

**Locational Determinants of
Japanese Foreign Direct Investment in China**

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Executive Summary

The purpose of this report is to identify the locational determinants of Japanese foreign direct investment (JFDI) within the Chinese specific region. Understanding these determinants can not only enrich the previous studies on the distributions of JFDI in China, but also provide economic rationales for public policies that intend to influence the locational choices of foreign investors in general and Japanese investors in particular.

In this report, it reviews the whole trends and characters of JFDI in China from 1980 to 2010 based on the historic data and a literature review. It is found that most of JFDI flowed into China's eastern coastal regions and specific provinces. In order to explore the reasons in detail, the research collected firm-level data to analyze locational determinants of JFDI in China by main two approaches: First, using the Chinese statistical yearbook and the data from municipal bureaus of commerce in provincial capital cities which have first-hand statistic data on JFDI within its regions. Second, collecting data coming from the surveys conducted by Japanese Bank of International Cooperation (JBIC).

The results of data analysis shows that the location choice of JFDI was mainly attributed to economic factor such as market size, market potential, GDP per capita, and not policy preference or traditional locational indicators as previously assumed. Based on these findings, this paper proposes policy implications for the Chinese government and the recommendation on how to improve the investment environment.

Key Words: JFDI, locational determinant, policy, China, Japan.

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1. Introduction

“Foreign direct investment (FDI) is conventionally defined as a form of international inter-firm cooperation that involves a significant equity stake in or effective management control of host country enterprises. However, in China, FDI is considered to encompass also other, non-equity co-operations such as contractual joint ventures, compensation trade, and joint exploration (Qian, Wilson, & Qiao, 2002). After 30 years since China began to implement its economic reform and “Opening Up” policy in 1978, China has attracted foreign direct investment (FDI) of \$871.3 billion in total (China's Ministry of Commerce, 2008), which maintained the sustained growth trend. It has become the largest FDI recipient developing country in the world.

Foreign investment has become an important motivation of China's economy. FDI inflows have brought capital, management skills, and advanced technologies to China, and, to a large extent, have contributed to its rapid economic growth. For instance, the import and export of foreign-invested enterprises (FIE) in 2011 achieved to \$1860.2 billion with growth rate of 16.2%, accounting for 51.1% of China's total imports and exports for the same period (China's Ministry of Commerce, 2011). The foreign-invested enterprises played an important role in the rapid growth of China's import and export.

As we all known, Japan is a major capital exporter of the world and the

major investment and trade partner for China. Based on the foreign direct investment statistics data released by the United Nations Conference on Trade and Development (UNCTAD), it showed that Japan's foreign direct investment amounted to about \$ 115.6 billion, an increase of 105.5%, jumping to second place in the world in 2011(UNCTAD, 2011), As the first country to invest in China, according to the data of Ministry of Commerce in 2011, Japan's total foreign direct investment in China was 6.3 billion dollars accounting for a large proportion of 5.5% (China's Ministry of Commerce, 2011), which is the China's first largest country of origin. However, there was a significant issue that the large share of Japanese foreign direct investment (JFDI) flowed into China's eastern coastal region with accounting for 90% of the total amount, while not more than 10% of JFDI flowed into the central and western region, mainly in Sichuan, Shaanxi Province. In order to speed up the regional economic development, Chinese central and local government intend to encourage more FDI toward the central and western region. So, Japan is inevitably the main target country for these areas to attract foreign direct investment.

Although the inflow of FDI increased steadily in recent years, China is still faced with some challenges in attracting FDI. Currently, more and more developing countries have realized the function of FDI in promoting the local economic development and launched many kinds of preferential policies in order

to attract FDI. The competition between China and other developing countries became more intense than before. With Chinese economic development, the labour cost is growing and exceeded the neighbour countries such as India, Indonesia, and Thailand. The China's low cost advantage in attracting FDI is gradually lost. Therefore, it is difficult to attract Japan's investment into China than before under the current policy on investment promotion. How to make out more perfect policies or provide superior investment environment for Japanese investors is the issue that we need to solve urgently.

The previous research on Japanese FDI mainly focused on the volume and sector structure (Lee & Cheong, 1999; OECD, 2002; Zhang, 1994), while the research on the location choices of Japanese FDI within China is scarce. Currently, issues related to the location choice of FDI in China have drawn increasing interest from both academics and industry analysts. Recent studies showed that the size of the market and consumption potential had attracted foreign investors (Beamish, & Wang, 1989; Luo, & Connor, 1998; Henley, Kirkpatrick, & Wilde, 1999). The purpose of this study is to examine the following hypothesis: ①How China's initial government-sponsored preferential policy has influenced the location choice of Japanese firms? ②If Japanese investors responded to policy incentives in the specific economic zones, or if other factors drove the location decision? ③We also infer if the economic rapid growth contributed to the

locational preference of Japanese foreign direct investment in Chinese specific region? Understanding these determinants can not only enrich the previous studies on the distributions of FDI in China, but also provide economic rationales for public policies that intend to influence the locational choices of foreign investors in general and Japanese investors in particular.

2. Background of JFDI in China

2.1 Historical Overview

Table 2.1 and Figure 2.1 have showed the historical development of Japanese foreign direct investment in China and will be referred to the following explanation.

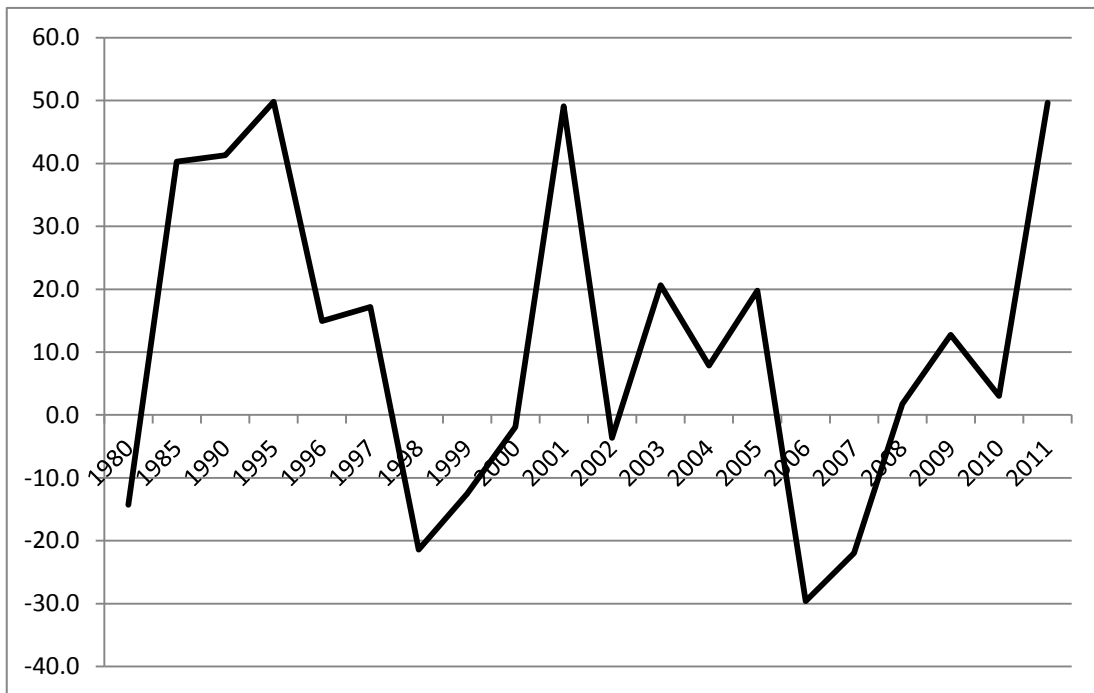
Table 2.1: Japanese Direct Investment in China (1979-2011) Unit: \$ million, %

Year	Total Foreign Direct Investment		Japanese Direct Investment		
	Amount	Growth Rate	Amount	Growth Rate	Ratio
1979			14		
1980			12	-14.3	
1985	1956	37.8	315	40.3	16.1
1990	3487	2.8	503	41.3	14.4
1995	37806	11.1	3212	49.8	8.5
1996	42135	11.5	3692	14.9	8.8
1997	45257	7.4	4326	17.2	9.6
1998	45463	0.5	3400	-21.4	7.5
1999	40319	-11.3	2973	-12.6	7.4
2000	40715	1.0	2916	-1.9	7.2
2001	46878	15.1	4348	49.1	9.3
2002	52743	12.5	4190	-3.6	7.9
2003	53505	1.4	5054	20.6	9.4
2004	60630	13.3	5452	7.9	9.0
2005	60325	-0.5	6530	19.8	10.8
2006	63021	4.5	4598	-29.6	7.3
2007	74768	18.6	3589	-21.9	4.8
2008	92395	23.6	3652	1.8	4.0
2009	90033	-2.6	4117	12.7	4.6
2010	105736	17.4	4242	3.0	4.0
2011	116011	9.7	6348	49.6	5.5
Total	1073183		73457		

Source: ①China Statistical Yearbook(1980-2009), China National Bureau of Statistics; ② Foreign Investment Statistics(2010,2011), China Ministry of Commerce; ③ International Balance of Payments Statistics(1979), Japanese Ministry of Finance.

Figure 2.1 Growth Rate of Japanese Direct Investment in China (1979-2011)

Unit: %



Source: ①China Statistical Yearbook(1980-2009), China National Bureau of statistics; ② Foreign Investment Statistics(2010,2011), China Ministry of Commerce; ③ International Balance of Payments Statistics(1979), Japanese Ministry of Finance.

Japanese direct investment in China began in 1979, when there was only one investment project, with the amount of funds \$14 million. Table 2.1 shows the whole history of Japanese foreign direct investment in China. It can be divided into four major development stages according to the significant Chinese economic

policy shifts (Liu, 2011).

2.1.1 Start-up stage (from 1979 to 1990)

On July 1, 1979, the law of “Foreign Joint Ventures in People's Republic of China” was passed at the second meeting of the Fifth National People's Congress. It marked that China's economic reform and “opening up” policy had just started. The Chinese government established some special economic development zones in the eastern costal region. During this period, due to the Chinese legislation on the utilization of foreign capital was not perfect, the Japanese direct investment in mainland China was in the stage of small-scale exploratory investment. As Table 2.1 shown, in the late 1980s, Japan's direct investment in China made a rapid increase with the average growth rate of 15% per year from 1986 to 1990. However, the total size of investment remained small, amounting to only \$ 503 million in 1990.

2.1.2 First investment boom and adjustment stage (from 1991 to 2000)

After entering the 1990s, Chinese government accelerated the pace of opening up and economic reform and development. The State Council promulgated the "provisions to encourage foreign investment" and proposed a series of preferential policies on the hardware facilities, capital and credit, tax, which greatly promoted the introduction of foreign investment in China. At the same time, Japan's labor-intensive industries speeded up the transferring to

developing countries in East Asia because of the appreciation of the yen. Under such situation, Japanese direct investment to China grew rapidly and emerged the first high tide. For example, Japan's direct investment in China amounted to \$3.2 billion in 1995, an increase of 49.8% over the previous year, this was equivalent to 6.39 times of 1990. However, after 1997, due to the impact of the Asian financial crisis and the economic crisis in Japan, Japan's direct investment to China began to decelerate. Subsequently, the amount of investment was reduced to \$2.9 billion in 2000, equivalent to 90.8% in 1995.

2.1.3 Second investment boom and adjustment stage (from 2001 to 2008)

After China's entry into the WTO in 2001, it started a new round of high-speed economic growth. During the same period, Japan's economy also appeared the longest prosperity after World War II from the beginning of 2002. Due to the need of domestic investment in China continued to maintain a rapid development posture, Japan's direct investment in China emerged a new climax of rapid development once again. The amount of investment achieved to a new record high of \$6.53 billion in 2005, which was equal to 2.24 times in 2000. Even though China's economy did not significantly affected before United States financial crisis in 2008, as Japanese enterprises worried about Chinese economy overheating and the rising of labor costs, the Japan's large-scale investments in the field of automotive, electrical machinery, iron and steel came to an end and

adjusted the strategy of investment in China. Japan's direct investment in China emerged the deceleration and adjustment situation again (Liu, 2011). In three years after 2005, the amount of investment continued to decline and reduced to \$3.65 billion in 2008 less than 44.1% of total investment in 2005.

2.1.4 New development stage (from 2009 to now)

With the outbreak of United States financial crisis in September, 2008, the world economy entered into the severe recession situation. Affected by the financial crisis, Japan's overall foreign direct investment had been under attack greatly, which it declined 42.9% and 23.3% respectively in 2009, 2010 compared with the last year (Liu, 2011). However, in this economic crisis, the Japanese direct investment in China did not slow down, but continued to maintain its growth momentum with average growth rate of 7.85% in the same period. As for China's economy recovered firstly and then pulled the world's economic development. According to the data of China's Ministry of Commerce in 2011, Japan's total foreign investment in China was 6.3 billion dollars with the amazing growth rate of 49.6%, which is the China's first largest country of origin.

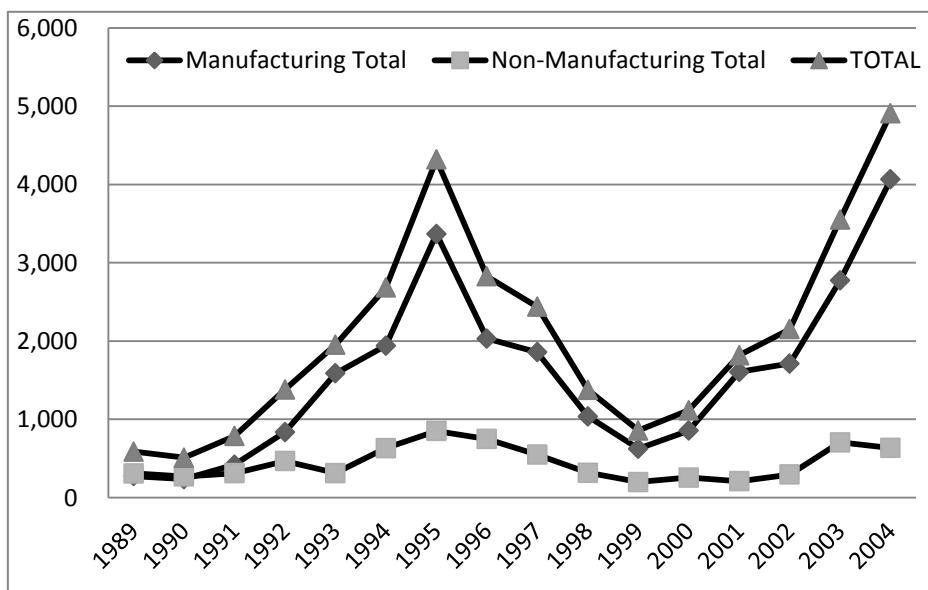
2.2 Characters of JFDI in China

As Japan is China's important trade and investment partner, in terms of its industrial distribution, mode of investment and investment region, it presents distinctive features.

2.2.1 Industrial distribution

With the global economic restructuring and multinational companies' readjusting the layout of global production, the Japanese enterprises accelerated the industrial transfer to China. During this process, the transfer of industry structure had also undergone a change. As shown in Figure 2.2, in 1980s, Japan's direct investment mainly focused on the non-manufacturing sector, while in 1990s, it transferred from the non-manufacturing sector to the manufacturing sector with the largest amount of investment in 1995. In Figure 2.3, it can be seen that for the manufacturing sector, it mainly concentrated in the labor-intensive industries such as electronic, textile, machinery, metal industry. After China's accession to WTO, the industrial structure of Japan's direct investment in Chinese was still the manufacturing-based and continued to expand the non-manufacturing fields.

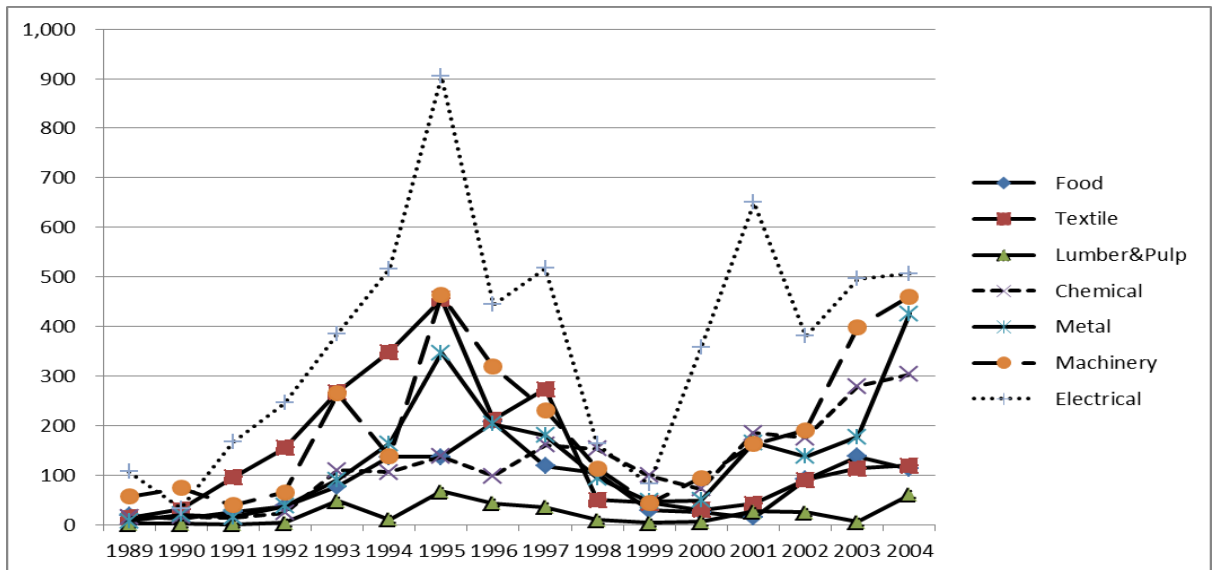
Figure 2.2 Japanese Direct Investment (Industry-China) Unit: JPY100 million



Source: Outward Direct Investment (Industry - China), Japanese Ministry of Finance, 2004.

Figure 2.3 Japanese Direct Investments in Manufacturing Industry

Unit: JPY100 million



Source: Outward Direct Investment (Industry-China), Japanese Ministry of Finance, 2004.

2.2.2 Mode of investment

In the early stage, the major motivation of Japanese investment to China was to obtain the low costs labor and make it become into Japan's global production base and export base. Therefore, before 1990s, Japanese enterprises primarily employed the mode of joint venture (Special Research Department, 2011). Since the introduction of "market for technology" foreign policy by Chinese government, especially after China's accession to the WTO, the Japanese investment priority in China transferred from the production of export products to the occupation of the

Chinese domestic market. In order to expand China's large potential market, more and more Japanese multinational corporations intend to take the mode of sole proprietorship, cooperative alliance and set up all-round investment approach integrating research and development, production, sales, after-sales service (Li, 2006).

2.2.3 Investment regional distribution

The locational distribution of Japan's direct investment in China at beginning was very scattered. As it was noted in the Table 2.2 that it currently had formed three gathering region—Yangtze River Delta region, Bohai Sea region and South China region. In terms of the actual use of Japanese investment, the South China region accounted for 13.1%; Yangtze River Delta region accounted for 41.5%; Bohai Sea region accounted for 32.9% from 2001 to 2010. It was worth noting that the advantages in attracting Japanese FDI of Yangtze River Delta region and Bohai Sea region was becoming increasingly prominent by more higher growth rate than that of South China region. In 2010, the top five provinces or cities in actual use of Japanese investment were: Jiangsu, Shanghai, Guangdong, Liaoning, Beijing, with the percentage of 23.6%, 22.2%, 11.2%, 10.8%, 8.7% respectively.

Table 2.2: Regional Distribution of Japanese Direct Investment in China

Unit: \$ billion, %

Region	Province/City	2010	2001-2010	Subtotal	Proportion
Bohai Sea region	Beijing	3.55	37.42	150.78	32.9
	Tianjin	0.89	21.13		
	Shandong	2.11	35.99		
	Hebei	0.71	6.38		
	Liaoning	4.39	49.86		
Yangtze River Delta region	Jiangsu	9.63	104.31	189.78	41.5
	Shanghai	9.08	85.47		
South China region	Guangdong	4.58	53.68	60.08	13.1
	Fujian	0.58	6.4		
Middle and West region	Jiangxi	0.31	3.05	15.2	3.3
	Henan	0.19	1.68		
	Hubei	0.6	8.66		
	Sichuan	0.38	1.81		
Total		40.84	457.63	415.84	90.9

Source: China Foreign Investment Report, 2011

2.3 Change and Trends of JFDI

In the late 1980s, Japan became the biggest source of foreign direct investment in the world. The main beneficiaries of the rapid increase in investment flows were developed countries. In East Asia, the newly industrial economies (NIEs) of Hong Kong, South Korea, Singapore, and Taiwan were, at first, production bases for Japanese manufacturing in the early 1980s. But in the late 1980s, these countries became new, expanding consumer markets, attracting huge Japanese investments in the service sector, while investments in manufacturing shrank rapidly because of rising labor costs. Then the Association of Southeast Nations (ASEAN) and China became Japan's new production base. During this period, Japan shifted its labor-intensive industry to China in order to seek low-cost labor and raw materials and meet the needs of the world market, which this process was basically completed in 1997. After entry into the 21st century, Japan began to transfer its technology and capital-intensive industries to China, focusing on automobiles, machinery manufacturing, transportation equipment, chemical industry. Zhai and Zhang suggest that Japanese direct investment in the sector of finance, insurance and business services will remain extended trend.

Recently, along with the raising of the labor cost and energy price within China specially in the east region, the improvement of investment environment in

other developing countries, Japanese enterprises are transferring their labor-intensive industry from the east region to the mid-west region within China and to other Asian countries like India, Vietnam, Thailand in order to reduce the production costs and investment risk. Accordingly, the whole scale of Japanese direct investment in China will decline gradually; the industry structure of investment will upgrade which will be in line with the direction of China's utilization of foreign direct investment in future (Zhai & Zhang, 2010).

3. Literature Review

With more and more obvious influence of FDI on the international economy, the issue on foreign direct investment has increasingly become a hot research topic in the international academic community. Different scholars put forward different points of view from different angles and formed different academic genre, trying to explain the phenomenon of foreign direct investment in theory.

3.1 Theoretical Basis of FDI

There are many theoretical papers that examine foreign direct investments (FDI)'s issues, and main research on the motivations underlying FDI were developed by Hymer (1960), Vernon (1966) and Dunning (1973). Economists believe that FDI is an important element of economic development in all countries, especially in the developing ones.

3.1.1 Monopoly Advantage Theory

In 1960s, economists dominantly utilized international trade theory to explain international capital movement. The traditional international trade theory was based on the assumptions of perfect competition. These theories deemed that capital flow was mainly caused by difference between rates of return on investment between two different counties. Rate of return on investment in capital-abundant countries or developed countries was lower than that in developing countries without abundant capital endowment, which led to the

investment from the developed countries to the developing countries (Ohlin, 1933).

In 1960, Hymer challenged the traditional international trade theory in his Ph.D. thesis titled with “The International Operations of National Firms: A Study of Direct Foreign Investment”. He found that traditional international trade theory had difficulty in completely explaining the motives of MNEs’ engagement in FDI through an empirical study of the U.S. MNEs. Hymer took market imperfections as his theoretical assumption and utilized the industrial organization approach to analyze MNEs’ FDI activities. Then, he formed the monopolistic advantage theory. This theory indicated that under the condition of market imperfections, MNEs possess firm-unique advantages or monopolistic advantages which were not available to other countries’ enterprises. This is one of the key reasons of MNEs’ engagement in FDI. MNEs’ monopolistic advantages include: 1) Superior knowledge advantages or intangible assets including management and organization skills, marketing skills and patent; 2) Economies of scale; 3) Access to raw materials; 4) Cost and financial advantages; 5) Production efficiency and product differentiation. Hence, MNEs must have unique advantage or monopolistic advantage so as to overcome the additional cost of oversea investment, to counteract the disadvantages they face in competing with indigenous firms in host country, and to ensure the profitability of their oversea

investment.

3.1.2 Production Cycle Theory

Production cycle theory was firstly developed by Vernon in 1966 that was used to explain certain types of foreign direct investment of the United States companies in Western Europe after the Second World War in the manufacturing industry.

Vernon (1966) believes that there are four stages of production cycle: innovation, growth, maturity and decline. According to the point of view of Vernon, in the first stage the U.S. multinational corporations create new innovative products for local consumption and then export the surplus products in order to expand the foreign markets. According to the theory of the production cycle, after the Second World War, Europe has increased demand for manufactured products like those produced in USA. Thus, American firms began to export, having the advantage of technology in the international competition.

In the first stage of the production cycle, manufacturers have an advantage by owning new technology; along with the product development technology becomes well known. Manufacturers will standardize the product, but there will be many companies that can copy it. Thereby, European firms had started imitating American products that U.S. firms were exporting to these countries. In order to maintain their market shares in those countries, the U.S companies were forced to

invest and perform production on the local markets.

This theory intended to explain certain types of investments in Europe Western made by U.S. companies from 1950 to 1970. Although there are areas where Americans have not possessed the technological advantage and foreign direct investments were still made during that period.

3.1.3 The Eclectic Theory

The eclectic theory developed by Professor Dunning (1973, 1980, 1988) is a mix of three different theories of direct foreign investments (O-L-I):

(1) “O” from Ownership advantages

This refers to intangible assets, which are, at least for a while exclusive possessions of the company and may be transferred within transnational companies at low costs, leading either to higher incomes or reduced costs. In order to successfully enter a foreign market, a company must have its own specific advantages and using them abroad leads to higher marginal profitability or lower marginal cost than other competitors. There are three types of specific advantages: monopoly advantages in the form of privileged access to markets through ownership of natural limited resources, patents, trademarks; technology, knowledge broadly defined so as to contain all forms of innovation activities; economies of large size such as economies of learning, economies of scale and scope, greater access to financial capital.

(2) “L” from Location

Location advantages of different countries are the key factors to determining who will become host countries for the activities of the transnational corporations. The specific advantages of each country can be divided into three categories (Gorg & Greenawa, 2002): the economic benefits consist of quantitative and qualitative factors of production, costs of transport, telecommunications, market size; political advantages which common and specific government policies that affect FDI flows; social advantages includes distance between the home and home countries, cultural diversity, attitude towards strangers.

