition economies represent a high of USD 800 billion or 45% of the total (UNCTAD, 2016). Per UNCTAD's latest report (2016), the increase in FDI flows to developed economies was driven by a surge in cross-border M & As during the year, with the

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value of deals rising by 109% to USD 631 billion. In 2015, the value of cross-border M & As (USD 721 billion) is roughly equivalent to the one of announced greenfield investments (USD 766 billion), which historically have always been higher (UNCTAD, 2016).

While Japan ranks second of the top 20 home economies for FDI outflows in 2014 and 2015 with USD 114 billion and USD 129 billion, it does not even make the top 20 host economies for FDI inflows (UNCTAD, 2016). Compared to other advanced nations and China, foreign investment flows and positions in Japan remain relatively small (World Bank, 2017). Over the period 1990–2015, FDI inflows as a percentage of GDP stood at 0.14% for Japan, compared to 2.13% for OECD countries, 3.46% for the European Union, 1.47% for the United States, and 3.65% for China (World Bank, 2017). As for FDI stocks over the period 2009–2013, they accounted for 3.7% of GDP in Japan, compared to 30.5% in OECD countries, 40.8% in the European Union, 23.7% in G20 countries, 18.1% in the United States, and 26.3% in China (OECD, 2014).

Successful inbound investment into Japan by way of acquisitions has been found to hinge on a few key principles including selecting acquisition targets that will not elicit resistance, show sensitivity to the local culture (avoiding confrontations), negotiating as equals, avoiding headcount reductions as much as possible, keeping out of the public eye, and making a commitment to this specific geography (Hibbard, Shultz, Wouters, & Zelezny, 2009). Furthermore, the simultaneous expansion of fast growing economies in Asia has redirected FDI away from Tokyo towards other destinations (Fig. 1).

In such context, the idiosyncrasies of this original nation must not only be considered in analyzing FDI, but could also foretell the future of other mature economies. The case of Japan is rather significant, since the country has been attracting far less foreign investment than other mature economies, as reflected by dismal inbound FDI stock and flows respectively. The analysis of its particular domestic business context can offer insights into FDI decision-making in mature economies. Inbound FDI could still offer higher returns in Japan, provided that investors can rely on a robust rationale to identify latent FDI opportunities. This study fits with Hennart and Slangen (2015) recommendation of further research into entry decision processes, and with Peng (2004) argument that the determination of international success and failure of firms is a fundamental research question for international business (IB). It helps clarify incentives and deterrents for inbound FDI in Japan, map out investment options based on entry strategies and market maturity.

2. Literature review

2.1. Foreign direct investment

The OECD defines FDI as a “category of investment that reflects the objective of establishing a lasting interest by a resident enterprise in one economy (direct investor) in an enterprise (direct investment enterprise) that is resident in an economy other than that of the direct investor” (OECD, 2008: 234). Unlike portfolio investment, FDI implies the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence – although not necessarily control – on the management of the enterprise. The OECD sets the ownership threshold of direct or indirect ownership at 10% or more of the voting power of an enterprise resident in one economy by an investor resident in another economy as evidence of FDI (OECD, 2008). This paper focuses on inbound FDI flows – investments by non-resident investors in the reporting country – and on FDI positions (stocks) in Japan. According to the OECD (2008, p. 234), “FDI flows and positions include equity (10% or more voting shares), reinvestment of earnings and inter-company debt”. FDI is generally expressed as a share of GDP to make comparisons among countries meaningful.

FDI can be broadly segmented into vertical (Helpman, 1984) and horizontal (Markusen, 1984) investments. The former are investments where “firms locate different stages of production in different countries”, and the latter where “multi-plant firms duplicate roughly the same activities in multiple countries” (Glass, 2008: 1163). There are fundamentally three arguments whereby FDI is considered to be a source of great benefits to those countries that can attract it. First, unlike international portfolio investment, FDI can bring in much needed resources and methods in the form of know-how, technology, and products, into the recipient country, and these investments are committed for the long term (Fukao & Amano, 2003). Second, inbound FDI has been found to increase employment, output and productivity (Kimino, Saal, & Driffield, 2007). And third, inbound investment provides a measure of openness which itself is an engine for growth (Bailey, 2003; Kimino et al., 2007). In addition, because inbound FDI means production at home, it can decrease imports, boost exports, and eventually shape up the recipient country’s balance of payments.

Dunning (1993) has put forth four types of FDI, natural resource seeking, market seeking, efficiency seeking, and strategic asset or capability seeking (Dunning & Lundan, 2008). These types of FDI are determined by the host country’s factors that drive FDI inflows. Resource seeking FDI is motivated by available abundant natural resources, market seeking FDI by host country market size, efficiency seeking FDI

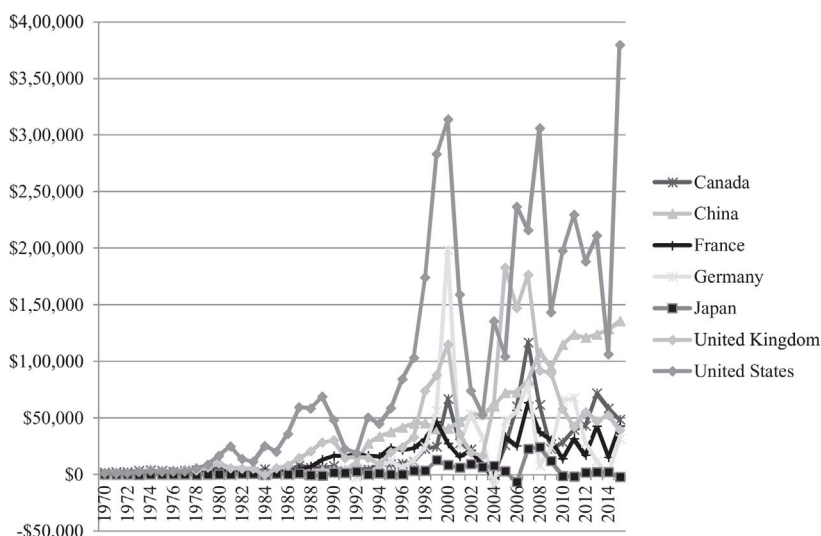


Fig. 1. Direct investment in reporting economy (Inbound FDI flows) (US Dollars at current prices and current exchange rates in millions). Source: UNCTAD (2017).

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