(3) “I” from Internalization

Supposing the first two conditions are met, it must be profitable for the company the use of these advantages, in collaboration with at least some factors outside the country of origin (Dunning, 1973, 1980, 1988).

This third characteristic of the eclectic paradigm OLI offers a framework for assessing different ways in which the company will exploit its powers from the sale of goods and services to various agreements that might be signed between the companies. As cross-border market internalization benefits is higher the more the firm will want to engage in foreign production rather than offering this right under license, franchise.

Eclectic paradigm OLI shows that OLI parameters are different from

company to company and depend on context and reflect the economic, political, social characteristics of the host country. Therefore the objectives and strategies of the firms, the magnitude and pattern of production will depend on the challenges and opportunities offered by different types of countries.

3.2 Research on FDI in China

Numerous studies have been conducted to explain the level of FDI activity in China since the reforms in late 70s. From the aspect of conventional microeconomics, firms seeking business abroad are motivated by production cost, resource acquisition, minimization of competition risk and market penetration (Daniels & Radebaugh, 1998). From the locational advantage aspect, Bende-Nabende, Ford, Sen, and Slater (2000) has noticed that FDI is influenced by four categories of factors: cost-related factors; the investment environment improving factors; macro-economic factors; and the development strategy of the host country. As there are international differences in production resources and market imperfections of one kind or another, firms move across the borders and produce in higher-return countries. A paper by Razin (2002) has provided a comprehensive review on the theories of FDI. He pointed out that early literature tried to explain FDI at the micro-economic level in terms of market imperfections, ownership, product superiority, cost advantages, economies of scale, multi-plant economies, advanced technology, marketing, and product distribution. In

macro-economic terms, FDI focused in the positive effects of exchange rates, as a depreciated exchange rate lowers the cost of production and investment in the host countries. Alternatively explanations for FDI have focused on regulatory restrictions, tariffs, quotas, infrastructure quality and political stability.

The existing studies of determinants of FDI in China can be grouped into three categories. First, there are studies which focused on the explanation of FDI across China using province-level data (Coughlin & Segev, 2000; Zhang, 2001; Shan, 2002). These studies found that the most important factors that attracted FDI inflow were average wage, labor quality, market size, and level of infrastructure development.

The second category in the existing literature is the studies which investigated FDI determinants in individual provinces only. The example study is by Ng and Tuan (2003), who investigated the locational distribution of FDI in the Guangdong province. Their study shows that transaction cost, firm size, and quota effects are all significant in the locational choice of foreign firms.

The last category is concerned with the aspect of investors from various countries and the motivation behind Western and Asian direct investment (Fung et al., 2002; Zhang, 2000, 2001). The studies of Fung et al. (2000, 2002) found that both the United States and Japanese direct investment are significantly influenced by labor quality. However, comparing U.S. direct investment in China to Hong

Kong direct investment in China, U.S. direct investments are more sensitive to local market demand. However, Hong Kong investments are much more sensitive to low labor cost.

3.3 Research on JFDI in China

With regard to the location choices of Japanese FDI in China, many studies emphasize that Japanese FDI displays a distinctive location pattern, indicating that it may seek unique location factors. Schroath, Hu and Chen (1993) showed that Japanese joint ventures tend to be concentrated in China's northeastern regions. They argued that geographic and cultural factors play an important role in this spatial concentration. Qu and Green (1997) suggested that FDI from the USA, Japan, and European countries is interested in city sizes, consumption levels, and infrastructure in its location decisions, while FDI from Hong Kong is generally oriented by cultural and geographic distances. Zhao and Zhu (2000) argued that Japanese FDI pursues resources, while American and European FDI chase higher labor productivity and strong local economic bases. He (2003) suggested that, in addition to Japanese special location preferences compared to other FDI home countries in China, Japanese investors from different sectors may have their own particular location choices. Zhou, Delios, and Yang (2002) investigated Japanese FDI inflows to 190 Chinese cities from 1980 to 1998 and showed that Japanese FDI tends to be agglomerated to the prior Japanese subsidiaries. This kind of

Japanese nationality-specific FDI agglomeration was also found in Europe and in the USA (Ford & Strange 1999; Head, Ries, & Swenson, 1995, 1999; Smith & Florida, 1994).

According to the basic theory of FDI, both at the macroeconomic level, and at the enterprise level, there indeed exists the rational motivation for foreign direct investment across countries. A large number of empirical studies have shown that the distribution of foreign direct investment among countries and within countries is extremely uneven. As for China, it was a very obvious phenomenon that most of FDI flowed into the eastern region. The existing studies (Qian, Wilson, & Qiao, 2002) on FDI in China have identified eight potential most important factors that attracted FDI inflow were market demand and market size; agglomeration; labor quality; labor cost; the level of scientific research; degree of Openness; political risk; FDI substitutes. Moreover, it also shows that different FDI source countries have different preferences for these factors. As one of the main capital-exporting countries in the world, many studies had shown that Japan had its own distinctive determinants of FDI in China by comparing with other developed countries. As the target country of our research, we intend to explore the locational determinants underlying JFDI by comparing with different preference for investment motives in specific region within China.

4. Data and Analysis

We have discussed the main factors that affected the Japanese investors to invest in China in above section. We still intend to examine the determinants behind the Japanese FDI in the different region within China in detail, because it will reveal the different importance of these factors which influence the distribution of Japanese FDI, which is our main concern in this report.

4.1 Survey Review

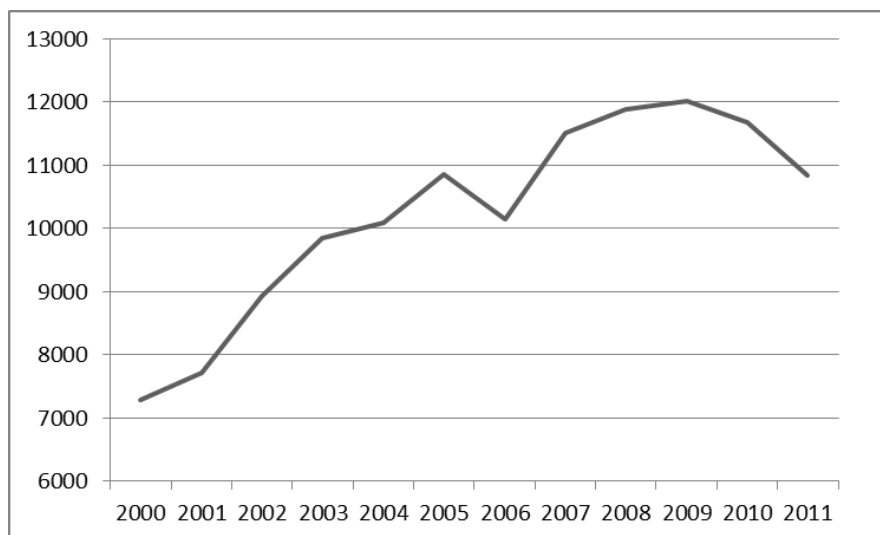
We plan to use questionnaire surveys to collect original data on Japanese FDI within China at beginning. As it will be very difficult to do so by individual power, we utilize the second-hand data of questionnaire surveys conducted by Japan Bank for International Cooperation (JBIC) of Japanese government. The result of survey was released in “Survey Report on Overseas Business Operation by Japanese Manufacturing Companies”, which is more comprehensive and authoritative than other data sources (see Appendix 2).

The survey was carried out from July to September, 2011. The objectives of this survey are manufacturing companies that have three or more overseas affiliates (including at least one production base). “Overseas business operations” is defined as production, sales, and R&D activities at overseas affiliates, as well as outsourcing of manufacturing and procurement. Main survey topics included: ① medium-term business prospects; ② evaluations of overseas business

performance; ③promising countries or regions for overseas business operations; ④supply chains network since the Great East Japan Earthquake; ⑤infrastructure businesses overseas.

The total amount of companies which the questionnaires were mailed to was 977, while the respondent companies were 603, representing the higher response rate of 61.7%. The survey indicates that the annual totals of the overseas affiliates of the companies that responded to the questionnaire have gradually declined since two years ago (see Figure 4.1). The survey covered more than 14 industry types among the respondent companies such as electrical equipment & electronics, automobiles, chemicals and so on (see Table 4.1).

Figure 4.1: No. of Overseas Affiliates (2000-2011)



Source: Survey Report on Overseas Business Operation by Japanese Manufacturing Companies, JBIC, 2000-2011.

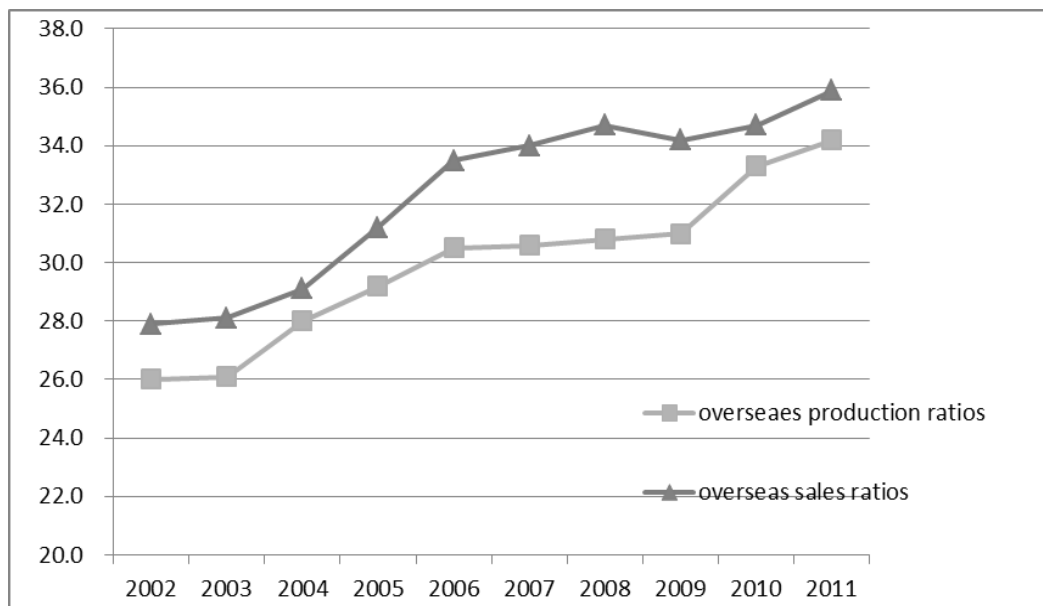
Table 4.1: No. of Respondent companies by Industry Type

Industry Type	No. of Respondent Companies	Ratios (%)
Electrical Equipment Electronics	103	17.1
Automobiles	97	16.1
Chemicals	96	15.9
General Machinery	54	9.0
Precision Machinery	36	6.0
Foods	34	5.6
Textiles	31	5.1
Metal Products	20	3.3
Nonferrous Metals	18	3.0
Ceramics, Cement & Glass	16	2.7
Steel	15	2.5
Petroleum & Rubber	14	2.3
Transportation(excl .Automobiles)	11	1.8
Paper, Pulp & Wood	6	1.0
Other	52	8.6
Total	603	

Source: Survey Report on Overseas Business Operation by Japanese Manufacturing Companies, JBIC, 2011

As for the performance of Japanese overseas business operations, the survey shows that the percentage of overseas production and sales will continue to rise. In 2010, the overseas production ratio reached a record high of 33.3%. It estimates that Japanese companies will continue to increase their overseas production ratio in the medium-term plans. The FY2010 ratio of overseas sales increased slightly by 0.5 points over the previous fiscal year, and in the FY2011 the overseas sales ratio is expected to rise even higher (see Figure 4.2).

Figure 4.2: Ratios of Overseas Production*1 and Overseas Sales*2 Unit: %



*1: $(\text{Overseas Production}) / (\text{Domestic Production} + \text{Overseas Production})$

*2: $(\text{Overseas Sales}) / (\text{Domestic Sales} + \text{Overseas Sales})$

Source: Survey Report on Overseas Business Operation by Japanese Manufacturing Companies, JBIC, 2002-2011.

In order to identify the relative important factors representing the locational

determinants from the point of view of Japanese investors, we will classify the main determinants into two categories—location advantage and regional determinants.

4.2 Location Advantages of JFDI in China

Location advantage refers to the attractiveness of specific factor endowments in host country for investment by MNEs (Dunning, 1988). Location advantages include natural resources, economic environment, cultural and social factors, political power, legal environment and etc. We want to select India, Thailand as our object of comparison in this aspect, because they are the comparable countries for China. India is the second most populous country in the world and one of the most attractive countries for FDI in recent years. Thailand, the representative countries of Association of Southeast Asian Nations (ASEAN) is geographically close to China and has more close economic relationship and common interests. China and the ten ASEAN countries officially set up China-ASEAN Free Trade Area completed on January 1, 2010. It is the largest free trade zone among developing countries. It covers 1.9 billion people which total GDP achieves to \$6 trillion, the trade amounts to \$4.5 trillion (<http://baike.baidu.com/view/824741.htm>, 2012) . Therefore the location advantages seen from the investing in China for Japanese investors are not absolute advantages but advantages of China in comparison with other countries.

4.2.1 Location advantage of China compared with India

With India's rapid economic development and improving of the domestic investment environment, the actual amount of Japanese FDI to India and the future expectations were gradually rising. Due to survey of JBIC, India will replace China as the first promising country in the view point of Japanese companies over the long term (next 10 or so years) (see Table 4.2).

Table 4.2: Top 10 Promising Countries over the Long-term

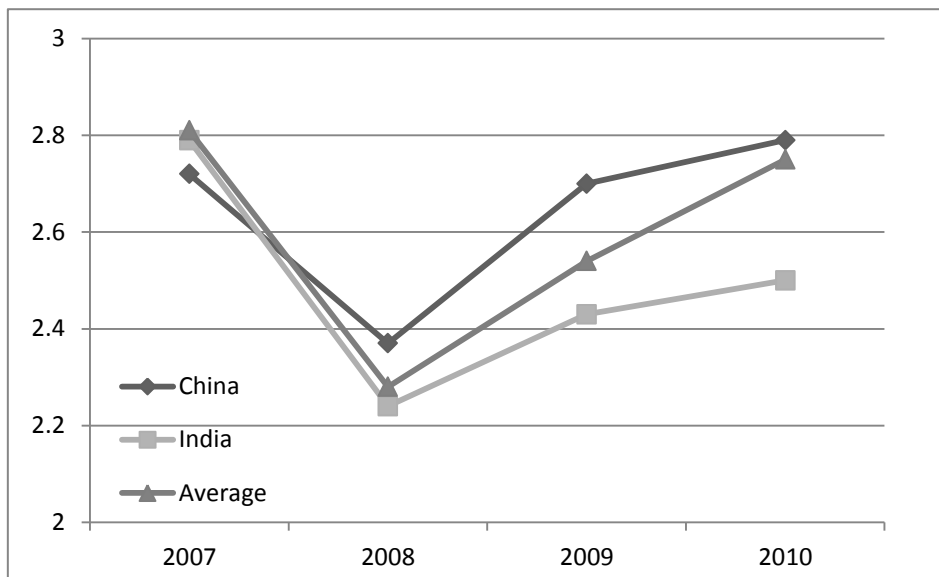
Rank	Country	No. of companies (420)	Share (%)
1	India	333	79.3
2	China	299	71.2
3	Brazil	196	46.7
4	Indonesia	147	35.0
5	Vietnam	146	34.8
6	Thailand	114	27.1
7	Russia	95	22.6
8	USA	36	8.6
9	Mexico	25	6.0
10	Malaysia	21	5.0

Source: Survey Report on Overseas Business Operation by Japanese Manufacturing Companies, JBIC, 2011.

However, China was still seen as more profitable country than India within the Asian countries in recent year. In Figure 4.3 below, China gained higher scores with 2.79 than India with 2.5. The survey showed that “Good performance of sales in the country/region” gained the highest ratio with about 85%, when Japanese companies were asked for the following given reasons for satisfaction with profitability in China. This was also supported by the investigation on the reasons for China as promising for Japanese overseas operation. The top two reasons were “Future growth potential of local market” and “Current size of local market” (JBIC, 2011). It suggested that the huge potential local market was China's location advantage compared with India.

1. Good performance of sales in the country/region
2. Good performance of exports in the country/region
3. Successful cost cuts (personnel, materials, etc.)
4. Cost cuts via consolidation of manufacturing
5. Manufacturing facilities brought fully on line
6. Foreign exchange gains

Figure 4.3: Satisfaction with Profits by Asian Countries



Source: Survey Report on Overseas Business Operation by Japanese Manufacturing Companies, JBIC, 2011.

4.2.2 Location advantage of China compared with Thailand

Within Asian countries, Thailand was seen as the most profitable country than Japan with roughly 40% companies giving response of either “somewhat satisfactory” or “satisfactory” concerning the profitability, firstly surpassing China as the No. 1 in this regard (see Table 4.3). Although the ranking of Thailand in the promising countries gradually upgraded, from the 5th in 2009 to the 3rd in 2011, China had always occupied the first position. According to the survey, comparing the main reasons for China as promising with Thailand, both countries have same feature of “future growth potential of local market”. Because the average wages are rising in China, so the ratio of companies citing the No. 1 issue of “rising labor

costs” continues to rise year by year, while the most frequently cited issue for Thailand was “security/social instability”, with 45.1% of the respondent companies listing this issue. Although there was few obvious direct impact of this issue on production, it appears that a certain degree of concern about the situation in Thailand exists. Therefore, the stable political situation and social environment was China's location advantage compared with Thailand.

Table 4.3: The Top 5 Countries More Profitable than Japan

Country	No. of response (1)	Total response (2)	Ratio: (1)/(2) (%)
1. Thailand	119	314	37.9
2. China	162	475	34.1
3. Indonesia	54	201	26.9
4. NIEs 3 *3	48	223	21.5
5. Malaysia	39	193	20.2
Total	654	2957	22.1

*3: NIEs 3: Korea, Taiwan, Hong Kong

Source: Survey Report on Overseas Business Operation by Japanese Manufacturing Companies, JBIC, 2011.

4.3 Regional Determinants of JFDI within China

According to the survey of JBIC, when the Japanese companies were asked

to name top 5 promising countries for overseas business operation over the medium-term (the next three or so years), China was still be ranked no. 1 in the promising countries or regions for Japanese FDI. However the amount of Japanese companies choosing China as promising country and the percentage share of China declined a little compared with last year(see Table 4.4). Moreover, the ranking of China in promising country will drop to the second place over the long-term (next 10 years or so). It indicates that the regional determinants within China have some changes behind the Japanese FDI and China's status is gradually declining in the view point of Japanese investors.

Table 4.4: Rank of Top 10 Promising Countries over Medium-term

Ranking		Country	No. of Companies		Percentage Share *4	
2011	2010		2011	2010	2011	2010
1	1	China	369	399	72.8	77.3
2	2	India	2697	312	58.6	60.5
3	4	Thailand	165	135	32.5	26.2
4	3	Vietnam	159	166	31.4	32.2
5	5	Brazil	145	127	28.6	24.6
6	6	Indonesia	145	107	28.6	20.7
7	7	Russia	63	75	12.4	14.5

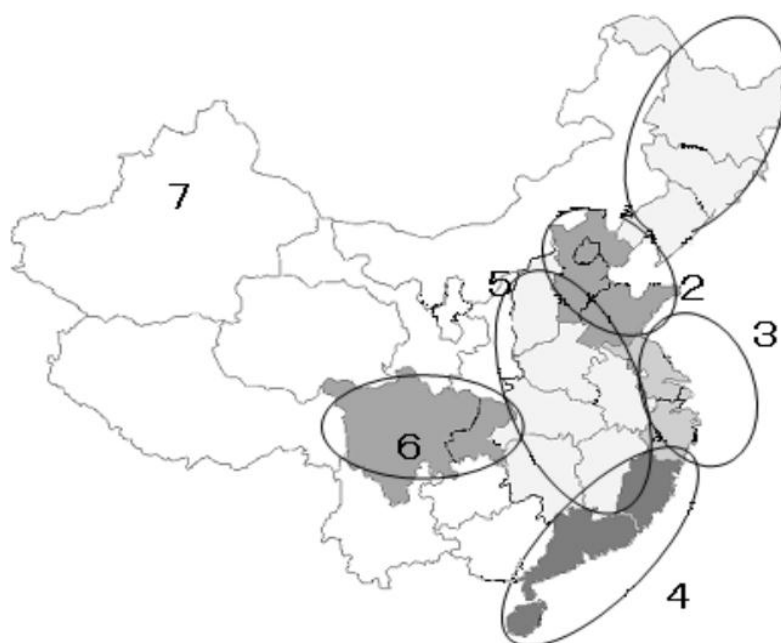
8	8	USA	50	58	9.9	11.2
9	10	Malaysia	39	29	7.7	5.6
10	10	Taiwan	35	29	6.9	5.6

*4: No. of responses citing country / Total No. of respondent companies

Source: Survey Report on Overseas Business Operation by Japanese Manufacturing Companies, JBIC, 2010, 2011.

In order to looking for the reasons leading to this trend in detail, we would like to further examine the regional determinants of Japanese FDI within China by classifying China geographically into 7 regions as following (see Figure 4.4):

Figure 4.4: The Main Region within China



Source: Survey Report on Overseas Business Operation by Japanese Manufacturing Companies, JBIC, 2011

1. Northeastern China: Heilongjiang, Jilin, Liaoning
2. Northern China: Beijing, Tianjin, Hebei, Shandong
3. Eastern China: Shanghai, Jiangsu, Zhejiang
4. Southern China: Fujian, Guangdong, Hainan
5. Inland-Central China: Shanxi, Henan, Anhui, Hubei, Jiangxi, Hunan
6. Inland-Western China: Sichuan, Chongqing
7. Inland-Western China : Regions other than Sichuan and Chongqing

According to the survey of JBIC, when the Japanese companies were asked to point out 3 promising region each for manufacturing and sales within China, the results indicated the obvious phenomenon that the Eastern Coastal region (including Eastern, Southern and Northern China) was the most preferred area for Japanese investors as their first respond. In the Table 4.5, 241 companies selected Eastern Coastal China as the 1st promising region for production within 310 companies responding to this question. In particular, Eastern China attracted most of Japanese FDI for both manufacturing and sales with 153 companies responding it as the first promising region. As Eastern China has Shanghai, with the country's highest domestic per capita GDP, Zhejiang province, with its 4th highest, and Jiangsu province with its 5th, it has large size of current local market and future growth potential, which is the main determinant for Japanese companies arranging the manufacturing and sales base over the medium-term.

Moreover, it is worth noting that more and more Japanese companies see Inland-Central China as the preferred region for manufacturing. As shown in the Table 4.5, Inland-Central China obtained 40 votes in the first promising region among Japanese companies in 2011, more than the amount of 25 in 2010, exceeding Northern China and ranking at the 3rd place. In the light of survey report of JBIC, most of companies in the automotive industry regard inland central region as the predominant manufacturing base with 30 companies (2 assembly and part 28), followed by electrical and electronic equipment with 24 companies (11 assembly and parts 13).

Table 4.5: The 1st Promising Region Within China

Region		2011 Year		2010 Year	
		No. 1 of Citing Companies	Ranking	No. 1 of Citing Companies	Ranking
Eastern Costal region	Eastern China	153	1	210	1
	Southern China	50	2	58	3
	Northern China	38	4	65	2
Inland-central China		40	3	25	4
Northeastern China		17	5	15	5
Inland-Sichuan/Chongqing		10	6	10	6

Inland-Western China	2	7	2	7
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Source: Survey Report on Overseas Business Operation by Japanese Manufacturing Companies, JBIC, 2010, 2011.

5. Discussion

The objective of this report is to analyze the regional determinants of Japanese foreign direct investment in China. Based on the data of survey of JBIC, this paper examined the location advantages of Japanese FDI in China and regional determinants of Japanese FDI within China. It gives the evidence supporting some of the general trends observed in the basic theory of foreign direct investment. Furthermore this study generalizes some key influences on Japanese firm's sub-national location choices within China. These influences can be attributed to typical regional factor endowment advantages.

As the traditional international trade theory explained that higher profitability on investment in developing countries without abundant capital endowment led to the foreign investment inflow from the developed countries with abundant capital (Ohlin, 1933), it was supported by the investigation on the reasons for satisfaction with profitability in choosing China as promising for Japanese overseas operation. Moreover, the location advantages as following which are significantly different from the other host countries still make China as the first promising country to attract more Japanese FDI inflows than the neighboring Asian countries and others, which provided the empirical proof of the eclectic theory developed by Professor Dunning (1973, 1980, 1988), the studies which focused on the explanation of FDI across China using province-level data (Coughlin & Segev,

2000; Zhang, 2001; Shan, 2002).

Reasons for China as Promising (JBIC, 2011):

1. Future growth potential of local market;
2. Current size of local market;
3. Inexpensive source of labor;
4. Supply base for assemblers;
5. Concentration of industry.

Besides, as for the regional distribution of Japanese FDI within China, the similar regional factor endowment advantages such as higher economic developing level represented by GDP per capita, higher market size, the better transport infrastructure, geographical location, and lower labor costs for export-oriented FDI inflows make huge amounts of Japanese FDI inflows concentrate in eastern coastal cities or provinces and result in the significant disparity of economic development across Chinese eastern, middle, and western provinces(Li, 2005). The data of JBIC shows that the Japanese companies selected Eastern Coastal China (including Eastern, Southern and Northern China) as the No. 1 promising region for production. In particular, Eastern China attracted most of Japanese FDI for both manufacturing and sales, although its influence has declined somewhat because the wages are rising relatively quickly than other regions within China year by year. On the contrary, this study did not stand by the

findings that Japanese joint ventures tend to be concentrated in China's northeastern regions conducted as shown by Schroath, Hu, and Chen (1993). They argued that geographic and cultural factors play an important role in this spatial concentration. It was indicated that the attraction of the Northeastern China for Japanese FDI has lagged far behind the Eastern China even the Inland-central region. In order to deeply understand this uneven distribution of Japanese FDI within China, I would like to further explain the main factors leading to such phenomenon.

Turning to factors related to the quality of the investment location, Japanese FDI in China was sensitive to the overall "quality" of an investment location, that is; how well a location was developed (Zhou, Delios, & Yang, 2001). This influence was more comprehensive beyond that of the government policy designations as the government policy did not necessarily capture the "quality" of a location. This was especially true that there was not much change in the situation of Japanese FDI gathering in eastern regions even after Chinese central government gave more preferential policies to the central and western regions in 2008.

Market-oriented factors represented by the future growth potential of local market and current size of local market, was positively related to foreign direct investment inflows. This result was found in the full sample of survey of JBIC, as

well as in the manufacturing sub-sample. As China's economy will continue to maintain a rapid growth rate that has been forecast, Japan's firms need to make new strategic decision towards more intensive development of local market penetration. This means establishing regional production networks across China to try to occupy the Chinese market and satisfy domestic demand in China. With such a strategy, export-related factors become less persuasive, and market-oriented factors directed towards improving performance of sales begin to hold greater weight in the location decisions of Japanese firms.

It was worth noting the specific features of Japanese FDI that Japanese investors in China, compared to their counterparts in the USA, seem to be more responsive to the location decisions of previous Japanese affiliations. A potential explanation would be that it is much more difficult for foreign investors to access local information from China than from the USA. Japanese investors, by simply duplicating the previous location choices of Japanese FDI in China, would save time and reduce costs on the information collection of each alternative province. Another possible explanation would be that China has far fewer specialized infrastructures and services for Japanese investors than for the USA, so Japanese investors, through their own spatial agglomeration, must establish and share their desired services or infrastructures that are generally not available in China(Cheng & Stough, 2006).

As shown in my data analysis, with the strengthening in the influence of Inland-central region on Japanese firm's location choices, there is some evidence that Japanese firms begin to transferring their labor-intensive industry from Eastern Coastal region to Inland-central region or from China to the other Asian countries. The low-labor-cost advantage of China may not be sustainable as China now faces the growth in wages and intensive competition from its neighboring countries such as Vietnam, Laos, and India, which are also have cheaper labor, and take a variety of policies to attract foreign direct investment in recent years. Therefore, the rising of labor cost became the issues of concern paid the most attention by Japanese firms in deciding investment location.

On the other hand, Japanese investors may want to consider investing in provinces not yet filled with competitors of FDI. More and more Japanese companies feel the high pressure from the intense competition with other companies which is viewed as the 3rd issues in determining the investment location in China (JBIC, 2011). This feature might point to a 'ceiling effect' in agglomeration in which stiff competition for resources in heavily-invested areas, might have led a firm to seek alternative investment locations (Zhou, Delios, & Yang, 2001). In fact, accompanied with the so-called 'tilted policy' towards developing the Western Region, the Chinese government begins to encourage foreign capital to move investments into the inland and the Western region by

providing various incentive schemes like investment benefits, tax benefits, and financing benefits. It would be a good opportunity for Japanese investors to rearrange their foreign direct investment within China so as to obtain the sustainable high profitability.

Through this study, I recognize that with the improvement of the investment environment in China, the purpose of Japanese FDI will transfer from export-oriented to market-oriented. Under this trend, the original motivations represented by preferential policies and low cost factors will play more weakening role in attracting FDI inflow. Therefore, the government should reconsider the current policy and make some adjustment.

There is no doubt that FDI has been proved to be the major driving force for economic growth for China. “ Foreign direct investment has two positive impacts: it has improved the liquidity of the Chinese economy, and thus facilitated other investments (e.g. more business opportunities for local entrepreneurs as well as support businesses such as legal work, accountancy, construction, transportation, hospitality etc.). Secondly, it has created employment, earnings and thus taxation revenue for the central and regional governments. Such revenues have been fed back into the economy to boost the living standards of all Chinese people, further boosting the economy, facilitating a virtuous-cycle of prosperity for over two decades.” (Shaukat & Wei, 2005)

The policy makers attempting to influence the inflow of FDI into a region as well as its regional distribution must recognize the motives of foreign investors. If governmental policies are consistent with the strategic objectives of foreign investors, they will be successful. It also indicates the effectiveness of policy is periodic and changes with the environment, to the extent that investor's motivations are subject to change over time. Through examining various similarities or differences in both importance and magnitude of location determinants affecting Japanese FDI inflows in different regions within China, these meaningful locational determinants may be used to explain location decision-making of foreign investors. Some important implications of policies can be given as follows (Li, 2005):

Within these location determinants of FDI, the size of local market, the level of economic development, labor cost are the most important factor in determining the large FDI inflows. Obviously, in order to attract more FDI inflows, the promotion of the province's gross domestic product (GDP) and GDP per capita is an important way to speed up the economic development. In contrast, the demonstration effect of FDI inflows also contributed to the faster growth of the provincial economy. Therefore, utilizing the interactive relationship between FDI inflows and GDP, or GDP per capita is the basic economic policy to attract more FDI inflows in the backward western region to speed up economic development

and improve the living standards of the people in the west region.

China is a country which has rich labor resources and the comparative advantage of low labor costs. In particular, along with the construction of cities or towns, the majority of industrial workers were farmers rushing from countryside to the city or town. Therefore, the timing education policies or training programs, and re-education project can help these new industrial workers obtain technology and management know-how from rural areas, improve labor productivity, and thus absorb more FDI inflows.

The favorable geographical location and developed transport infrastructure may attract more FDI inflows due to the cost-effectiveness of investment and better investment environment. Therefore, the regional preferential policies related to improve the investment environment in the specific areas and backward western region can overcome the unfavorable location disadvantage. Thus, speeding up the construction of transport and communications in the western is considered to improve the investment infrastructure conditions to enhance the flow ability of these western areas to market of the developed areas, in order to attract more FDI inflows.

High level of marketing economy refers to the complete liberalization of the economy, the diversification of the economic components, which is conducive to establish better special production chain between enterprises, that is to say, this

will lead to construct comprehensive relationships in the FDI enterprise, between the upstream suppliers and downstream customers. Therefore, the relevant industrial policies to encourage the development of small and medium-sized enterprises can promote the absorption of more FDI inflows in China.

High human capital means that this may provide adequate industrial workers with skills or technology for enterprise, which may meet the outstanding demand of the industrial workers of FDI enterprises, so as to attract more foreign direct investment inflows. Therefore, in addition to the emphasis on basic education policy, the government institution should also be vigilant in the policy on research and development (R & D), training and consulting services, in order to optimize the allocation of labor resources.

Finally, the earlier preferential policies play an important role in the absorption of huge FDI inflows in China. However, the policy has resulted in inequality between the eastern and western regions in economic growth and income disparity. With China's accession to the WTO in 2001, all provinces have the full liberalization to the world. Therefore, fully utilizing positive role of the preferential policies on FDI inflows in China may widely guide FDI inflows from the eastern to the western region. In addition, by learn the lessons from the implementation of policy at the initial stages of opening its doors to the world, government institutions not only emphasized the relevant policies about the

labor-intensive industries for more jobs opportunities such as processing and assembly industry, but also stressed particularly in the capital-intensive and knowledge-intensive industries, accelerating the upgrade of the industrial or adjusting the economic structure such as the state-of-the-art technology industry, petroleum chemical industry, transportation and communications industries, particularly in the service trade industry and so on.

However, in order to improve the whole investment environment, besides adjusting the policy, Shaukat and Wei (2005) argued that further reforms are needed as following:

“The reform of investment laws is long overdue. For example, due to the current Chinese investment laws, foreign investors are prohibited from owning more than 25 percent of a commercial bank, and no single foreign investor can own more than 20 percent. Such limits on foreign ownership of its banks need to be removed. Also, foreign financial institutions that want to buy Chinese securities need to be freed from having to have at least \$10 billion in assets and to have been in business at least five years. Foreign-affiliated banks, brokerage firms and insurers need to be freed from restrictions on setting up multiple branches at one time.

It is well understood that the issue for government is how to manage the relationship between FDI and other political, social and cultural factors.

However, it is our opinion that the crucial importance of FDI for China may not be the FDI itself, but the degree of openness the government commits to in order to attract foreign capital. With a free market, free flow of international trade and capital, deregulation of businesses, the country will become the preeminent economic powers it aspires to be.

Thus China should continue its program of economic reforms, as a sustained healthy economic growth is the biggest attraction for foreign capital. However, any political reforms need to ensure that instability does not ensue. Market access barriers should be removed and it should encourage market-oriented FDI as this is preferable to export-orientated FDI since it leads to technology transfer and spillover effects. Such a path will help Chinese firms to climb up the technology ladder. Furthermore, China should speed up the privatization of state-owned companies, including banks; to develop a futures market for currency trading and to establish an independent credit-rating agency.”

Finally, the government should establish a special regional advantage in the western region of China such as skilled employees, the improved infrastructure to attract more foreign capital to the region. This will help to reduce the huge development gap between the eastern, southern and western regions.

6. Conclusion

6.1 Conclusion

As a little of work has been undertaken concerning the sub-national characteristics of Japanese foreign direct investment in China, this report demonstrates that the sub-national characteristics of foreign direct investment are an important aspect of FDI strategy in China. The sub-national location decision supposes in a large country such as China the considerable significant inter-regional variance exists, with the most dramatic difference being that between the developed eastern coastal provinces and the interior provinces. Through this paper, I conclude that the regional economic development such as economic growth rate, GDP per capita, local market size, and future growth potential of local market are the main factors driving the location decision of Japanese investors. The analysis of the location decision allows this study to contribute to the debate concerning the effectiveness of government sponsored incentives on the investment strategy of foreign investors.

This paper shows that, there is a time-varying impact of the preferential policies on foreign investment location decision of Japanese foreign investors in the eastern costal region, from the early stage of pulling in export-oriented industries for cheaper production costs to more recent investments aiming to occupy the huge domestic market. With the change in the structure and strategy of

Japanese investors, they focus on to a greater local market penetration and the development of regional production networks. Factors such as the local economic development potential, market size, and concentration of industry other than policy differentiation among cities are likely to have a growing influence on Japanese investment location decisions.

This paper shows that the rising of labor cost become the most serious issues encountered by Japanese investors in China. This can explain why the inland-central regions with relative low labor cost increasingly turn into the first choice of Japanese investors recently. Japanese firms are also shown the risk-reverse. In other words, they avoid investing in a country with high political risk represented by the high social instability, unclear execution of legal system, complicated tax system, and insufficient protection for intellectual property rights. For example, the Japanese investors chose “Security/social instability” as the first issue when investing in Thailand even though Thailand gained the highest score in the countries more profitable than Japan.

For China to develop sustainable, national competitive advantage, it will have to move from being a country which attracts FDI based on low costs, to one which has comprehensive advantages based on high quality human resources, the transparent and stable policy system, the completed legal system, which means optimizing the overall investment environment.

6.2 Future Research

Although I make these arguments, I realized that there are some limitations in my study which will lead to the further studies in the future. As the survey of JBIC did not conduct the investigation on how China's initial government-sponsored preferential policy has influenced the location choice of Japanese firms, the study has several limitations that deserve further investigation. First, the importance of determining factors that may change over time. Similarly, the location determinants of foreign direct investment may differ by industry. Furthermore, due to data limitation, we were not able to consider the effect of FDI policies, tax incentives, and foreign portfolio investment to FDI in China. Finally, we believe corruption and the effects of bureaucratic red tape are also important deterring factors of FDI. A future study would seek to determine if the same relationships exist between the variables for a longer period of time.

China's entry to the World Trade Organization (WTO) raises new questions regarding the evolution of China's "open door" policy and China's recent efforts to boost economic growth in its western region. The WTO requires that an FDI host country should provide "national treatment" to foreign investors, i.e., neither foreign nor domestic investment may have preferential treatment. This national treatment requirement poses serious challenges to China's open door policy, which is centered on a variety of development zones and special treatment to

foreign investors. Future research is then urgent for potential policy measures consistent with the WTO's national treatment requirement and their implications on the location choices of foreign investment in China.

I acknowledged that a more micro-analytic approach in which investor motivations are modeled more explicitly, rather than inferred, would enhance the cogency of our statements. This study would also benefit from permitting greater heterogeneity among firms to enter the analysis. These points could help develop a better understanding of why Japanese FDI has grown in non-policy designated areas. This approach would likewise develop a stronger behavioral analysis of Japanese FDI as it could consider dimensions such as a firm's experience in China, its relationship to other firms in industrial networks such as horizontal and vertical keiretsu, and the ownership structure of subsidiaries, as moderators of the identified influences on location choice.

Although there are numerous other topics which are worth researching further, the current results do carry an important policy implication in that they highlight that provincial officials have more to do to encourage domestic-market oriented and capital-intensive Japanese FDI in the future. Japanese FDI that seeks markets are more likely to occur if economic reforms go even further and if the government opens more markets to foreign investors. Furthermore, the government should provide more financial support for education to enhance the

labor quality and to improve the skill level of labors.

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Appendices

Appendix 1: Regional Distribution of Japanese Direct Investment in China (2001—2010)

Unite: \$ billion

Region	Province/City	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Bohai Sea region	Beijing	2.04	2.01	2.34	2.63	9.46	5.61	3.04	4.39	2.35	3.55
	Tianjing	2.69	1.59	2.67	4.64	4.31	1.85	0.92	0.85	0.72	0.89
	Shandong	3.43	3.84	4.33	5.62	7.09	4.27	2.6	1.58	1.12	2.11
	Hebei	1.02	0.56	1.23	0.32	0.45	0.51	0.38	0.65	0.55	0.71
	Lioaning	6.34	8.04	3.11	8.6	3.65	2.65	2.14	4.72	6.22	4.39
Yangtze River Delta region	Jiangsu	9.69	9.26	11.77	9.9	12.08	13.41	8.46	8.8	11.31	9.63
	Shanghai	6.75	6.24	10.56	9.63	11.38	8.2	8.31	6.56	8.76	9.08
South China region	Guangdong	5.15	4.21	2.36	5.27	9.43	6.68	5.47	5.06	5.47	4.58
	Fujian	1.12	0.83	1.14	0.45	0.68	0.36	0.53	0.45	0.26	0.58
Middle and West region	Jiangxi	0.13	0.25	0.13	0.73	0.9	0.23	0.15	0.12	0.1	0.31
	Henan	0.6	0.11	0.28	0.11	0.06	0.05	0.14	0.02	0.12	0.19
	Hubei	0.27	0.11	4.98	0.72	0.85	0.47	0.16	0.17	0.33	0.6
	Sichuan	0.15	0.17	0.07	0.13	0.36	0.08	0.06	0.01	0.4	0.38
Total		43.48	41.9	50.54	54.52	65.3	47.59	35.89	36.52	41.05	40.84

Source: China Foreign Investment Report, 2011

Appendix 2: Survey Report on Overseas Business Operations by Japanese manufacturing Companies.

Survey Report on Overseas Business Operations by Japanese Manufacturing Companies

Results of the JBIC FY2011 Survey:

-Outlook for Japanese Foreign Direct Investment (23rd Annual Survey)-

December 2011

Research Division, Policy and Strategy Office for Financial Operations
Japan Bank for International Cooperation



JAPAN
BANK FOR
INTERNATIONAL
COOPERATION

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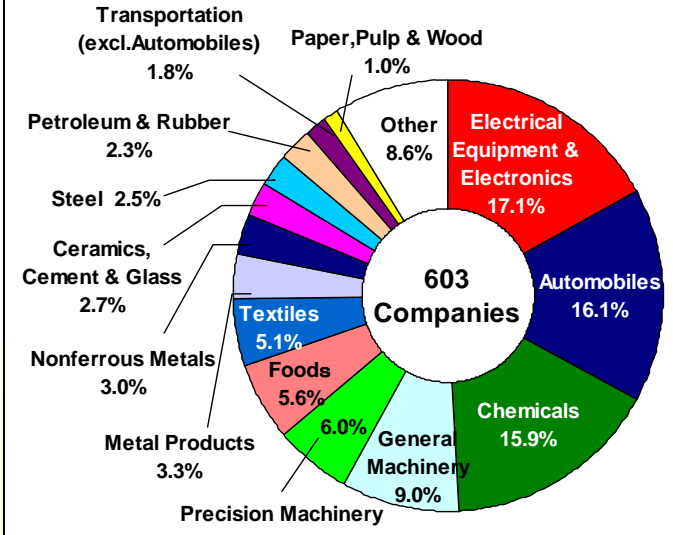
Survey Overview and Companies Surveyed

1. Survey Overview

Survey Overview

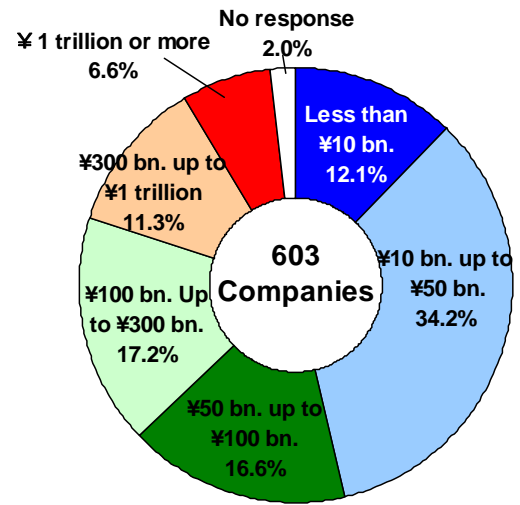
- **Survey targets:** Manufacturing companies that have three or more overseas affiliates (including at least one production base)
- **No. of companies questionnaires were mailed to:** 977
- **Responses returned:** 603 (response rate: 61.7%)
- **No. of foreign affiliates of respondent companies:** 10,841
- **Period of survey:** Sent in July, 2011
Responses returned from July to September
Face-to-face interviews (33) and phone interviews (116) conducted from August to October
- **Main survey topics:**
 - Medium-term business prospects
 - Evaluations of overseas business performance
 - Promising countries or regions for overseas business operations
 - Supply chains network since the Great East Japan Earthquake
 - Infrastructure businesses overseas
- **Note:** “Overseas business operations” is defined as production, sales, and R&D activities at overseas affiliates, as well as outsourcing of manufacturing and procurement.

Figure 1: No. of Respondent Companies by Industrial Classification



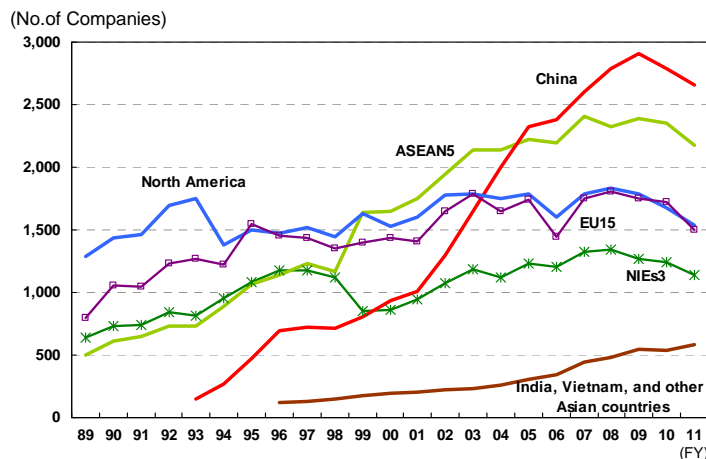
Industry Type	No. of Respondent Companies
Electrical Equipment & Electronics	103
Automobiles	97
Chemicals	96
General Machinery	54
Precision Machinery	36
Foods	34
Textiles	31
Metal Products	20
Nonferrous Metals	18
Ceramics, Cement & Glass	16
Steel	15
Petroleum & Rubber	14
Transportation (excl. Automobiles)	11
Paper, Pulp & Wood	6
Other	52
Total	603

Figure 2: No. of Respondent Companies by Net Sales



Net Sales	No. of Respondent Companies
Less than ¥10 bn.	73
¥10 bn. up to ¥50 bn.	206
¥50 bn. up to ¥100 bn.	100
¥100 bn. up to ¥300 bn.	104
¥300 bn. up to ¥1 trillion	68
¥1 trillion or more	40
No response	12
Total	603

Figure 3: No. of Overseas Affiliates



Note 1: Data for China starts from FY1993. Data for other Asian countries starts from FY1996.

Note 2: Singapore was included in NIEs until FY1998 and in ASEAN from FY1999. EU15 is defined as the EU line from FY2004.

Figure 4: No. of Overseas Production Bases

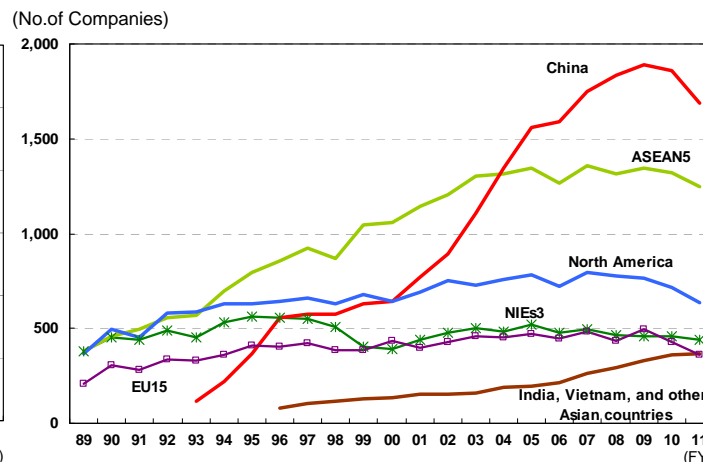


Figure 5: No. of Bases of Companies that Continually Respond (279)

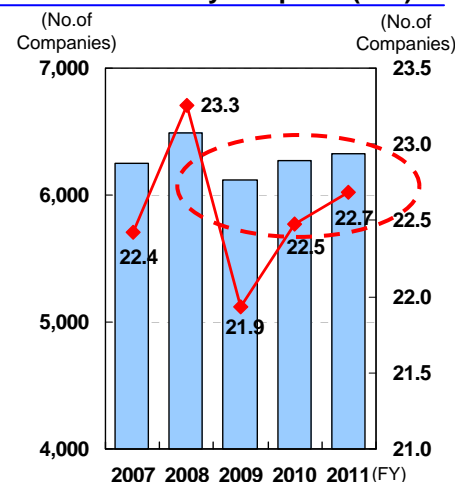


Figure 6: By Function and Region

(n=594) (Unit: No. of companies)

	NIEs3	ASEAN5	China	India, Vietnam, & other Asian countries	North America	Latin America	EU15	Central & Eastern Europe	Other European Countries & CIS Nations	Russia	Oceania	Middle East	Africa	Total
Production	440	1,247	1,691	367	636	214	360	120	22	16	57	20	25	5,215
Sales	622	681	779	165	544	232	921	89	52	39	108	60	31	4,323
R&D	6	38	70	11	71	7	44	2	0	2	3	0	1	255
Other	74	208	122	44	282	67	171	11	6	11	30	11	11	1,048
Total	1,142	2,174	2,662	587	1,533	520	1,496	222	80	68	198	91	68	10,841
(Year-on-year change)	-100	-180	-129	50	-141	-12	-224	-24	-24	-5	-36	4	-23	-844

The Classification of Major Regions

NIEs3 (Korea, Taiwan, Hong Kong)
ASEAN5 (Singapore, Thailand, Indonesia, Malaysia, Philippines)
North America (United States, Canada)
EU15 (United Kingdom, Germany, France, Italy, Netherlands, Belgium, Greece, Luxembourg, Denmark, Spain, Portugal, Austria, Finland, Sweden, Ireland)
Central & Eastern Europe (Poland, Hungary, Czech Republic, Slovak Republic, Bulgaria, Romania, Slovenia, Albania, Croatia, Serbia, Montenegro, Bosnia-Herzegovina, Former Yugoslav Republic of Macedonia)

The Classification of Areas in China

Northeastern China (Heilongjiang, Jilin, Liaoning)
Northern China (Beijing, Tientsin, Hebei, Shandong)
Eastern China (Shanghai, Jiangsu, Anhui, Zhejiang)
Southern China (Fujian, Guangdong, Hainan)
Inland China (Provinces other than those mentioned above and autonomous regions)

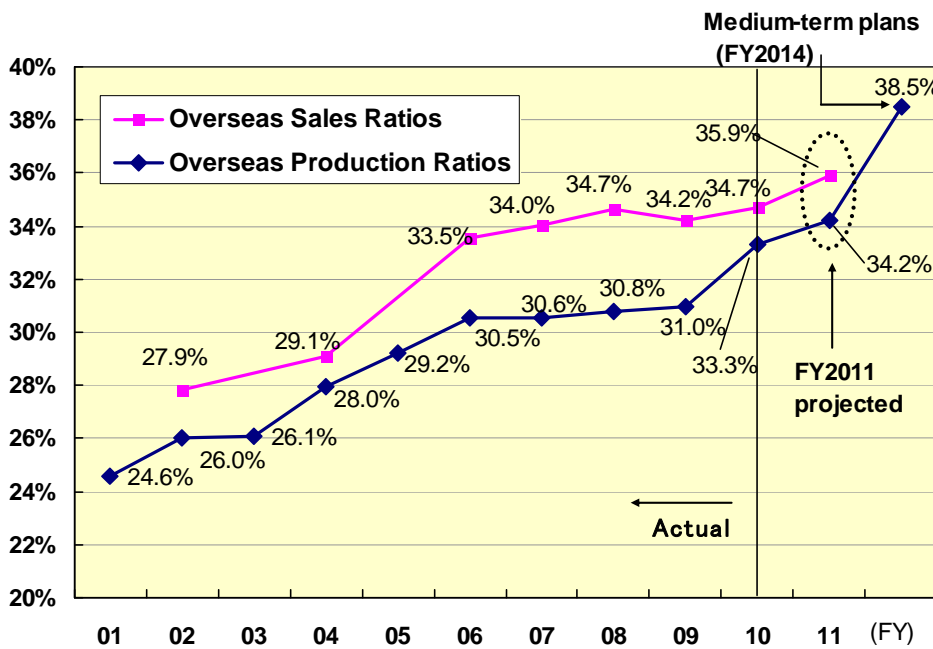
■ With the exception of India and Vietnam, the increase in overseas bases has slowed down

- Figures 3 and 4 show the annual totals of the overseas bases of the companies that responded to the questionnaire. With the exception of India and Vietnam, the number of overseas bases has been on the decline since the survey of two years ago, although part of this trend may have to do with the fact that companies with many overseas bases did not respond.
- If we look at change in the number of bases for the past five years (Figure 5) of companies that have consistently responded to the survey (279 companies), we see that the numbers are returning to levels seen prior to the collapse of Lehman Brothers (i.e. the "Lehman Shock"), but the rate of increase seems to be peaking. This is likely a manifestation of an ongoing shift in Japanese manufacturers from building new bases overseas to bolstering their existing ones (see Figures 36—43).

Note: See Appendix 6 for values by industry.

3. Overseas Production and Sales Ratios

Figure 7: Ratios of Overseas Production*1 and Overseas Sales*2



■ Ratios of overseas production and sales will continue to rise

- At 33.3%, the FY2010 overseas production ratio reached a record high. FY2011 forecasts and medium-term plans alike indicate that companies will continue to increase their overseas production ratio. The average ratio of medium-term plans in particular (now at 38.5%) is quickly approaching the 40% mark.
- The FY2010 ratio of overseas sales rose by 0.5 points over the previous fiscal year, and in the FY2011 projections the ratio is expected to rise even higher.

Figure 8: Ratios of Overseas Production*1 by Major Industry

	FY2008 (Actual)		FY2009 (Actual)		FY2010 (Actual)		FY2011 (Projected)		Medium-term plans (FY2014)	
		No. of respondent companies		No. of respondent companies		No. of respondent companies		No. of respondent companies		No. of respondent companies
Chemicals	22.0%	77	20.1%	73	23.0%	81	23.2%	79	28.5%	71
General Machinery	19.7%	60	22.5%	51	24.6%	50	25.6%	49	30.7%	44
Electrical Equipment & Electronics	43.4%	103	44.3%	97	48.2%	98	49.0%	97	53.7%	91
Automobiles	36.1%	97	32.6%	93	34.8%	89	35.9%	85	39.8%	79
All Industries	30.8%	563	31.0%	525	33.3%	544	34.2%	530	38.5%	495

Figure 9: Ratios of Overseas Sales*2 by Major Industry

	FY2008 (Actual)		FY2009 (Actual)		FY2010 (Actual)		FY2011 (Projected)	
		No. of respondent companies		No. of respondent companies		No. of respondent companies		No. of respondent companies
Chemicals	28.3%	88	28.4%	85	30.1%	92	30.6%	86
General Machinery	39.2%	66	37.0%	56	40.0%	54	41.7%	51
Electrical Equipment & Electronics	45.6%	107	46.2%	102	44.6%	101	46.1%	100
Automobiles	39.0%	104	36.3%	95	35.9%	91	36.2%	86
All Industries	34.7%	609	34.2%	570	34.7%	582	35.9%	556

*1 (Overseas Production) / (Domestic Production + Overseas Production)
 *2 (Overseas Sales) / (Domestic Sales + Overseas Sales)
 *3 Ratios were calculated by simply averaging the values the respondent companies provided.

I. Summary and Key Findings

- ◆ **Facing a meager prospect for growth in the domestic market, Japanese manufacturers, including mid-tier firms and small and medium enterprises (SMEs), are expected to strengthen and expand business operations in overseas markets to take advantage of their growth.**
- ◆ **The overseas business performance of the respondents continues to improve in FY2010, driven primarily by robust business performance in ASEAN countries such as Thailand and Indonesia. In promising countries for overseas business in the medium-term, rising labor costs posed the most important challenge to China, while underdeveloped infrastructure and legal framework/taxation system emerged as specific issues in India. Another trend is that Indonesia and Brazil have attracted more votes as promising this year.**
- ◆ **Whereas about 70% of Japanese manufacturers were affected by the Earthquake in procuring parts, they have overcome this hardship by obtaining replacements from either their own factories or other Japanese companies. The Earthquake also provided an opportunity for Japanese manufacturers to reassess and reconstitute their supply chain network. In the meantime, prolonged or further constraints in power supply may induce some companies to scale down their domestic operations.**
- ◆ **Although Japanese manufacturers have interest in overseas infrastructure development, especially in emerging countries with robust market growth, there are a relatively limited number of companies that have actually entered in this area, even if including delivery of parts and equipment. A major trend going forward is that Japanese manufacturers will remain to engage in sales of parts and equipment in overseas infrastructure development and that there are few moving further to provide operation, management and maintenance services. Further, to move forward overseas infrastructure development, it is essential to identify and meet local needs, find reliable local partners and strengthen cost competitiveness.**

I. 2. Key Findings (Annual Questions)

- **It has become clear that Japanese manufacturers including mid-tier firms and SMEs have an intention to strengthen overseas business.**
 - Partly affected by the Earthquake, the number of Japanese manufacturing companies with an intention to strengthen domestic business has plummeted to the lowest level (25.9%), while there was a record increase (87.2%) in the number of companies willing to strengthen overseas business. That clearly shows that Japanese manufacturers including mid-tier firms and SMEs have a strong intention to expand overseas business with a view to take benefits from growth in overseas markets. Both overseas production ratio and overseas sales ratio have continued to grow and their growth has gained momentum after the collapse of Lehman Brothers (i.e. the “Lehman Shock”). Furthermore, overseas production percentage is forecast to increase further, up to the 40% range, over the coming years (p. 4 and 12).
- **Japanese manufacturers showing their intention to strengthen or expand overseas operations tend to maintain or strengthen domestic operations as well.**
 - Of the companies with an intention to strengthen or expand overseas operations (506 companies), 303 respondents reply that they will maintain domestic operations, while 142 companies state that they even have an intention to strengthen or expand domestic operations. This means that approximately 90% of the companies with an intention to strengthen overseas business will maintain or expand domestic operations. Whereas there exist moves that some companies will strengthen overseas business and reduce domestic operations at the same time, this seems to reflect activities of some medium-sized companies in sales which have sought overseas expansion (p. 12 and 14).
- **The degrees of satisfaction with net sales and profits are higher in Thailand and Indonesia; by industry, steel, petroleum and rubber, and automobiles.**
 - The degrees of satisfaction with net sales and profits in FY 2010 show a brisk recovery from the sharp drop following the “Lehman Shock”. Ranking high on the list are Thailand and Indonesia by country, and steel, petroleum and rubber, and automobiles by industry. Particularly notable is the improvement made by the automobile sector in the Southeast Asian countries. Although the impact of Thailand’s flooding caused by heavy rain this summer is not covered in this survey, we need to closely monitor adverse effects of the disaster on the Japanese manufacturers’ production activities for the coming months, because nearly half of the responding companies have production bases in the country (p. 8 and 11).
- **As promising countries for overseas business over the medium-term, the percentage shares of votes to China and India hit a peak.**
 - Although China and India ranked 1st and 2nd respectively as most promising countries for overseas business over the medium-term, their percentage shares of votes have hit a peak. Regarding China, Japanese manufacturers express raised awareness about increasing labor cost while pointing out legal practices and other issues as challenges for doing business. With regard to India, while many Japanese manufacturers continue to consider the underdeveloped infrastructure as an issue, they are increasingly recognizing specific issues such as unclear execution of legal practices and taxation system as India gathers more interest (p. 8, 10, pp. 16-18).
- **Among promising countries, Indonesia and Brazil are on a roll.**
 - While emerging countries such as Thailand and Indonesia climbed in the list of the promising countries or regions for overseas business over the medium-term, Indonesia and Brazil particularly have gathered more votes from companies with concrete business plans and it is expected that more Japanese companies will actively enter these countries for the coming years. In the meantime, it is also notable that Cambodia moved up to the top 20 ranking group for the first time (p.15 and 24).
- **Merger and acquisition (M&A) activities increased primarily in the emerging economies.**
 - The number of companies engaged in M&A activities doubled to 70 from the previous survey’s 36. Of the increased portion (34 companies), 21 took place in the emerging countries, which was largely attributable to India (increased by 6) and Brazil (increased by 6). By industry, brisk activities were seen in the chemicals (17 companies) and food (16) sector (p. 28).

I. 2. Key Findings (Topics)

- **Japanese manufacturers have responded to disruptions of the supply chain network caused by the Earthquake either by “not changing supply source” or by “procuring from Japanese alternate companies”.**
 - As many as about 70% (422 companies) out of 603 responding companies were affected by the Earthquake in procuring parts and components. Half of them (212 companies) did not change their procurement sources, while a little more than 40% (191 companies) looked to other Japanese companies for alternative procurement sources. However, the companies that relied on foreign alternate sources for procurement, including those that did so only for part of products, remained approximately 20% (95 companies) of the total affected companies (p. 33 and 34).
- **“Reconstituting the supply chain network” is the major risk diversification measure in the wake of the Earthquake.**
 - From the point of risk diversification in the wake of the Earthquake, the responding companies have accelerated a move of “identifying a wider picture of the overall supply chain network” and “multiplying supply sources.” On the other hand, many companies have already done “the development of multiple domestic production bases” and added “the alternate functions of domestic plants to overseas plants.” As a result, it is only a small number of companies that took these measures anew in the wake of the Earthquake. In addition, this survey shows that only part of the companies took such new measures as “maintaining extra stock” or “requesting suppliers to take risk diversification measures” (p. 35).
- **Power supply constraint if getting more serious or prolonged may lead to scaling down domestic operations.**
 - Although about 70% (429 companies) out of 603 responding companies take the power supply constraint as a serious problem, as many as about 70% (434 companies) have kept their business projections unchanged even under the constraint this summer. However, close to 20% (113 companies) respond that they might revise the outlook of business projections and most of them suggest a scale-down in domestic operations in the case that the constraint gets more serious or prolonged (p. 35).
- **While about 30% of the respondents find a business opportunity in overseas infrastructure development, those already entering this area are limited.**
 - Japanese manufacturing companies which find a business opportunity in overseas infrastructure development account for 192 companies out of the responding 603 companies (response rate: 31.8%). However, the companies that have already entered this area still number 126 companies, even if including those simply supplying parts and components. On the other hand, the companies which responded as a business opportunity but not actually entered this area amount to 76 companies, which account for about 40% of the companies which find a business opportunity in this area. By sector, renewable energy and water business attract more interest. By industry, companies primarily in chemicals, electrical equipment and electronics indicate more interest, hoping for increasing demand for component parts (pp. 36-39).
- **Emerging countries with high potentiality of market growth gather more votes as promising in overseas infrastructure development. The United States is also seen as promising in environment-related sectors.**
 - Following China and India, emerging countries such as Vietnam, Indonesia, Thailand and Brazil gather more votes as promising in all sectors because of their high potentiality of market growth. In developed countries, the United States is also seen as promising in the environment-related sectors such as smart grid, smart community and renewable energy (p. 40).
- **Japanese manufacturers are mainly engaged in selling parts and equipments in overseas infrastructure development.**
 - Many companies which have already entered in overseas infrastructure development will remain to engage in simply selling parts and equipments for moving it forward and there are few moves to provide operation, management and maintenance services (pp. 41-43).
- **The agendas for moving forward overseas infrastructure development are: “find reliable local partners,” “identify and meet local needs” and “strengthen cost competitiveness.”**
 - In particular, it is crucial to “find reliable local partners” before they enter this area and to “strengthen cost competitiveness” after that (p. 44 and 45).

II. Performance Evaluations (FY2010 Performance)

II. 1. Evaluations of Degrees of Satisfaction with Profits and Net Sales (by major country and region) p.8

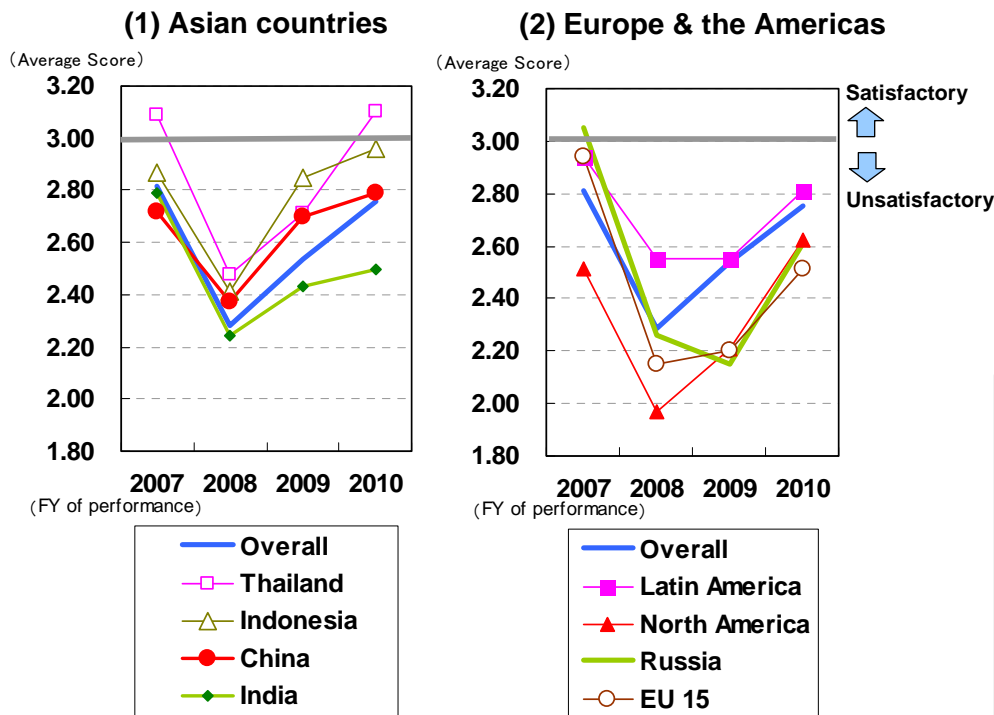
Q. Which of the following applies concerning your company's FY2010 net sales and profits compared with initial targets in the countries/regions overseas you invested in?
 ⇒ 1: Unsatisfactory 2: Somewhat unsatisfactory 3: Can't say either way
 4: Somewhat satisfactory 5: Satisfactory

Figure 10: Satisfaction with Net Sales/Profits (all-industry averages)

(FY of performance)	FY2008	FY2009	FY2010
Net Sales	2.34 (-0.59)	2.55 (+0.21)	2.85 (+0.30)
Profits	2.28 (-0.53)	2.54 (+0.26)	2.75 (+0.21)

Note1: These figures are simple averages of assessments by country and region.
 Note2: Numbers in parentheses indicate the increase/decrease over the previous year's.

Figure 11: Satisfaction with Profits (By region)



Note: See Appendix 7 for more detailed data collated by country/region.

Figure 12: Distribution in Responses about Satisfaction with Profits (FY2010 performance)

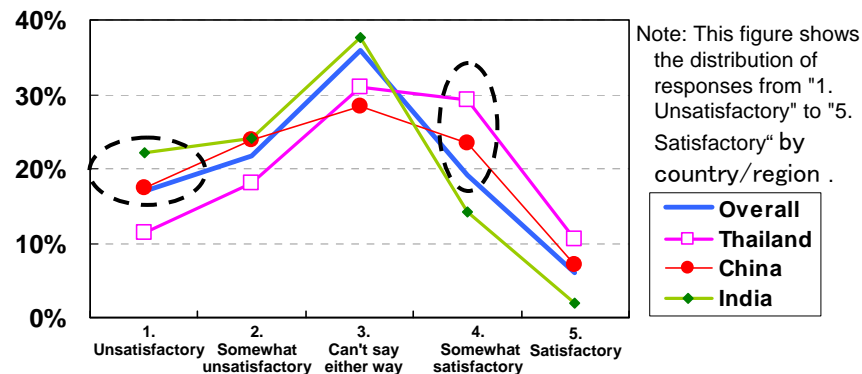


Figure 13: Countries/Regions More Profitable than Japan (Descending order by ratio)

Country/Region	(Companies)		
	"More Profitable than Japan" responses (1)	Total responses (2)	Ratio: [(1)/(2)]
1. Thailand	119	314	37.9%
2. China	162	475	34.1%
3. Indonesia	54	201	26.9%
4. NIEs 3	48	223	21.5%
5. Malaysia	39	193	20.2%
Total	654	2,957	22.1%

Note 1: When companies were asked to evaluate performance in countries/regions in which they had businesses, they were asked to point out those which had higher rates of profitability than Japan.

Note 2: "Total responses(2)" is the sum of the number of companies that responded to inquiries about satisfaction with profits and those that responded only to the comparison of profitability with Japan.

■ Albeit slowly, sales and profitability are improving for overseas businesses

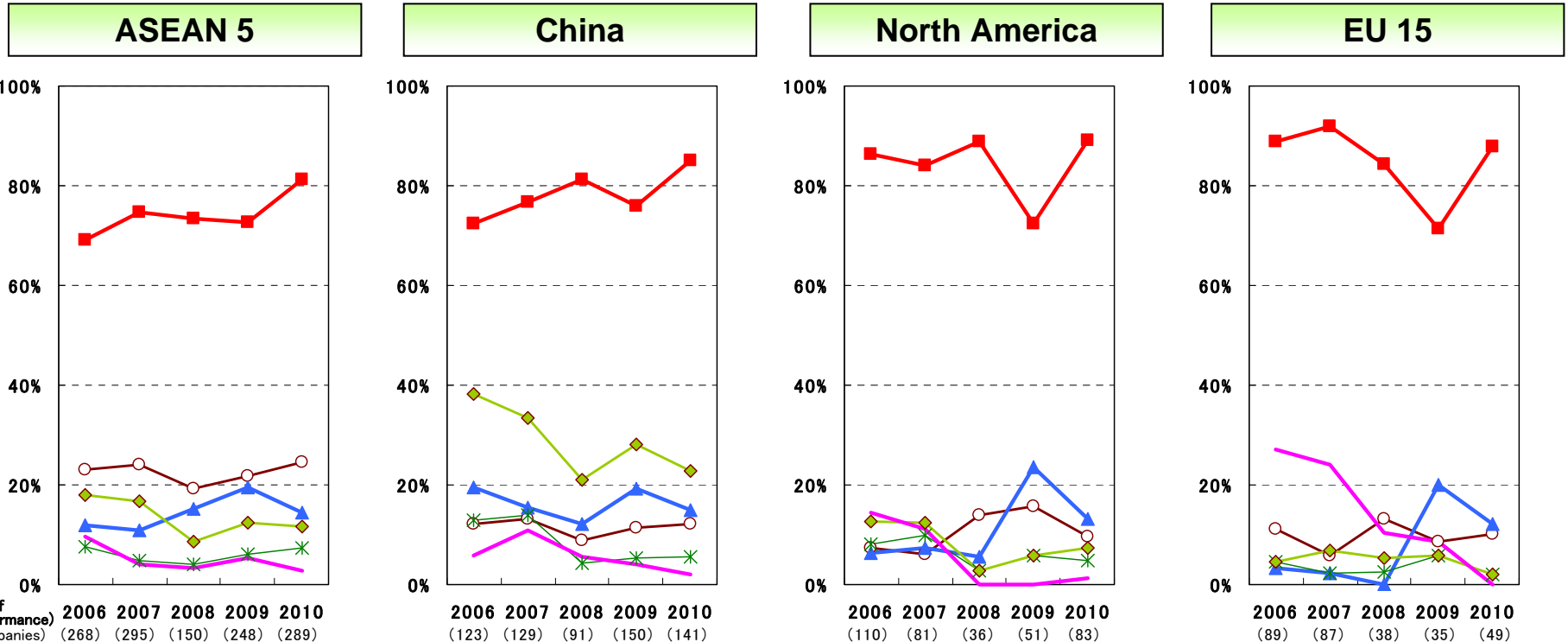
• Satisfaction figures for FY2010 performance have steadily improved since the lows after the "Lehman Shock". Specifically, satisfaction over net sales is at 2.85 (a 0.21 point year-on-year increase), and satisfaction over profitability has grown to 2.75 (a 0.21 point year-on-year increase). That said, levels have not reached "3", which was initially targeted (see Figures 10 and 11).

■ Satisfaction levels rise for ASEAN and NIEs, but companies are facing hurdles in India

• ASEAN5 and NIEs3 nations have received high marks in terms of both sales and profits. Thailand fared particularly well, with roughly 40% of companies giving responses of either "4. Somewhat satisfactory" or "5. Satisfactory" concerning profitability. The same rates of response for India, on the other hand, did not even reach the 20% level (16.2%). Despite the high expectations for the local market, the effects of fiercer competition and other factors are thought to be behind the difficulty in meeting initial targets for India (see Figures 11 & 12 and Appendix 7).

II. 2. Reasons for Satisfaction with Profitability (by major country and region)

Figure 14: Reasons for Satisfaction with Profitability over Time (Multiple response)



Note: Companies who responded with “4. Somewhat satisfactory” and “5. Satisfactory” regarding profitability were asked for the reasons for those responses on a region/country basis. The percentages represent the ratios of each choice to the total number of responses (shown in parentheses under the fiscal year of performance) for reasons given for the relevant region/country. Multiple responses were possible.

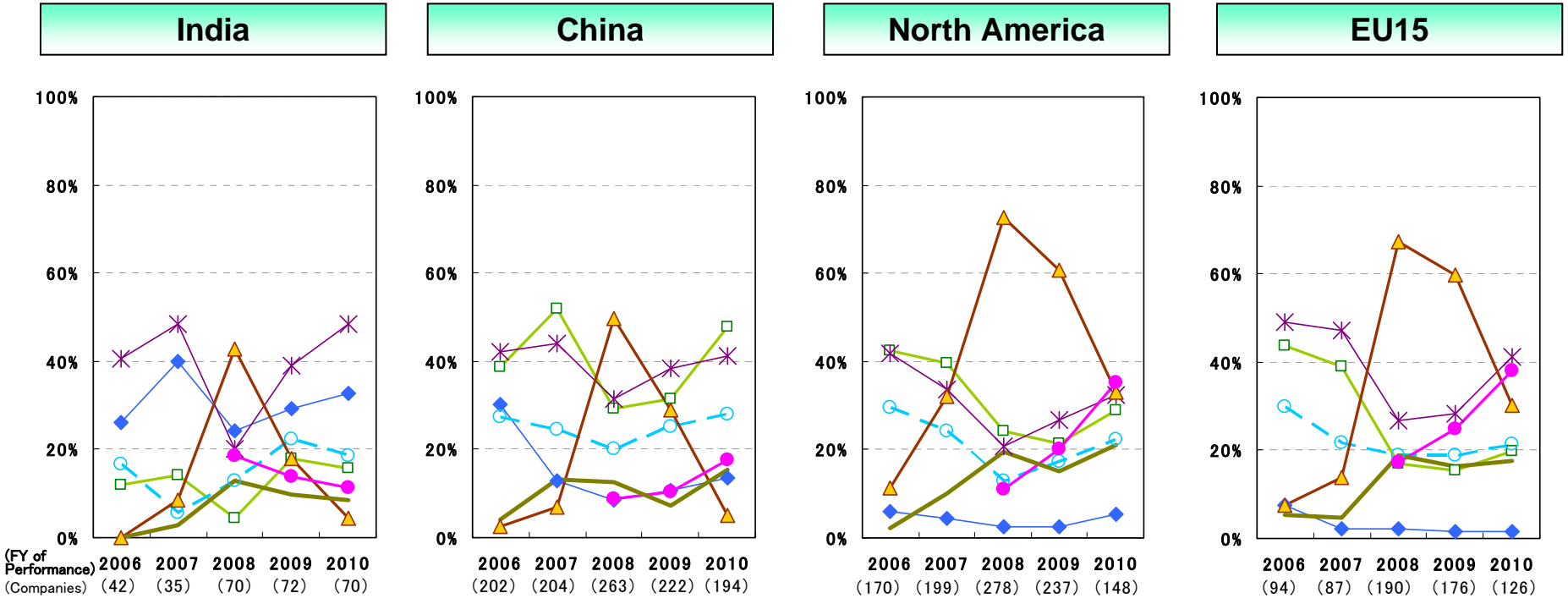
- 1. Good performance of sales in the country/region
- 2. Good performance of exports in the country/region
- ▲ 3. Successful cost cuts (personnel, materials, etc.)
- ✱ 4. Cost cuts via consolidation of manufacturing
- ◆ 5. Manufacturing facilities brought fully on line
- 6. Foreign exchange gains

Overall, sales in local markets are performing better

- The ratio of companies that listed “1. Good performance of sales” as a reason for satisfaction in ASEAN5 was 81.3%, with particularly good performance reported in Indonesia, Malaysia, and Thailand (85.7%, 85.3, and 83.9%, respectively). Another characteristic of ASEAN5 is that “2. Good performance of exports” is the second most frequently cited reason for satisfaction, which indicates that the region is being for centers of supply within and outside ASEAN.
- The ratio of “5. Manufacturing facilities brought fully on line” responses for China is decreasing year by year, suggesting that production activities in China have gotten off the ground for more and more companies. (Note that no companies listed “5” for India.)
- The ratio of “3. Successful cost cuts” responses has declined for North American and EU15, while “1. Good performance of sales” responses have seen an upturn, which suggests that companies in these regions are successfully improving their profitability through their business activities, not cost cuts.

II. 3. Reasons for Dissatisfaction with Profitability (by major country and region)

Figure 15: Reasons for Dissatisfaction with Profitability over Time (Multiple response)



Note 1: Companies who responded with "1. Unsatisfactory" and "2. Somewhat unsatisfactory" regarding profitability were asked for the reasons for those responses on a region/country basis. The percentages represent the ratios of each choice to the total number of responses (shown in parentheses under the fiscal year of performance) for reasons given for the relevant region/country. Multiple responses were possible.
 Note 2: "6. Decreased competitiveness of products due to a strong Yen" was added as a choice beginning with the FY2009 Survey (covering FY2008 performance).

- 1. Difficulty in cutting costs (personnel, materials, etc.)
- 2. Not brought fully on line right after establishment
- 3. Demand for discounts from customers
- 4. Difficulty in getting customers (intense competition)
- 5. Shrinking market due to economic fluctuations
- 6. Decreased competitiveness of products due to a strong Yen
- 7. Foreign exchange losses (including effects of Yen rates in consolidated accounting)

China and India: Although there are strong Expectations for local markets, competition is getting even fiercer

- In China, the ratio of companies citing "1. Difficulty in cutting costs" reached 47.9% (16.4 point increase year on year), which is the No.1 reason for dissatisfaction. It is followed by "4. Difficulty in getting customers" as the 2nd reason and "3. Demand for discounts from customers" as the 3rd reason. These top 3 reasons indicate that the competition in the local market is getting fiercer.
- In India, many companies cite "2. Not brought fully on line right after establishment" as a reason for dissatisfaction with profitability, which is characteristic of emerging economies. As well as in China, the ratio of companies citing "4. Difficulty in getting customers" increases.

North America and EU15: The strong Yen is quickly rising as a reason for being dissatisfied

- As the ratio of companies citing "5. Shrinking market due to economic fluctuations" decreases, those citing "6. Decreased competitiveness of products due to a strong Yen" are rapidly increasing.

II. 4. Evaluations of Degrees of Satisfaction with Net Sales and Profits (by industry)

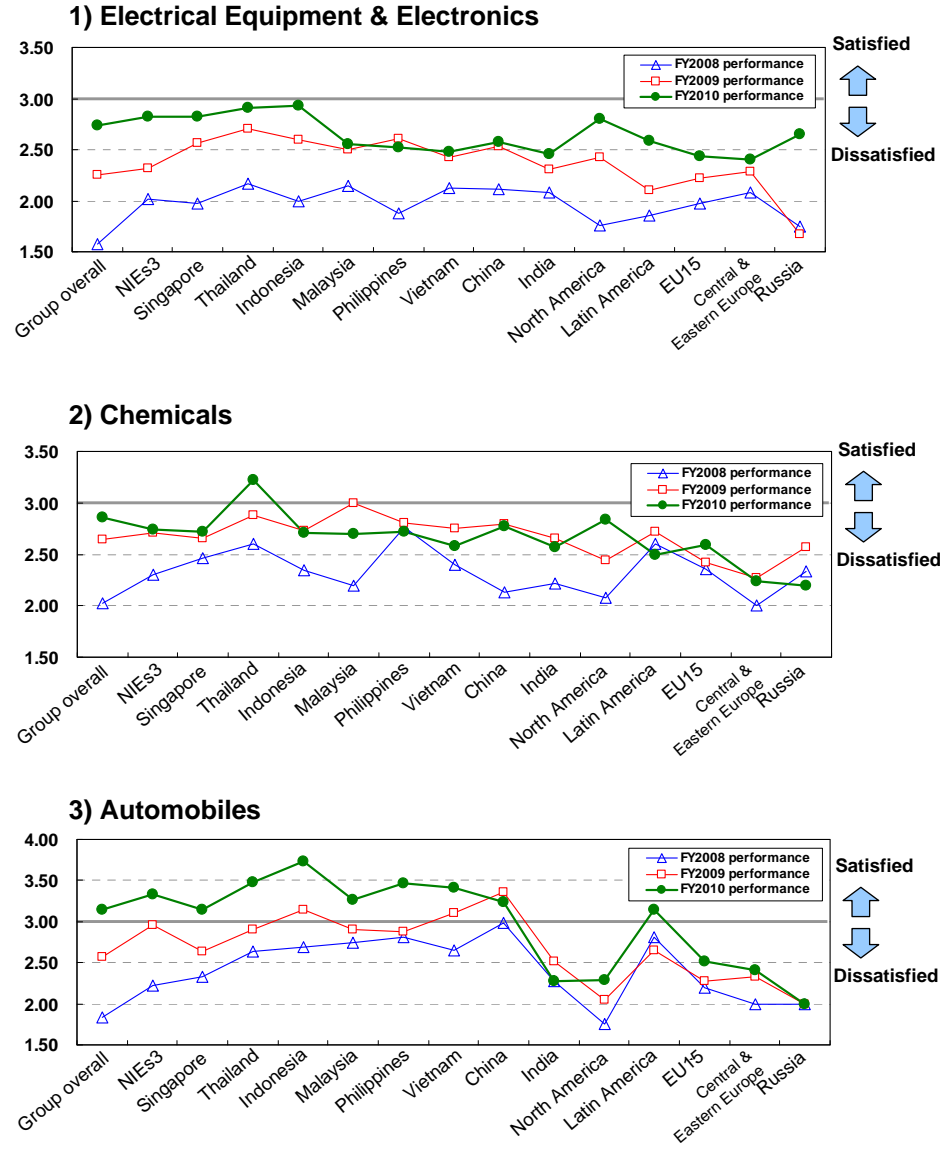
Figure 16: Evaluating Satisfaction of Net Sales & Profits (FY2010)

	Average by industry		Comparison with last FY		No. of respondent companies	Countries/regions with highest average in profits
	Net sales	Profits	Net sales	Profits		
1. Steel	3.19	3.25	+0.34	+0.62	9	EU15 (4.00)
2. Petroleum & Rubber	3.26	3.13	+0.08	-0.03	14	Russia (3.75)
3. Automobiles	3.16	3.02	+0.38	+0.31	85	Indonesia (3.73)
4. Transportation (excl. Automobiles)	3.09	2.96	+0.11	+0.28	10	China (3.29)
5. Nonferrous Metals	2.98	2.91	+0.49	+0.34	18	Latin America (3.50)
6. Ceramics, Cement & Glass	2.92	2.90	+0.29	+0.25	13	Thailand (3.50)
7. Metal Products	2.88	2.82	+0.66	+0.50	18	Vietnam (3.33)
8. Other	2.86	2.78	+0.33	+0.19	46	Singapore (3.22)
9. Chemicals	2.83	2.74	+0.20	+0.07	87	Thailand (3.22)
10. Electrical Equipment & Electronics	2.71	2.68	+0.31	+0.28	91	Indonesia (2.93)
11. Textiles	2.63	2.62	+0.18	+0.10	27	Latin America (3.25)
12. Paper, Pulp & Wood	2.96	2.61	+0.64	+0.51	6	Thailand (3.50)
13. Foods	2.60	2.52	+0.10	+0.02	29	Singapore (3.00)
14. General Machinery	2.52	2.52	+0.30	+0.27	48	Singapore (3.05)
15. Precision Machinery	2.74	2.52	+0.58	+0.37	33	India (2.83)

Note: The industries in the table above are ordered according to average values for Profits from highest to lowest.

- More industries exceeded their initial targets of "3"**
 - In terms of assessments of FY2009 performance, only "Petroleum & Rubber" products exceeded "3", which means the equal level of the initial targets, but for performances in FY2010, satisfaction levels in the industries of steel, transportation, and automobiles improved (Figure 16).
 - It is noted that even in industries whose evaluation averages failed to reach "3", there were some countries/regions where profit margins were assessed higher than those in Japan (Appendix 7).
- The automobile industry got high marks in ASEAN5, particularly in Thailand and Indonesia**
 - Upon inquiring about the levels of satisfaction over profitability in the three main industries for which there were the most responses (Figure 17), it was found that there was a relatively higher degree of satisfaction in the ASEAN5 region, particularly in Thailand and Indonesia. Assessments were especially high in the automobile industry, where both countries demonstrated strong local market and solid business performance. In contrast, levels of satisfaction in India remain low.

Figure 17: Satisfaction with Profits by Country/Region (three key industries)

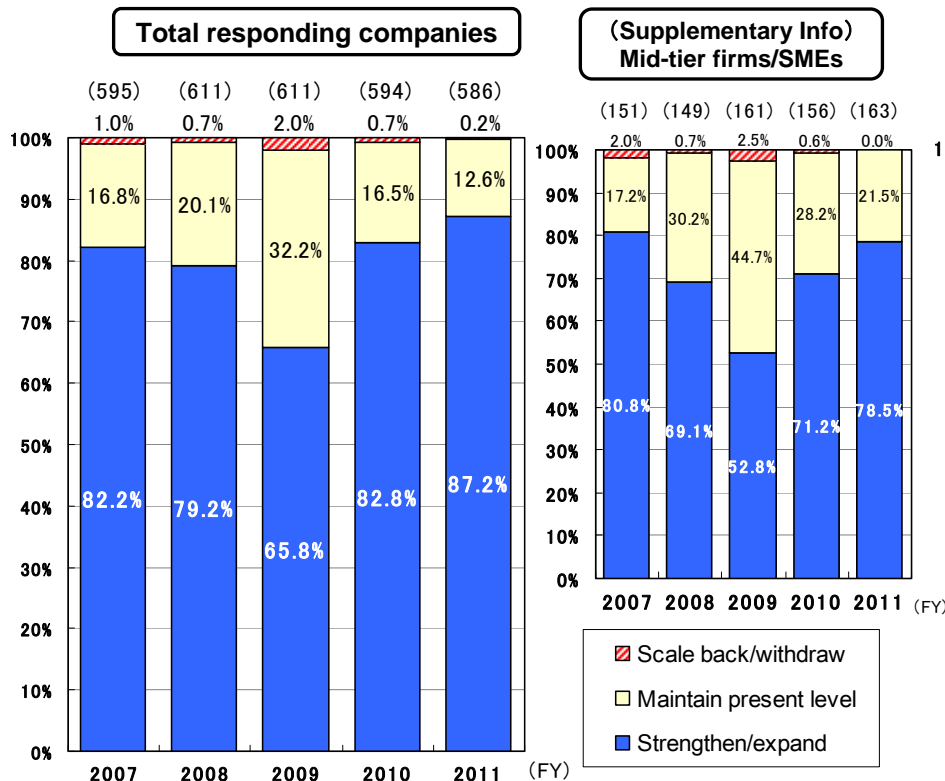


III. Business Prospects

Q. Question concerning medium-term (next 3 yrs. or so) overall prospects for overseas and domestic operations.

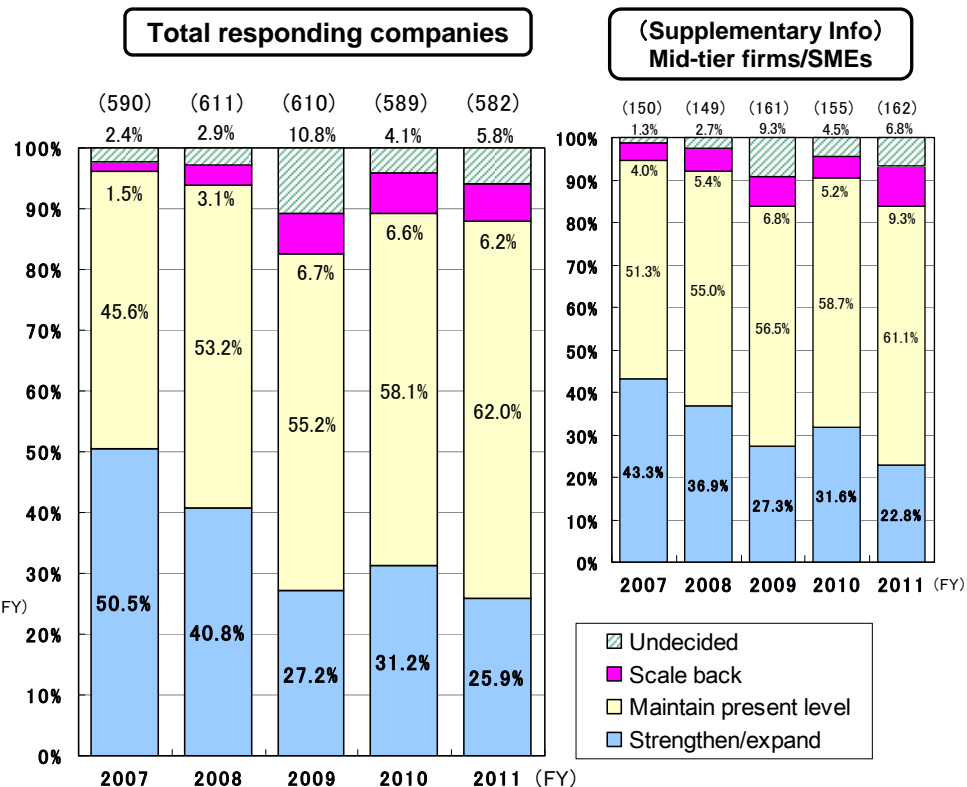
Overseas

Figure 18: Medium-term Prospects (next 3 yrs. or so) for Overseas Operations



Domestic

Figure 19: Medium-term Prospects (next 3 yrs. or so) for Domestic Operations



Note1: "Overseas operations" is defined as production, sales, and R&D activities at overseas bases, as well as the outsourcing of manufacturing and procurement overseas.

Note2: The numbers in the parentheses above the bar graphs indicate the numbers of responding companies to the question.

Note3: Mid-tier firms/SMEs are companies whose paid-in capital is less than 1 billion Japanese Yen.

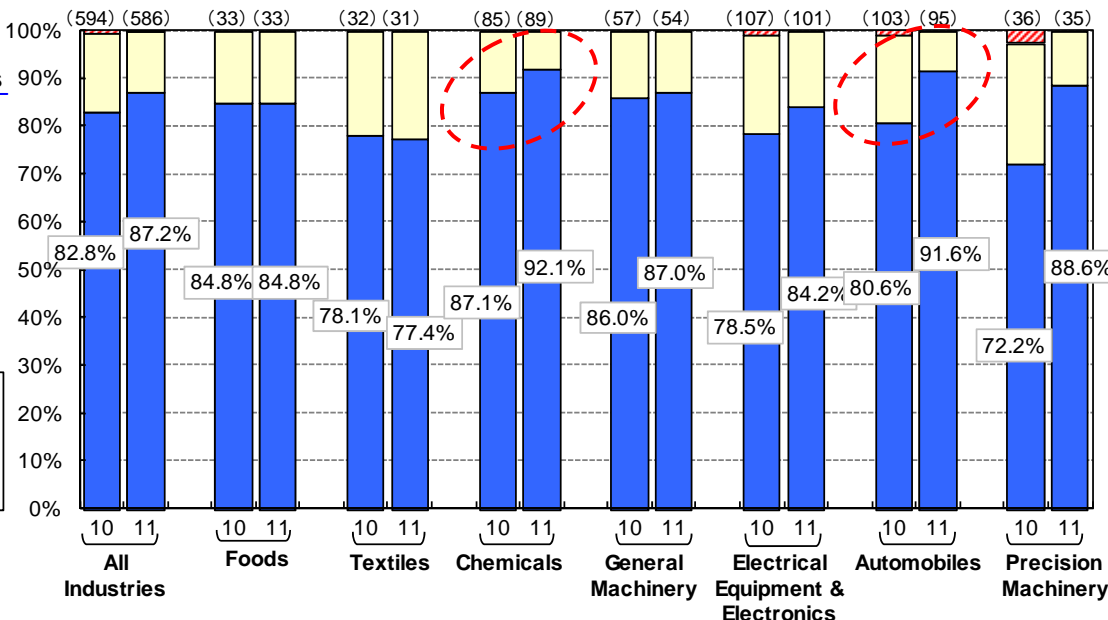
Large corporations and Mid-tier firms/SMEs alike are clearly bolstering their overseas businesses as a means to grow

- The number of companies that responded that they will "strengthen/expand" their overseas businesses was 511 companies, which was 87.2% of the total (a 4.4 point increase from the previous fiscal year), which was the highest ratio recorded since this survey began. The figures for Mid-tier firms/SMEs for the same were also very high at 78.5%, which is comparable to the record high of FY2007 (80.8%).
- As for domestic operations, companies see a meager prospect for growth in the domestic market, and in part due to the effects of the Great East Japan Earthquake, 361 companies, or 62.0%, responded that they would "maintain present levels", while 151 companies (25.9%) said they would "strengthen or expand" domestically, which is the lowest figure ever seen in this survey, a clear indication of overall intent to "maintain current levels". The ratio of SMEs saying they would "strengthen or expand" dropped even lower at 22.8%.
- Overall, large corporations and mid-tier firms/SMEs alike, not seeing prospects for domestic growth, are clearly seeking to reinforce their overseas business operations as a means for growth.

Figure 20:
Medium-term Prospects for Overseas Operations

Overseas

- Scale back/withdraw
- Maintain present level
- Strengthen/expand



Overseas: Companies in nearly all industries intend to “strengthen or expand” their operations

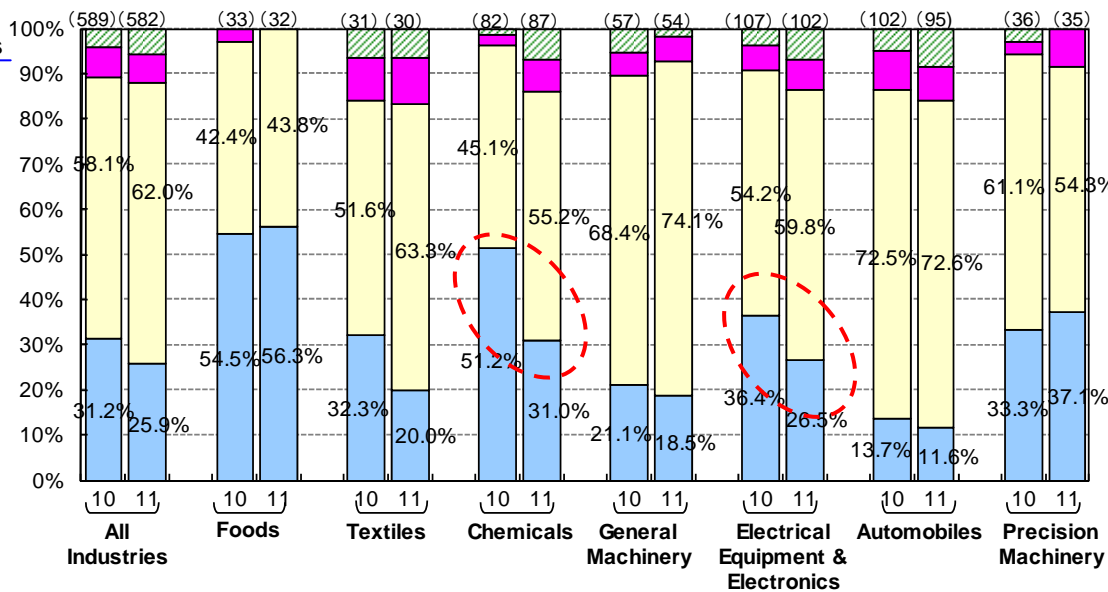
- Although eight fewer companies answered this question this time, 19 more companies responded that they would “strengthen or expand” operations.
- Particularly high ratios for “strengthen or expand” responses were seen in the chemical and automobile industries, both of which exceeded 90%. At the same time, it was “precision machinery” that saw the highest growth in such responses, passing the 80% mark (a 16.4 point year-on-year increase) for the first time in five years.

Note 1: “Overseas operations” is defined as production, sales, and R&D activities at overseas bases, as well as the outsourcing of manufacturing and procurement overseas.
 Note 2: Numbers in parentheses above the bar graph indicate the number of companies that answered the question.

Figure 21:
Medium-term Prospects for Domestic Operations

Domestic

- Undecided
- Scale back
- Maintain present level
- Strengthen/expand



The number of companies seeking to strengthen/expand declines while those looking to maintain current operations grow

- Compared with last year, the number of companies seeking to “strengthen or expand” decreased by 33 (a 5.3 point drop), while there were 19 more companies (a 4.0 point gain) in companies looking to “maintain present levels”, which shows that more companies have adopted a “wait and see” approach to domestic businesses. The number of “maintain present level” responses has consistently risen since the FY2007 survey.
- The ratio of “strengthen or expand” responses has decreased particularly sharply in the industries of Chemicals and Electrical Equipment & Electronics. The Great East Japan Earthquake severely damaged these two industries, and the effects are thought to be reflected in the responses.

Figure 22: Cross tabulation of overseas and domestic business prospects

Medium-term business prospects			Overseas production ratios					
Overseas businesses	Domestic businesses	No. of respondent companies	FY2010 actual		FY2011 projections		Medium-term plans (FY2014)	
			No. of respondent companies	%	No. of respondent companies	%	No. of respondent companies	%
Strengthen/expand (506 companies)	Strengthen/expand	142	27.2%	126	27.4%	124	31.1%	112
	Maintain present level	303	38.2%	283	34.7%	276	39.3%	262
	Scale back	33	42.0%	33	44.7%	32	53.4%	32
	Undecided	28	34.6%	26	35.0%	26	38.3%	21
Maintain present level (73 companies)	Strengthen/expand	8	25.0%	8	25.0%	8	26.3%	8
	Maintain present level	57	45.0%	47	44.5%	44	45.9%	43
	Scale back	3	51.7%	3	51.7%	3	51.7%	3
	Undecided	5	20.0%	4	20.0%	4	20.0%	4
Scale back/withdraw (1 company)	Strengthen/expand	1	15.0%	1	5.0%	1	-	0
	Maintain present level	0	-	0	-	0	-	0
	Scale back	0	-	0	-	0	-	0
	Undecided	0	-	0	-	0	-	0
Total		580		531		518		485

Note: This figure is a cross tabulation of 580 companies which answered both questions of the prospects for overseas operations (Figure 18) and the prospects for domestic operations (Figure 19).

■ About 90% of respondent companies reply that they will either strengthen or maintain domestic operations while they will either strengthen or maintain overseas operations

• The companies that would “strengthen or expand” levels of domestic operations while “strengthening or expanding” their overseas operations amounted to 142 companies. Those that would “maintain” levels of domestic operations with the intention of strengthening the overseas operations amounted to 303 companies, over half of total companies with the intention of strengthening “overseas operations”(506). In addition, of the companies that responded to “maintain” levels of overseas operations, 57 companies would “maintain” domestic operations, while eight would “strengthen or expand” their domestic operations. Combining four categories mentioned above, the total number of companies comes to 510. About 90% of the respondent companies (580) will either maintain or expand their domestic operations while either maintaining or strengthening their overseas operations.

■ Most companies indicating to “scale back” domestically are strongly overseas-oriented

• Meanwhile, there were 33 companies that indicated to “scale back” their domestic operations while they would “strengthen or expand” their overseas operations. As is clear from Figure 23, most of these (22 companies) are companies with less than ¥50 billion in sales and the distribution of these companies is fairly even across industries. It seems that these companies are traditionally very “overseas-oriented” and therefore have high ratios of overseas production. It is also assumed that the choices to scale back domestically are presumably management decisions made on a company-by-company basis.

Figure 23: Characteristics of companies scaling back

(1) Volume of net sales

	No. of companies choosing to scale back (A)	No. of respondent companies (B)	(A)/(B)
¥ 1 trillion or more	2	40	5.0%
¥300 bn. up to ¥1 trillion	2	68	2.9%
¥100 bn. up to ¥300 bn.	3	104	2.9%
¥50 bn. up to ¥100 bn.	4	100	4.0%
¥10 bn. up to ¥50 bn.	13	206	6.3%
Less than ¥10 bn.	9	73	12.3%
No Answer	—	12	—
Total	33	603	5.5%

(2) Volume of paid-in capital

	No. of companies choosing to scale back (A)	No. of respondent companies (B)	(A)/(B)
Large Corporations	20	437	4.6%
Mid-tier Corporations and SMEs	13	166	7.8%
Total	33	603	5.5%

(3) Industry

	No. of companies choosing to scale back (A)	No. of respondent companies (B)	(A)/(B)
Electrical Equipment & Electronics	6	103	5.8%
Automobiles	7	97	7.2%
Chemicals	6	96	6.3%
General Machinery	3	54	5.6%
Precision Machinery	2	36	5.6%
Other	5	52	9.6%
Petroleum & Rubber	1	14	7.1%
Textile	3	31	9.7%
Other than above mentioned industries	—	120	—
Total	33	603	5.5%

IV. Promising Countries/Regions over the Medium-Term

IV. 1. Promising Countries/Regions: Rankings

Figure 24: Promising Countries/Regions for Overseas Business over the Medium-term (next 3 yrs. or so)
(Multiple response)

(⇒See Appendix 1 for pre-FY2010 results and for Promising Countries/Regions for Mid-tier firms/SMEs over the Medium-term)

Q.

The respondents were each asked to name the top 5 countries that they consider to have promising prospects for business operations over the medium-term (the next three years or so).

$$\text{Percentage share} = \frac{\text{No. of responses citing country/region}}{\text{Total No. of respondent companies}}$$

Ranking			Country/Region (Total)	No. of Companies		Percentage Share	
2011	← 2010			2011	2010	2011	2010
1	—	1	China	369	399	72.8	77.3
2	—	2	India	297	312	58.6	60.5
3	↑	4	Thailand	165	135	32.5	26.2
4	↓	3	Vietnam	159	166	31.4	32.2
5	—	5	Brazil	145	127	28.6	24.6
5	↑	6	Indonesia	145	107	28.6	20.7
7	—	7	Russia	63	75	12.4	14.5
8	—	8	USA	50	58	9.9	11.2
9	↑	10	Malaysia	39	29	7.7	5.6
10	—	10	Taiwan	35	29	6.9	5.6
11	↓	9	Korea	31	30	6.1	5.8
12	—	12	Mexico	29	25	5.7	4.8
13	—	13	Singapore	25	21	4.9	4.1
14	—	14	Philippines	15	14	3.0	2.7
15	—	15	Turkey	12	8	2.4	1.6
16	↓	15	Australia	8	8	1.6	1.6
16	↓	15	Bangladesh	8	8	1.6	1.6
16	↑	24	Cambodia	8	4	1.6	0.8
19	↑	20	Myanmar	7	5	1.4	1.0
20	↓	19	Great Britain	6	6	1.2	1.2

■ Both No. of respondent companies and the percentage shares of China and India declines.

• The top two spots (China followed by India) remained the same. Although the number of respondent companies and the percentage shares of China and India declined a little, the trend that about 70% of respondent companies chose China as promising and about 60% of those chose India as promising remains the same.

■ Respondent Companies are clearly more interested in emerging countries: Emerging countries in the top 20 such as Indonesia, Thailand and Brazil gain more percentage share.

• Seeing the change of the percentage share year-to-year, Indonesia, Thailand and Brazil got higher percentage share with a 38-companies increase, a 18-companies increase, a 18-companies increase respectively. In addition, Asian emerging countries in the top 20 (excl, China, India and Vietnam), Mexico and Turkey generally gain more percentage share although some drop its ranking. In contrast, USA (incl, North America) and EU (incl, Europe) decrease the number of respondent companies and lose the percentage share as well. It is clearly said that the more interest of the respondent companies leads to the emerging countries where the domestic market is expected to expand.

■ Cambodia is ranked in the top 20 countries.

• Following the rise of Bangladesh and Myanmar to the top 20 in last year's survey, Cambodia rose to the 16th spot in this survey. The main reason of respondent companies which chose these three countries as promising are "inexpensive source of labor". Bangladesh with ca. 150 million population is chosen as promising because of "Future growth potential of local market".

Note 1: In addition to the countries listed above, the following regions also gained responses: EU/Europe (14 companies, 2.8% of the total); North America (13 companies, 2.6%); Eastern Europe (6 companies, 1.2%); Middle East (9 companies, 1.8%).

Note 2: Countries/regions are listed in alphabetical order in cases where they ranked the same.

Figure 25: Promising Countries/Regions for Overseas Business over the Medium-term (next 3 yrs. or so): Percentage Shares

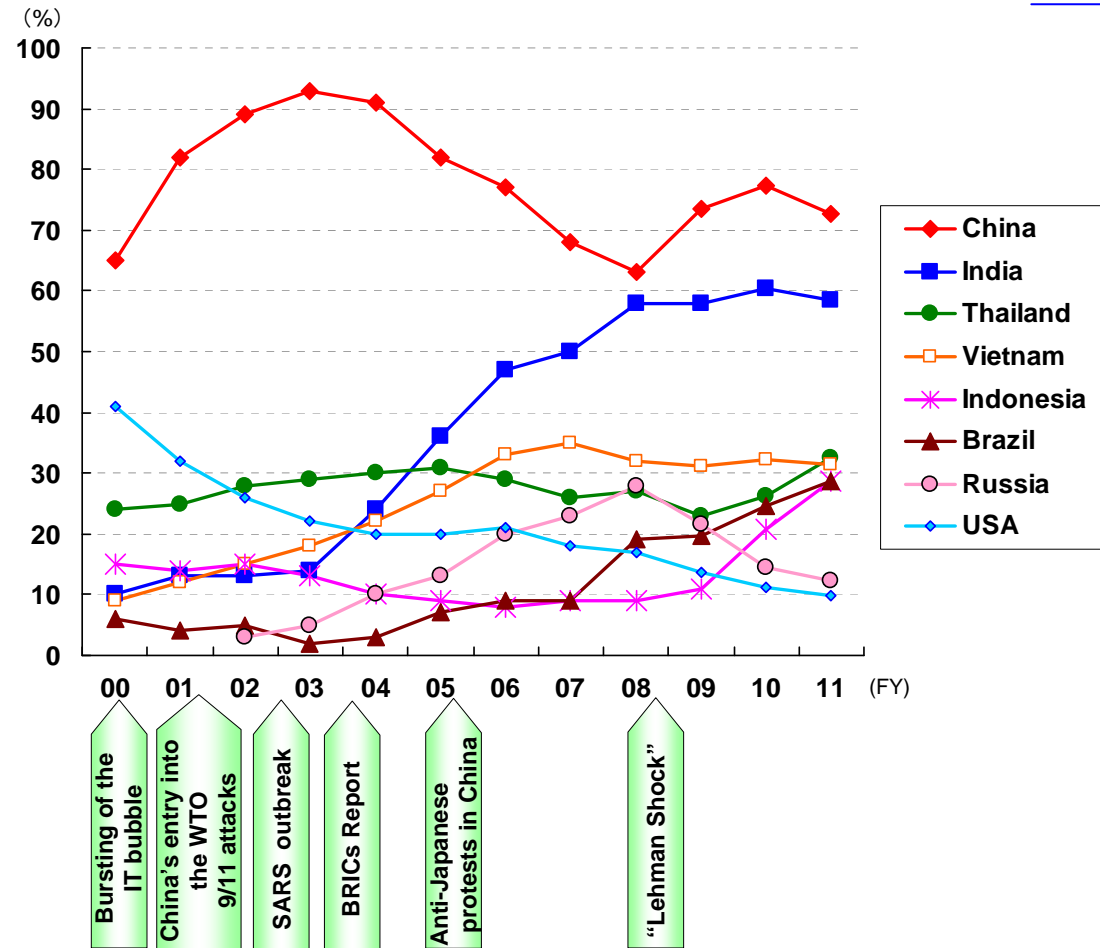


Figure 26: Promising Countries/Regions for Overseas Business over the Medium-term (by major industry)

Chemicals (No. of companies : 80)			Automobiles (No. of companies: 82)		
Rank	Country	No. of companies	Rank	Country	No. of companies
1	China	63	1	China	61
2	India	46	2	India	56
3	Thailand	26	3	Indonesia	38
4	Brazil	25	4	Thailand	35
5	Vietnam	23	5	Brazil	32
6	Indonesia	17	6	Mexico	17
7	USA	12	7	Vietnam	16
7	Malaysia	12	8	Russia	8
9	Korea	8	9	USA	4
9	Singapore	8	9	Malaysia	4

Electrical Equipment & Electronics (No. of companies: 86)			General Machinery (No. of companies: 48)		
Rank	Country	No. of companies	Rank	Country	No. of companies
1	China	61	1	China	30
2	India	54	2	India	28
3	Thailand	27	3	Brazil	17
3	Vietnam	27	4	Thailand	15
3	Brazil	27	5	Vietnam	14
6	Indonesia	16	6	Indonesia	13
7	Russia	9	7	Russia	8
8	Taiwan	6	8	USA	5
8	Philippines	6	9	Taiwan	4
10	Korea	5	10	Malaysia	3
			10	Turkey	3

Figure 27: Promising Countries/Regions over the Long-term (next 10 or so years)

Rank	Country/Region	No. of companies 420	Share
1	India	333	79.3%
2	China	299	71.2%
3	Brazil	196	46.7%
4	Indonesia	147	35.0%
5	Vietnam	146	34.8%
6	Thailand	114	27.1%
7	Russia	95	22.6%
8	USA	36	8.6%
9	Mexico	25	6.0%
10	Malaysia	21	5.0%

- In terms of the percentage share of votes for promising countries over the medium-term, China has lost its share to 72.8% with a 4.5-point decrease since last year survey although it maintained the top position (Figure 25). Although India rapidly gained its percentage share since FY 2003, its percentage share has leveled off around about 60% since FY 2008.
- Even in the main industries (chemicals, automobiles, electrical equipment and electronics, and general machinery), China and India are at the top as promising countries over the medium-term. In automobiles, China takes over 1st spot from India and India is down to 2nd spot in this survey (Figure 26).
- Although India and China maintained the 1st and 2nd positions, respectively as promising countries over the long-term, the number of companies citing Brazil (from 151 to 196 companies; a 45-companies increase) and Indonesia (from 93 to 147 companies; a 54-companies increase) as promising grew rapidly (Figure 27).

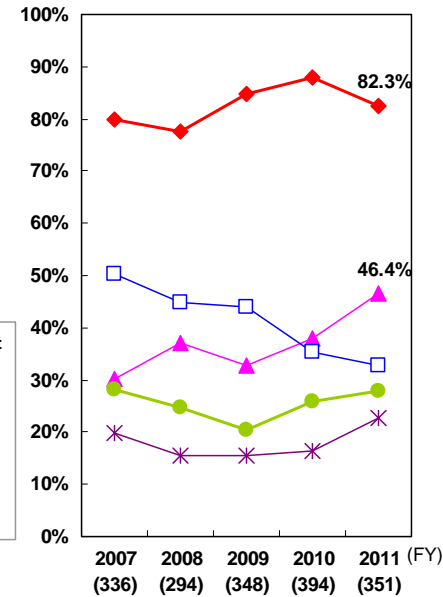
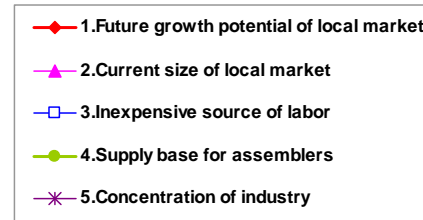
※See Appendix 2 & 3 for details of reasons/issues cited for the top 10 countries being viewed as promising

No. 1: China

Reasons

(Total No. of respondent companies: 351) (Note 1)

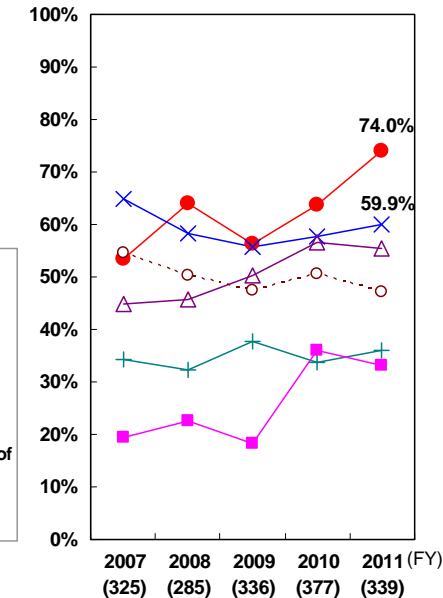
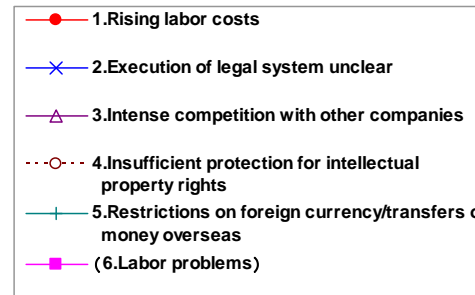
	No. of companies	Ratio (Note 2)
1 Future growth potential of local market	289	82.3%
2 Current size of local market	163	46.4%
3 Inexpensive source of labor	115	32.8%
4 Supply base for assemblers	98	27.9%
5 Concentration of industry	80	22.8%



Issues

(Total No. of respondent companies: 339)

	No. of companies	Ratio
1 Rising labor costs	251	74.0%
2 Execution of legal system unclear (frequent changes)	203	59.9%
3 Intense competition with other companies	188	55.5%
4 Insufficient protection for intellectual property rights	160	47.2%
5 Restrictions on foreign currency/transfers of money overseas	122	36.0%




■ The top four reasons given for being promising have not changed, but “concentration of industry” rose to the 5th position.
 ■ Because wages are rising in China, the ratio of companies listing “inexpensive source of labor” as a promising feature drops year by year, while the ratio of companies citing the No. 1 issue of “rising labor costs” continues to rise yearly.
 ■ The 2nd most frequently cited issue, namely “execution of legal system unclear”, has been increasing in ratio since FY2010. In interviews, companies cited frequent changes made to the legal system as well as differences in the way regulations are interpreted/implemented between the central government and local governments.

Note 1: The “No. of companies” here refers to the number of companies that responded to questions concerning “reasons for being a promising country” and “issues” out of the number of companies that listed that country/region in Figure 24. For this reason, the numbers of companies here may not be the same as in Figure 24.

Note 2: “Ratio” refers to the number of companies that cited “reasons for being a promising country” or “issues” divided by the total number of respondent companies.

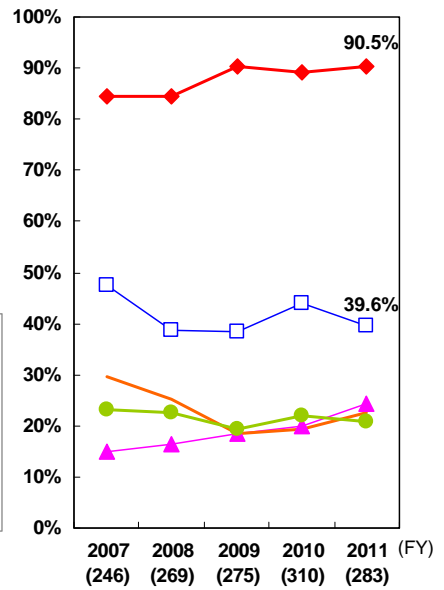
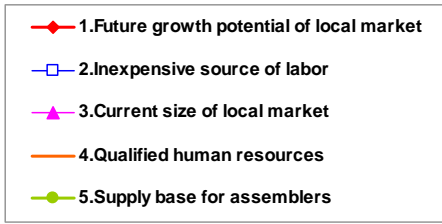
Multiple responses were possible to this question.

 **No. 2: India**

Reasons

(Total No. of respondent companies: 283)

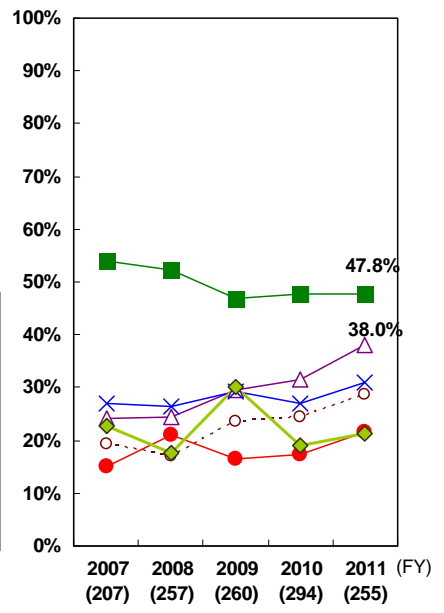
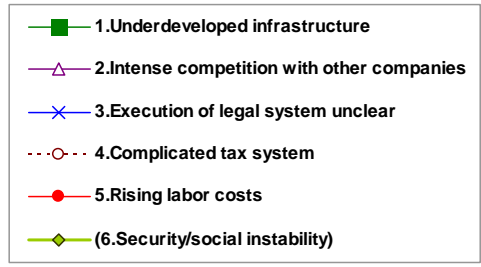
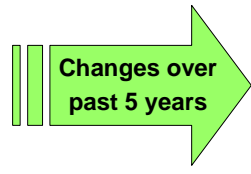
	No. of companies	Ratio
1 Future growth potential of local market	256	90.5%
2 Inexpensive source of labor	112	39.6%
3 Current size of local market	69	24.4%
4 Qualified human resources	64	22.6%
5 Supply base for assemblers	59	20.8%



Issues

(Total No. of respondent companies: 255)

	No. of companies	Ratio
1 Underdeveloped infrastructure	122	47.8%
2 Intense competition with other companies	97	38.0%
3 Execution of legal system unclear (frequent changes)	79	31.0%
4 Complicated tax system	73	28.6%
5 Rising labor costs	55	21.6%



■ Among the countries that listed India as promising, more than 90% cited the “future growth potential of the local market”, a clear indication of expectations for the Indian market.

■ Companies that have no bases of operation in India made up more than half of respondent companies. Companies *without* bases in India cited “security/social instability” (36 companies, 24.7%^[Note]) as the 4th issue, with the 5th being “complicated tax system” (32 companies). Among those companies, “rising labor costs” ranks 11th (24 companies), demonstrating differences in the perception of what the issues are depending on whether companies have bases there.

Note: The percentage was calculated by dividing by 146, which is the number of companies without bases in India but that listed India as a promising country for overseas operations over the medium-term.

Figure 28: Existence of Real Business Plans for Companies that Listed China/India as Promising (past 5 years)

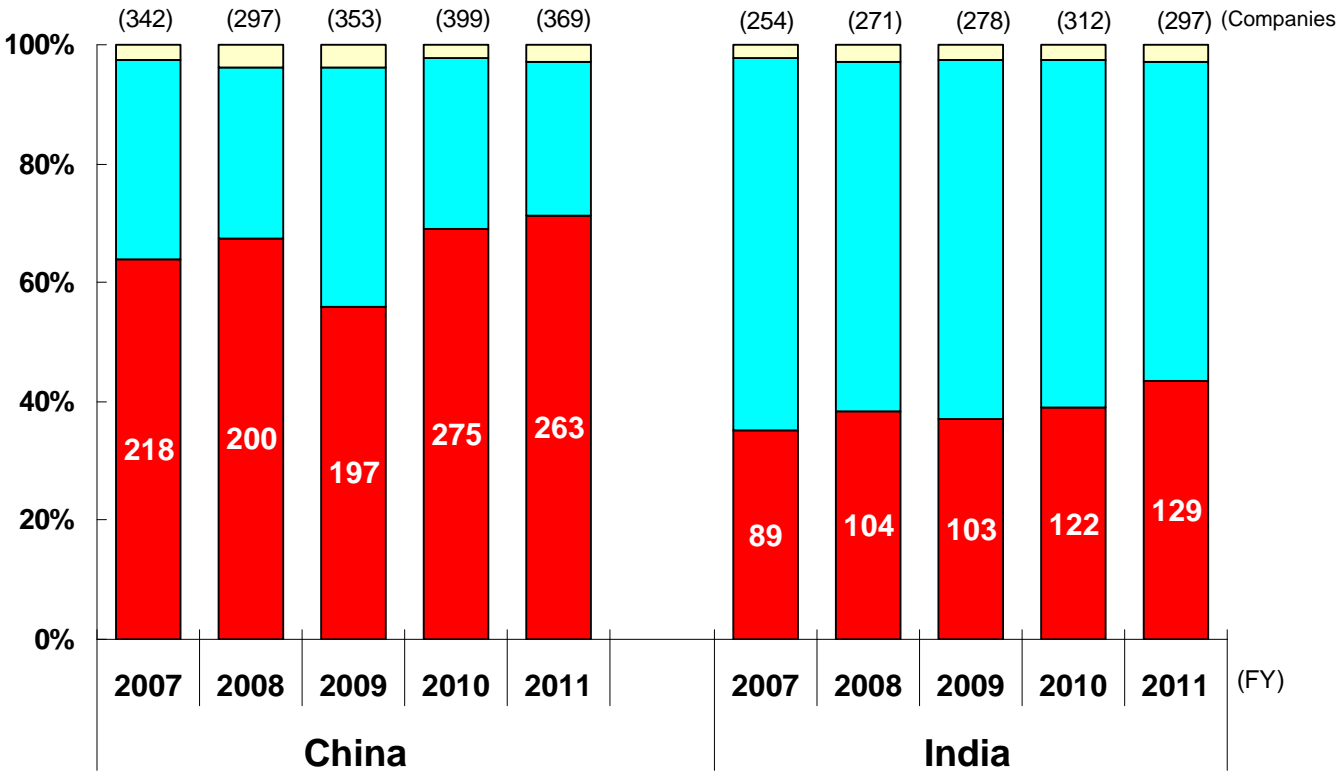
Q. Companies that named promising countries over the medium-term in Figure 24 were asked whether they had plans for each of the countries they chose. In the bar graph, the red represents the existence of plans, and the blue represents the absence of plans, where the total number of companies that responded with China and/or India is 100%.

Please note that the figures in parentheses denote the number of companies that responded with China and/or India.

■ Plans, including either for new business forays or additional investment, do exist

■ No concrete plans exists at this point

■ No response



■ Of the companies that listed the countries as promising, about 70% have plans for China and about 40% have plans for India

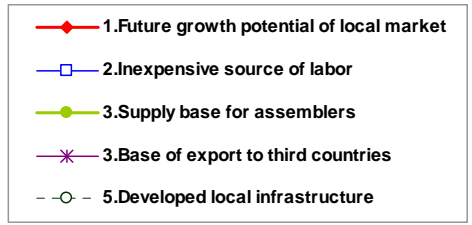
- Although the percentage shares for both China and India have declined compared to the previous survey, out of the companies that did count them as promising, the ratios of companies with plans for them increased.
- Although the share ratios of China and India are approaching each other, as shown below, there is a large disparity in terms of the presence or lack of business plans between the two countries.
- In the results of the FY2009 survey carried out just after the financial crisis precipitated by the collapse of Lehman Brothers, the ratio of companies with business plans for China fell sharply, but this figure has steadily risen since then, and in the present survey was 71.3%. That is, out of the companies that cited China as a promising country, over 70% have some sort of concrete business plans.
- India, on the other hand, saw its percentage share ratio continue to consistently grow from FY2007 to FY2010, although in the present survey it fell slightly (Figure 25). Of the companies that cited India as a promising country in this survey, the number of companies that said they have business plans grew by about 4.3 percentage points from the last survey, but this figure is still hovering around the 40% mark, suggesting that, just as in the previous survey, the level of hope perceived in India reflects more future expectations than immediate assessments.

 **No. 3: Thailand**

Reasons

(Total No. of respondent companies: 159)

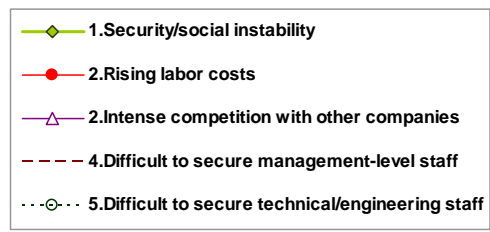
	No. of companies	Ratio
1 Future growth potential of local market	93	58.5%
2 Inexpensive source of labor	66	41.5%
3 Supply base for assemblers	53	33.3%
3 Base of export to third countries	53	33.3%
5 Developed local infrastructure	45	28.3%



Issues

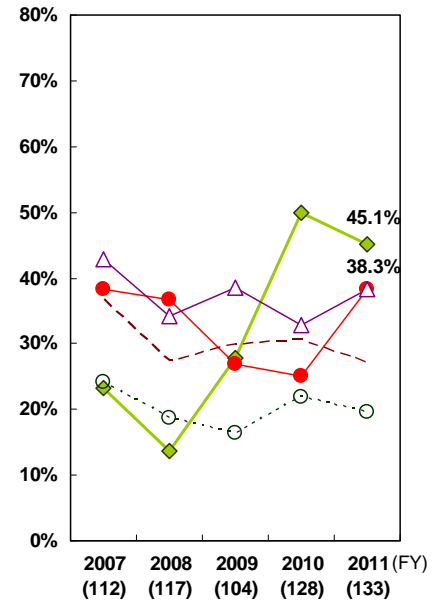
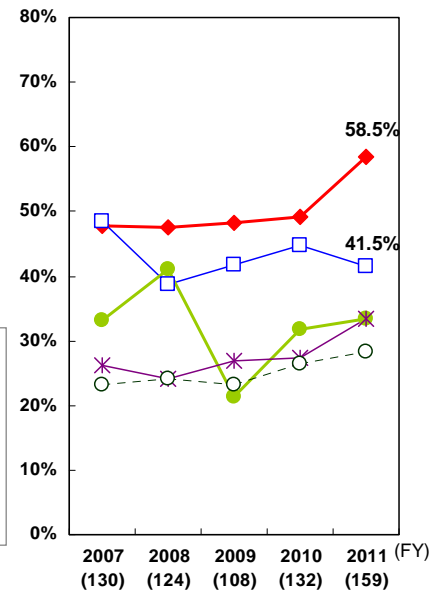
(Total No. of respondent companies: 133)

	No. of companies	Ratio
1 Security/social instability	60	45.1%
2 Rising labor costs	51	38.3%
2 Intense competition with other companies	51	38.3%
4 Difficult to secure management-level staff	36	27.1%
5 Difficult to secure technical/engineering staff	26	19.5%



■ While the No. 1 reason for listing Thailand as promising is the “future growth potential of local market”, it is also perceived as one of the best places for manufacturing centers in ASEAN countries. As evidence of this, the 3rd most frequently cited reason for being promising is its potential as a “base of export to third countries”, which was mentioned by more than 30% of respondent companies (a higher ratio than either Vietnam or Indonesia). It also has a highly rated infrastructure (the 5th reason), although it remains to be seen how badly the floods caused by heavy rain this summer will affect the production activities by Japanese manufacturers.

■ The most frequently cited issue this year as well was “security/social instability”, and out of the 60 companies that listed this issue, 83% companies already have bases in Thailand. Although there were few comments concerning the direct impact of this issue on production, it appears that a certain degree of concern over the situation in Thailand remains.



 **No. 4: Vietnam**

Reasons

(Total No. of respondent companies: 149)

	No. of companies	Ratio
1 Future growth potential of local market	105	70.5%
2 Inexpensive source of labor	94	63.1%
3 Qualified human resources	32	21.5%
4 Supply base for assemblers	25	16.8%
5 Base of export to third countries	23	15.4%

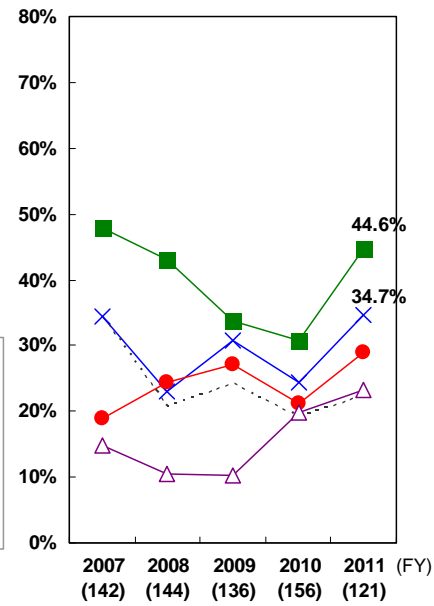
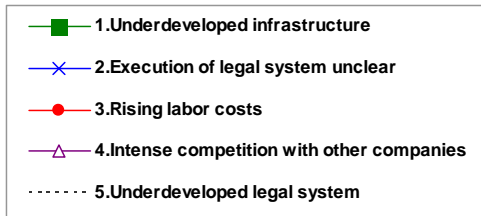
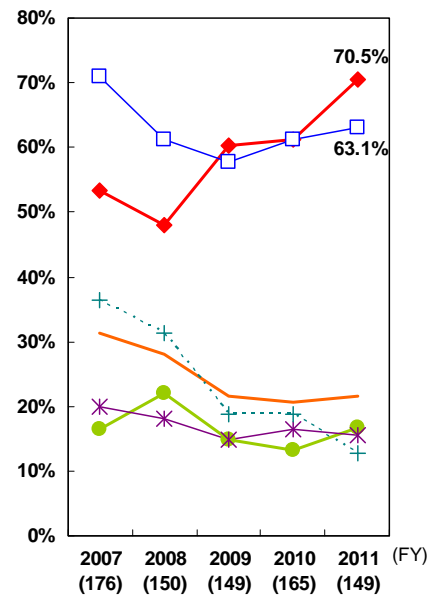
Issues


(Total No. of respondent companies: 121)

	No. of companies	Ratio
1 Underdeveloped infrastructure	54	44.6%
2 Execution of legal system unclear (frequent changes)	42	34.7%
3 Rising labor costs	35	28.9%
4 Intense competition with other companies	28	23.1%
5 Underdeveloped legal system	27	22.3%

■ Just as with last year, the No. 1 reason for seeing Vietnam as promising was the “future growth potential of local market”, the ratio of companies that cited this reason jumped from 61.2% to 70.5%. Up till now, Vietnam’s appeal often lied in its potential as a site for risk diversification (No.7 reason this year) and assembly/export bases, but interest in the local market is steadily growing.

■ One of the advantages of Vietnam is its labor market as seen in reason No. 2 “inexpensive source of labor” and No. 3 “qualified human resources”. However, it is important to note that more and more companies are beginning to cite “rising labor costs” as an issue. Similar to India, No. 1 issue was “undeveloped infrastructure” (13.8 point increase year on year).



 **No. 5: Brazil**

Reasons

(Total No. of respondent companies: 138)

	No. of companies	Ratio
1 Future growth potential of local market	126	91.3%
2 Current size of local market	40	29.0%
3 Supply base for assemblers	27	19.6%
4 Inexpensive source of labor	22	15.9%
5 Concentration of industry	12	8.7%

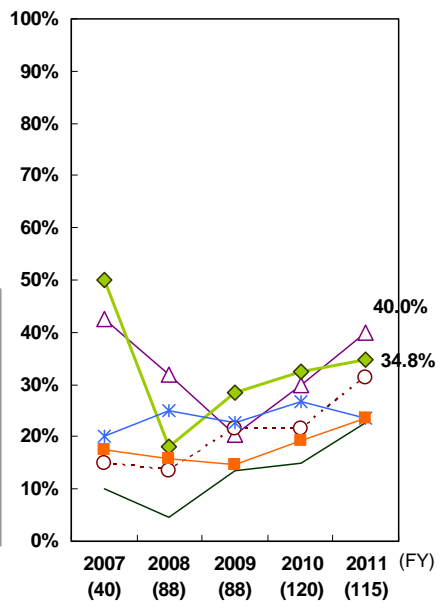
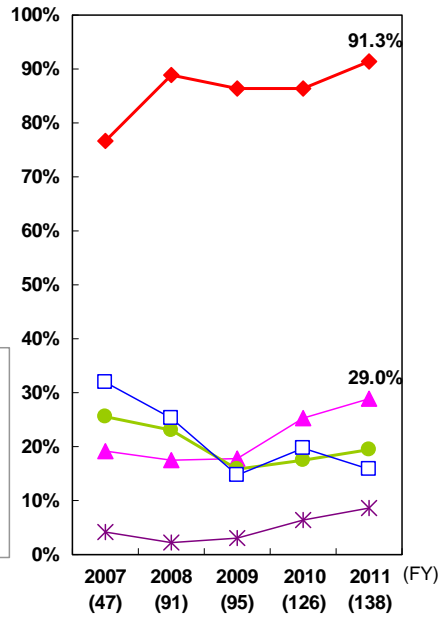
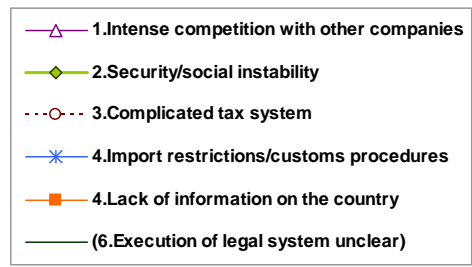
Issues

(Total No. of respondent companies: 115)

	No. of companies	Ratio
1 Intense competition with other companies	46	40.0%
2 Security/social instability	40	34.8%
3 Complicated tax system	36	31.3%
4 Import restrictions/customs procedures	27	23.5%
4 Lack of information on the country	27	23.5%

■ Reflecting the strong Brazilian economy, 91.3% of companies cited the “future growth potential of the local market”, which continues to be the No. 1 reason for seeing Brazil as promising. The 2nd most frequently cited reason was the “current size of the local market” (29.0%), which was the same as the previous survey.

■ As for issues, in the survey of two years ago “intense competition with other companies” was ranked 5th (20.5%), last year’s survey it was 2nd (30.0%), and in this year’s survey it was for the first time the No. 1 reason (40.0%), which is an indication that companies from all over the world are actively entering in Brazil. Meanwhile, concerns over “security/social instability”, which was the No. 1 issue in the previous survey, dropped to 2nd place, although the ratio of companies that listed this issue (more than 30%) did not change substantially from the previous survey.



 **No. 5: Indonesia**

Reasons

(Total No. of respondent companies: 141)

	No. of companies	Ratio
1 Future growth potential of local market	115	81.6%
2 Inexpensive source of labor	65	46.1%
3 Current size of local market	39	27.7%
4 Supply base for assemblers	37	26.2%
5 Base of export to third countries	22	15.6%

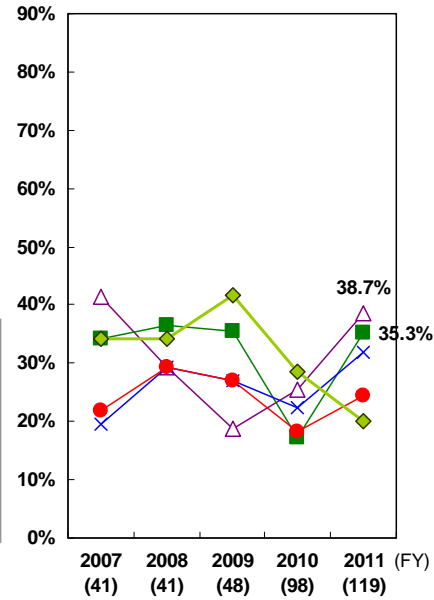
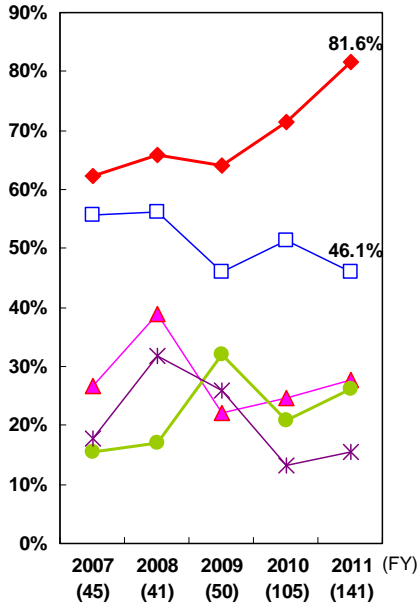
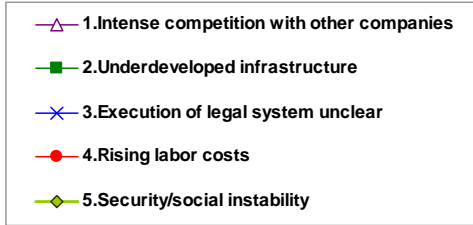
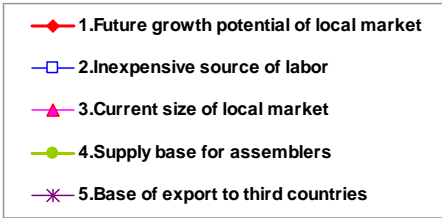
Issues

(Total No. of respondent companies: 119)

	No. of companies	Ratio
1 Intense competition with other companies	46	38.7%
2 Underdeveloped infrastructure	42	35.3%
3 Execution of legal system unclear (frequent changes)	38	31.9%
4 Rising labor costs	29	24.4%
5 Security/social instability	24	20.2%

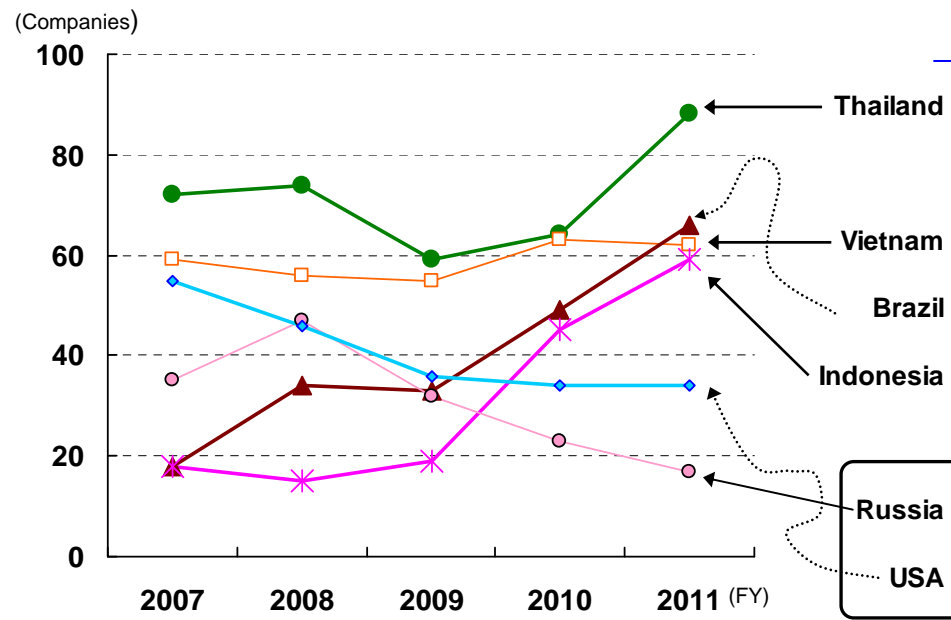
■ While reasons that reflect advantages in terms of production ranked No. 4 and 5, the appeal most often perceived is the “future growth potential of the local market”, which, like the previous fiscal year, is still the No. 1 reason and the number of companies citing it grew from 75 to 115.

■ Local competition is intensifying as more companies look to Indonesia. The No. 1 issue cited is “intense competition with other companies”, with the number of respondent companies jumping from 25 to 46. Indonesia’s “underdeveloped infrastructure” took the 2nd spot as this problem has become more apparent with the increase of local production level. “Security/social instability”, last year’s No. 1 issue, actually gained four more companies this year, but it dropped to 5th place on the list because of the increase in responses citing other issues.



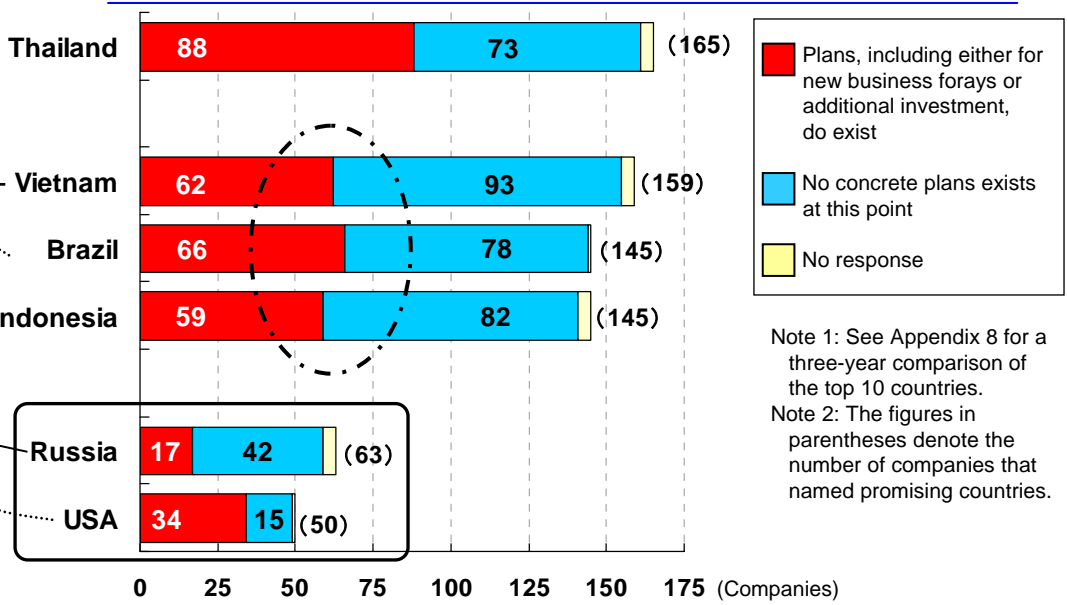
IV. 10. Existence of Real Business Plans (top 3 to 8 countries/regions)

Figure 29: No. of Companies with Concrete Business Plans for Promising Countries/Regions (past 5 years)



Q. Companies that named promising countries over the medium-term in Figure 24 were asked whether they had plans for each of the countries they chose. In the bar graph, the red represents the existence of plans, and the blue represents the absence of plans.

Figure 30: Existence of Concrete Business Plans for Promising Countries/Regions (FY2011)



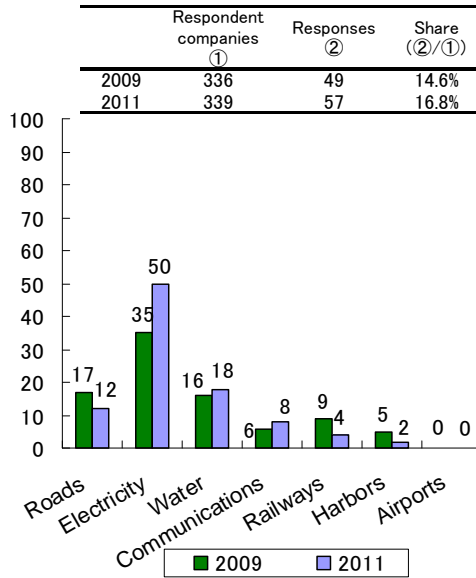
Note 1: See Appendix 8 for a three-year comparison of the top 10 countries.
 Note 2: The figures in parentheses denote the number of companies that named promising countries.

- In terms of companies with concrete business plans, the number of companies citing Thailand is well in the lead**
 - In the FY2011 survey results, Thailand rose to 3rd place in percentage share (Figure 24). As its percentage share rose, so did the number of companies with concrete business plans for operations there (Figure 29), with the result that out of the companies listing Thailand as a promising country for overseas operations, 53.3% (88 companies) now have concrete business plans of some kind (Figure 30), proving that companies have more than just a “wait-and-see” anticipation about the country.
- As to the number of companies with concrete business plans among promising countries, Indonesia and Brazil are in a roll**
 - As for the ratios of companies with business plans in the countries they cited as promising in this survey, Vietnam stands at 39.0% (62 companies), Indonesia at 40.7% (59 companies), and Brazil (which overtook Vietnam) at 45.5% (66 companies). Nevertheless, as with the case with India, less than half of the respondent companies have plans for these three countries (Figure 30). However, companies with concrete business plans for Brazil and Indonesia have more than tripled over the past five years (Figure 29).
- The difference between the U.S. and Russia is the presence or absence of real business plans**
 - As of FY2008, the number of companies with concrete business plans in Russia exceeded the same for the U.S., Brazil, and Indonesia, but since FY2009 (after the collapse of Lehman Brothers), that number continued to decline, and eventually all of these countries overtook Russia (Figure 29). As of FY2011, the percentage share is higher than the U.S., but only 27.0% (17 companies) of companies that view Russia as promising have real business plans. In contrast, 68.0% of companies (34 companies) that see the U.S. as promising have concrete plans for the country, which is double the Russia, in terms of the number of companies (Figure 30). It appears that while there is a strong sense of anticipation concerning Russia, companies find it difficult to translate that anticipation into actual business expansion into the country.

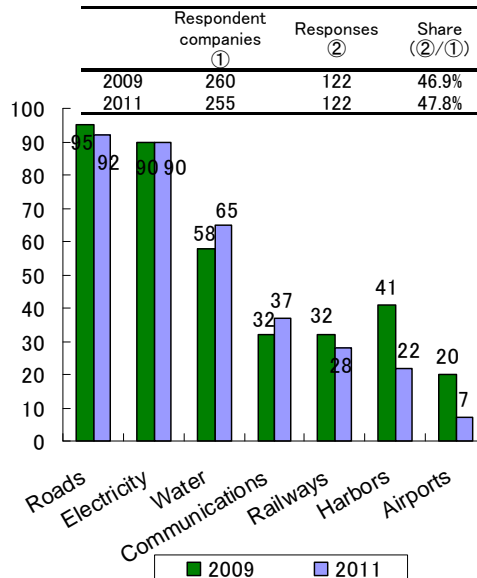
IV. 11. Infrastructure Issues in Promising Countries/Regions

Figure 31 Infrastructures that Need Improvement (multiple response)

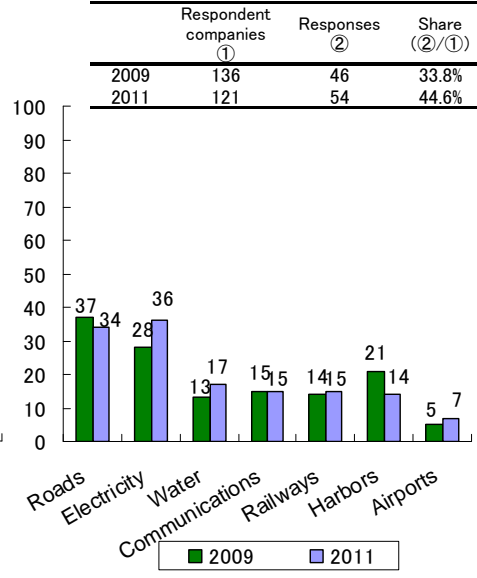
China



India



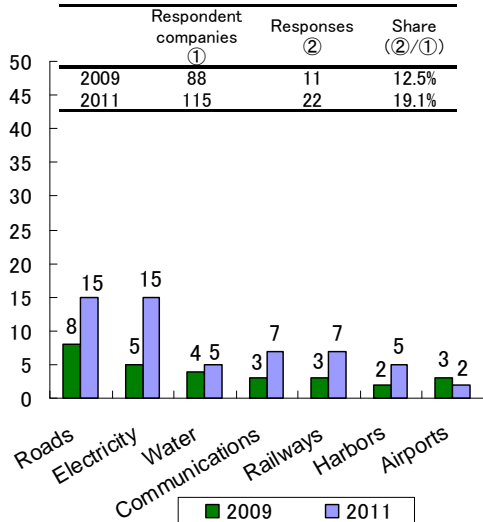
Vietnam



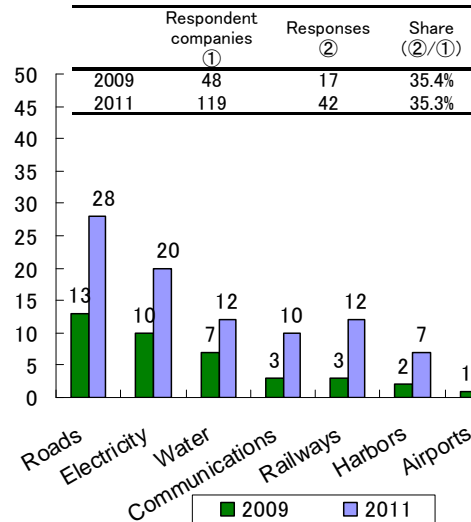
Note 1: The number of “respondent companies ①” is the number of companies which chose these countries as promising. The number of “responses ②” is the number of companies which point out “underdeveloped infrastructure” as an issue while choosing those countries as promising.

Note 2: Figure 31 shows the comparison with the result of FY 2009 survey which conducted the same question in this survey regarding infrastructures that need improvement.

Brazil



Indonesia



Top issue in Infrastructure for China is “Electricity” while issue for Thailand is almost none.

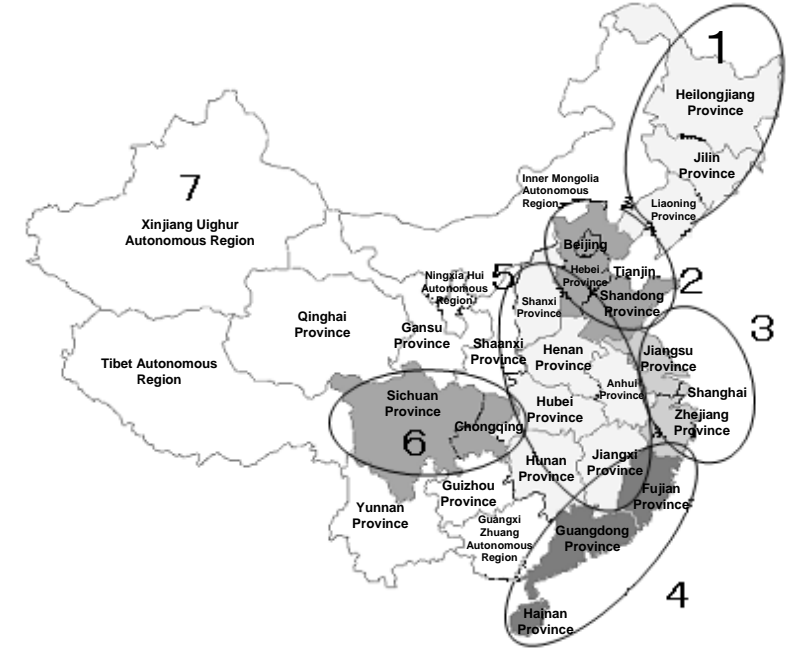
- Level of issues for infrastructure in China is lower than those in other countries such as India among high ranked countries as promising. “Electricity” stands out as an issue for infrastructure among those countries.
- Thailand is listed among the top promising countries, but only eight companies mentioned the infrastructure as an issue (out of 133 respondent companies in total), so it was excluded from the analysis this year.

Underdeveloped Infrastructures remain issues for India, Vietnam, Indonesia and Brazil.

- Among the companies that cited India, Vietnam, Indonesia, and Brazil as promising, the numbers of companies which cite “Underdeveloped infrastructure” as an issue are; 122 companies (India), 54 companies (Vietnam), 42 Companies (Indonesia), and 22 companies (Brazil), respectively.
- “Roads” and “electricity” are common areas which are need to be developed in all of these countries. In Brazil, electricity grew rapidly as an issue, while water is listed as the third most common issue in India, Vietnam, and Indonesia.

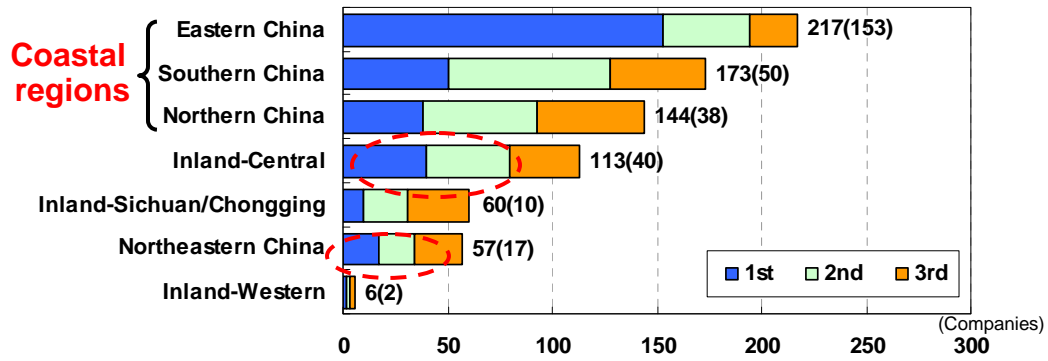
IV. 12. Supplementary Information (1): Promising Regions within China

Q. Companies that listed China among promising countries/regions over the medium-term (next 3 yrs. or so) were then asked to identify up to 3 promising regions each for sales and manufacturing within China. The figures in the graphs indicate the number of companies that chose each area, and the figures in parentheses are the number of companies that chose the relevant area as their first response.



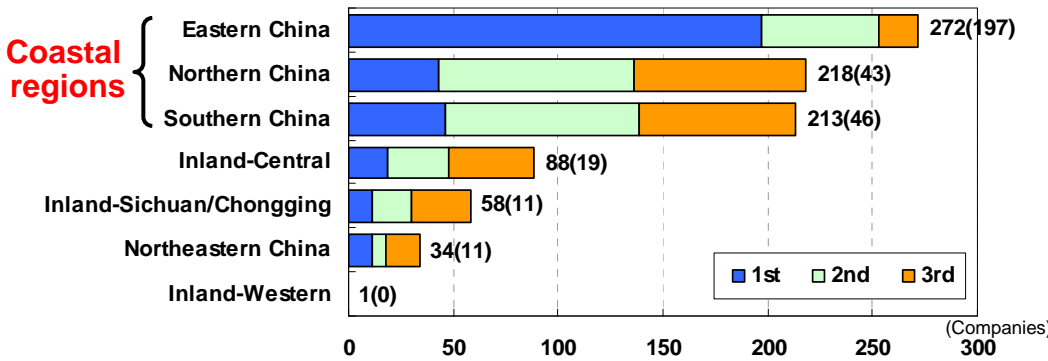
1. Northeastern China: Heilongjiang, Jilin, Liaoning
2. Northern China: Beijing, Tientsin, Hebei, Shandong
3. Eastern China: Shanghai, Jiangsu, Zhejiang
4. Southern China: Fujian, Guangdong, Hainan
5. Inland China
 - Central: Shanxi, Henan, Anhui, Hubei, Jiangxi, Funan
6. Inland China
 - Western: Sichuan, Chongqing
7. Inland China
 - Western: Regions other than Sichuan and Chongqing

Figure 32: (Production) Promising Regions within China



Note: The numbers of companies giving answers for 1st, 2nd, and 3rd were 310, 253, and 207, respectively, for a total of 770 selections, with 310 companies responding to the question (production).

Figure 33: (Sales) Promising Regions within China



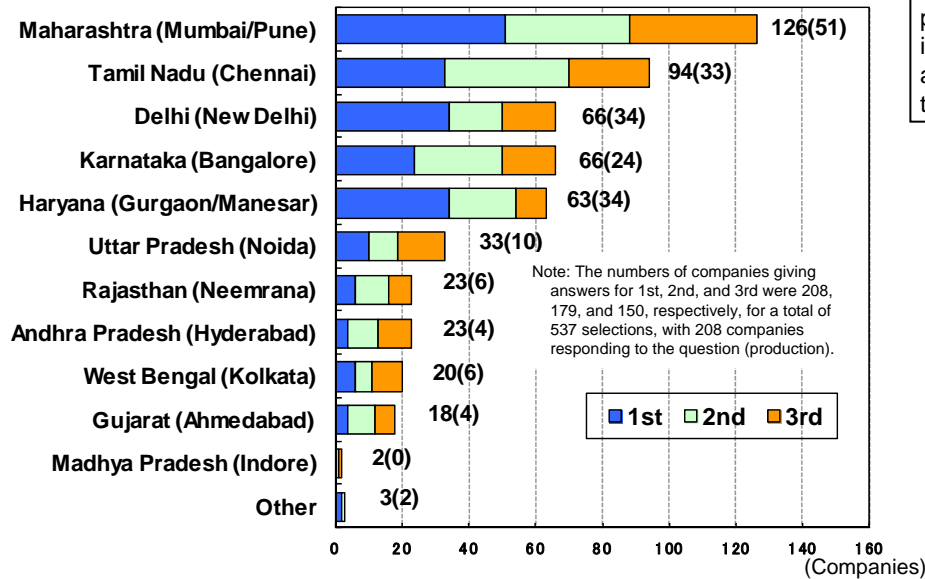
Note: The numbers of companies giving answers for 1st, 2nd, and 3rd were 327, 297, and 260, respectively, for a total of 884 selections, with 327 companies responding to the question (sales).

■ The prominence of Eastern China for both manufacturing and sales remains unchanged. Meanwhile, the appeal of Inland and Northeastern China is improving for manufacturing.

- The tendency to favor the coastal regions is obvious. Eastern China is deemed particularly promising as it has Shanghai, with the country's highest domestic per capita GDP, Zhejiang Province, with its 4th highest, and Jiangsu with its 5th. Although Eastern China is already the home of manufacturing and sales centers of the highest number of respondent companies, it is clear that companies still see it as promising over the medium-term.
- More companies see Inland and Northeastern China as promising for manufacturing than sales. As for the No. 1 rankings by numbers of companies, Inland-Central (40 companies) outpaced Northern China (38 companies). The industry in which the most companies view the Inland-Central region as promising is automobiles with 30 companies (2 in assembly and 28 in parts), followed by electrical equipment and electronics with 24 companies (11 in assembly and 13 in parts). For Sichuan and Chongqing, the industries are chemicals with 13 companies and electrical equipment and electronics also with 13 companies, and for Northeastern China it is the automobile industry with 17 companies viewing it as promising.

IV. 12. Supplementary Information (2): Promising Regions within India

Figure 34: (Production) Promising Regions within India



Q. Companies that listed India among promising countries/regions over the medium-term (next 3 yrs. or so) were then asked to identify up to 3 promising regions each for sales and production within India. The figures in the graphs indicate the number of companies that chose each area, and the figures in parentheses are the number of companies that chose the relevant area as their first response.

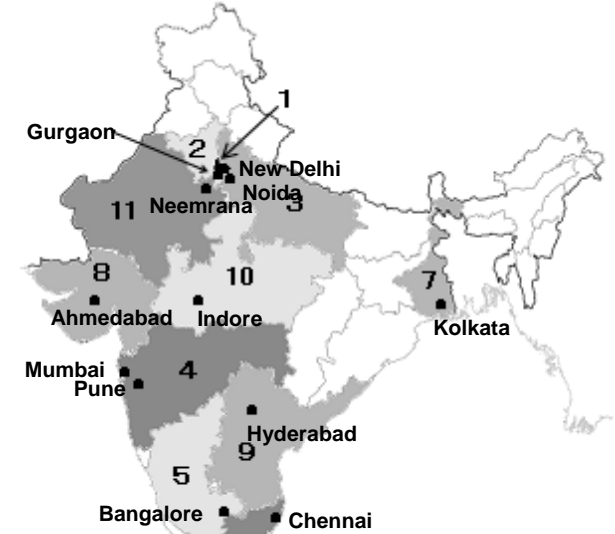
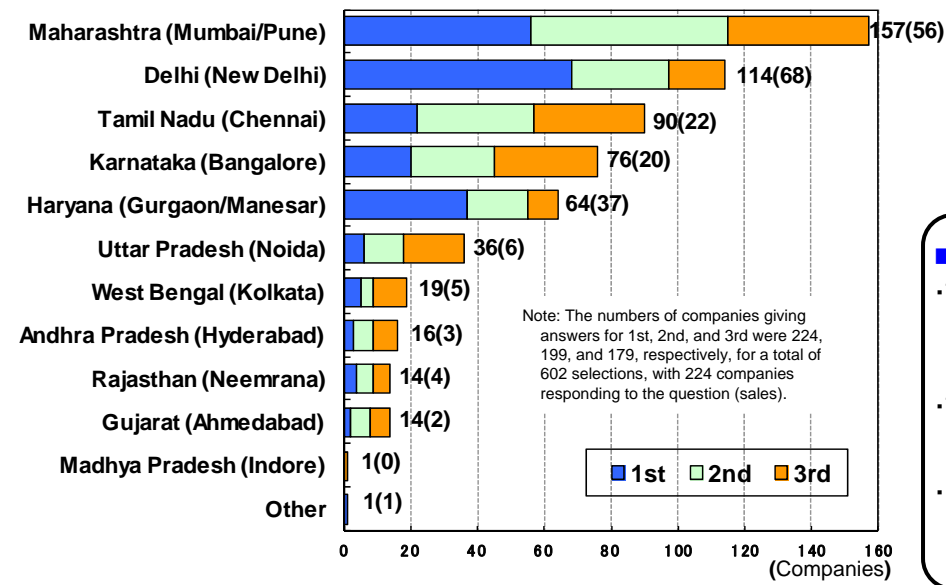


Figure 35: (Sales) Promising Regions within India



- 1. Delhi
- 2. Haryana
- 3. Uttar Pradesh
- 4. Maharashtra
- 5. Karnataka
- 6. Tamil Nadu
- 7. West Bengal
- 8. Gujarat
- 9. Andhra Pradesh
- 10. Madhya Pradesh
- 11. Rajasthan
- 12. Other

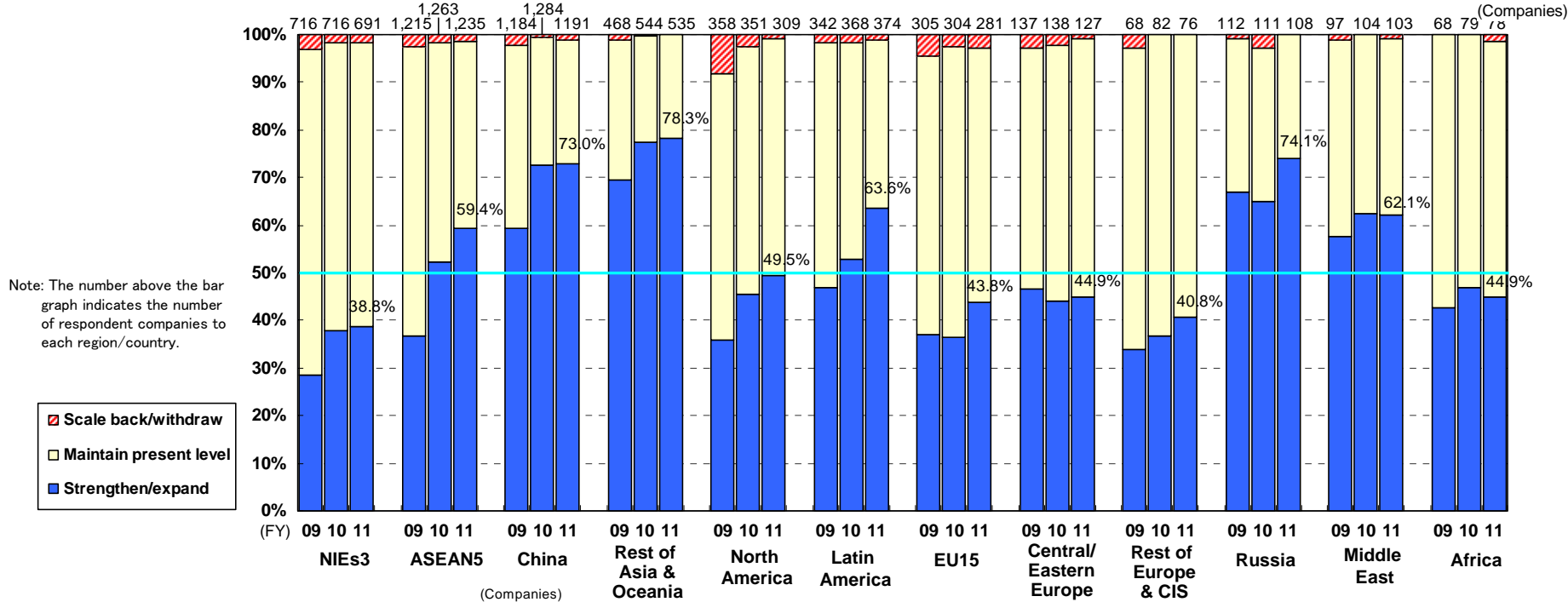
Maharashtra is popular for both manufacturing and sales

- The state of Maharashtra has India's second highest population. It is known as a major financial and commercial center, as exemplified by Mumbai, the state's capital. Maharashtra is also home to cities with a high accumulation of industry such as Pune, Nashik, and Aurangabad.
- Tamil Nadu was the 2nd most frequently cited region for production. The metropolis of Chennai is appealing because of its accumulation of Japanese companies and the presence of a large port.
- For sales, the National Capital Territory of Delhi, where the Indian capital is located, was the 2nd most frequently cited region, and had the most companies listing it as "1st".

IV. 13. Prospects for Overseas Operations by Region

Figure 36: Medium-term prospects for overseas operations (by region)

Q. Companies were asked about the medium-term (next 3 yrs. or so) prospects for businesses in countries/regions where they are currently operating or planning to operate.



Note: The number above the bar graph indicates the number of respondent companies to each region/country.

Scale back/withdraw
 Maintain present level
 Strengthen/expand

Country/region	FY2011	(FY2010)
1. North America	15	(8)
2. EU15	12	(6)
Developed countries	27	(14)
3. India	9	(3)
4. Brazil	7	(1)
5. Thailand	5	(3)
6. China	4	(6)
7. Vietnam	4	(2)
8. Indonesia	3	(1)
9. Korea	3	
10. Rest of Asia & Oceania	2	(1)
11. Central & Eastern Europe	2	
12. Africa	2	
13. Middle East	1	(2)
14. Malaysia	1	
Hong Kong		(1)
Singapore		(1)
Philippines		(1)
Emerging markets total	43	(22)
Total	70	(36)

(Supplementary Info)
Figure 37:
M&A Pursuits

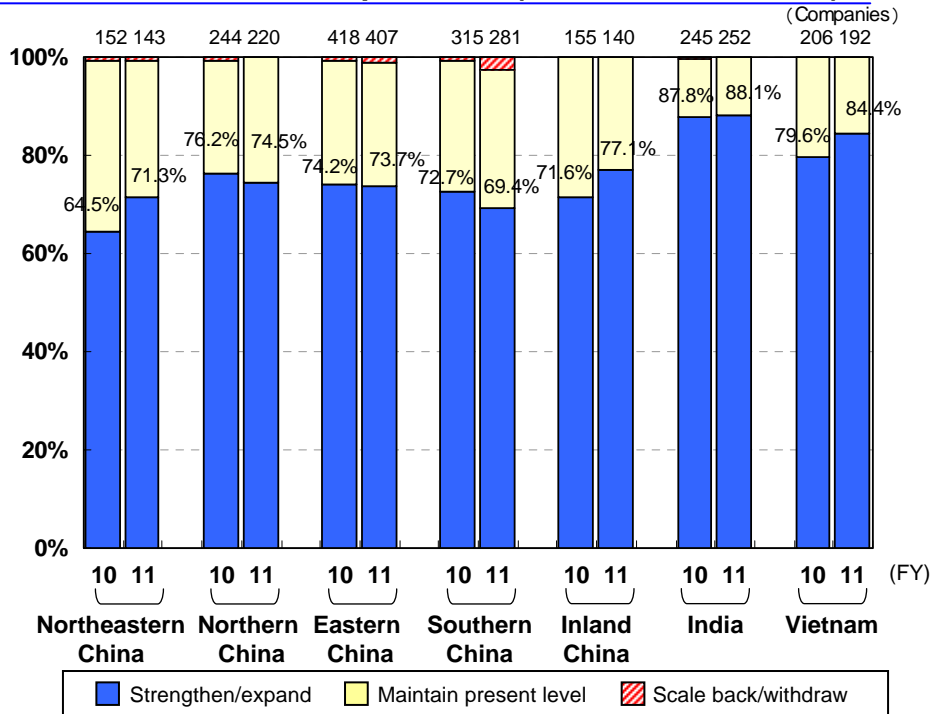
More companies looking to bolster existing production bases

- As shown in Figure 36, the number of companies wishing to strengthen or expand their operations in China, India, Vietnam (the latter two of which are classified as "Other Asian countries"), and Latin America continues to remain high. Meanwhile, the trend of decline in the number of companies wishing to strengthen their operations in Europe and Russia reversed.
- One of the characteristics of the "strengthening" trend in this year's survey was an increase in the number of companies that mentioned bolstering their production functions. The total number of respondent companies (total number of answers) to this question last year was 2,953, and 2,949 this year, i.e. roughly the same, but the number indicating they would build new centers of production increased by 64, while the number indicating they would strengthen existing centers increased by 118. With regard to sales, on the other hand, the number of companies responding that they would strengthen the sales bases they own remained about the same as last year, but those saying they would utilize outside agencies decreased by 216. Nevertheless, just as in last year's survey, the number of companies indicating that they would bolster sales functions was more than that for production.

Companies pursuing M&A projects increased, especially in emerging markets

- Beginning with last year's survey, "M&A pursuits" was added as a choice in the descriptions of what "strengthen or expand" would entail. In this year's survey, 70 companies chose that response, which is almost double the 36 companies that chose it last year. One possible explanation is that the current environment (i.e. a strong Yen) is more conducive to acquisitions. As for the regions in which companies are pursuing M&A, 15 companies said North America, 12 said EU15, and 9 said India. By industry, there were 17 companies in chemicals and 16 in foods.

Figure 38: Medium-term prospects for overseas operations (China/India/Vietnam)



Note1: The number above the bar graph indicates the number of respondent companies to each region/country.
 Note2: The percentage in the bar graph indicate the percentage share of the companies answering "strengthen/expand"

■ Companies strengthening businesses in China are shifting to Northeastern and Inland China

- The companies that responded to this question are currently operating in or planning to operate in China. As for manufacturing, the number of companies operating in Northern, Eastern, and Southern China, which previously saw a steady increase, has decreased slightly, while the number of companies operating in Northeastern and Inland China has continued its upward trend. This is a reflection of moves to decentralize manufacturing centers within China in part due to labor shortages, rising personnel costs, etc.

■ The establishment of new plants in India and Vietnam is once again on the rise

- In last year's survey, although there was an upward trend in strengthening existing manufacturing centers, the number of responses indicating that companies were building new centers had not changed much from the year prior. In this year's survey, however, "building new centers" increased by 18 companies for India and 7 for Vietnam, again on an upward trend.

Note: Figure 39 and 40 shows how the companies which answered "Strengthen/expand" in Figure 38 expands its facilities. Multiple responses were possible.

Figure 39: How to strengthen/expand by areas (production)

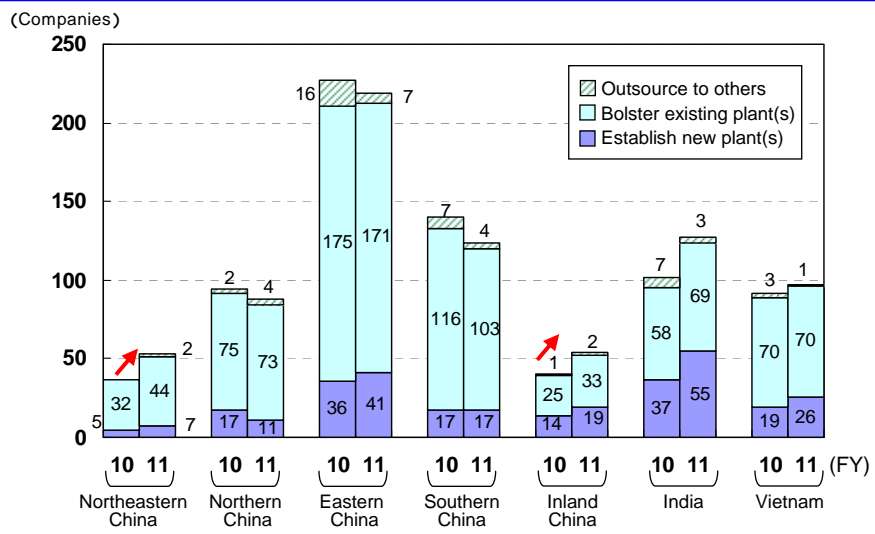


Figure 40: How to strengthen/expand by areas (sales)

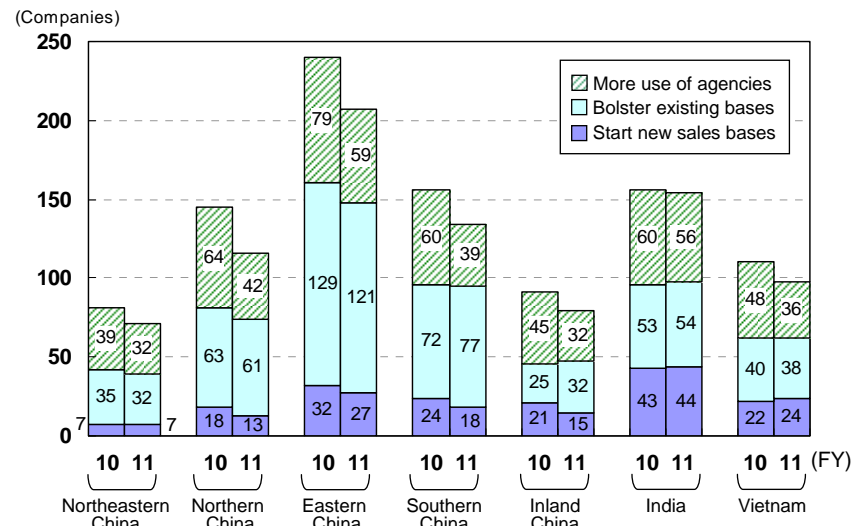
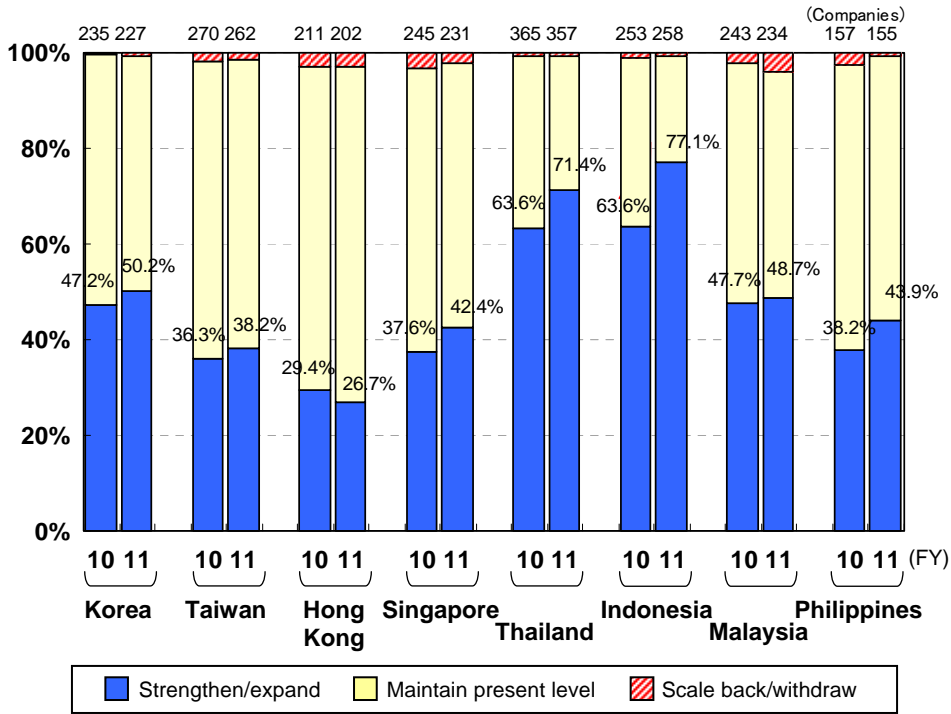


Figure 41: Medium-term prospects for overseas operations (NIEs3/ASEAN5)



Note: Figure 42 and 43 shows how the companies which answered "Strengthen/expand" in Figure 41 expands its facilities. Multiple responses were possible.

Figure 42: How to strengthen/expand by areas (production)

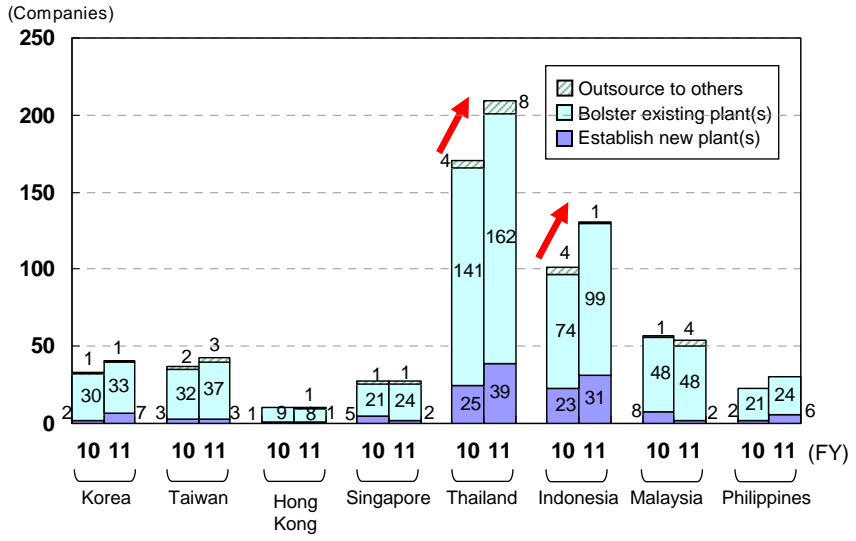
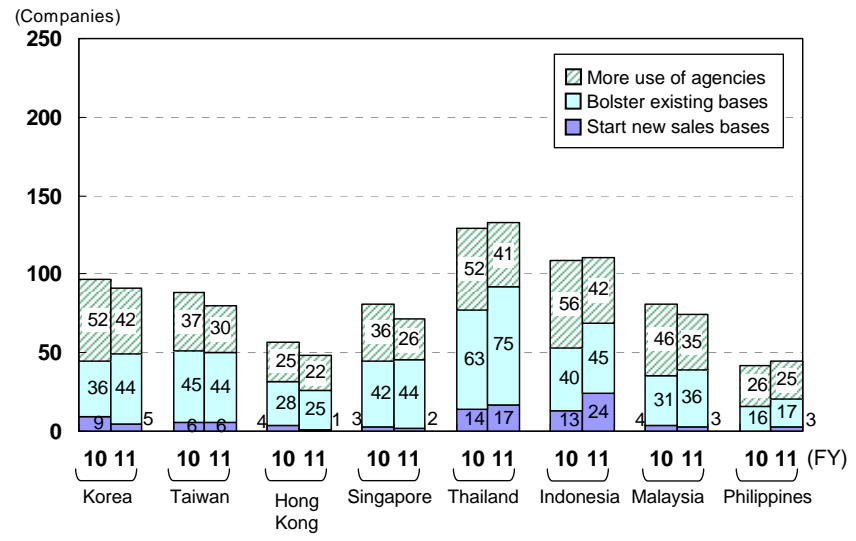


Figure 43: How to strengthen/expand by areas (sales)

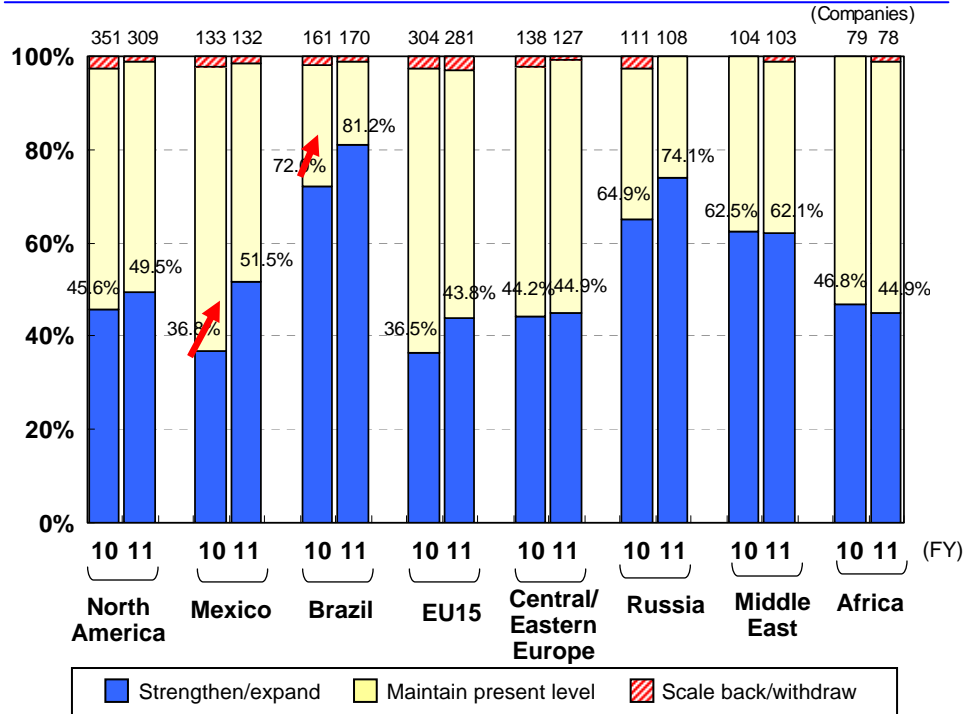


Note1: The number above the bar graph indicates the number of respondent companies to each region/country.
 Note2: The percentage in the bar graph indicate the percentage share of the companies answering "strengthen/expand"

■ Moves to bolster production in Thailand and Indonesia stand out
 • Among companies wishing to "strengthen/expand" operations in NIEs3 and ASEAN5 countries, Thailand and Indonesia, at over 70% get the highest rates of response (Figure 41). The desire to strengthen operations stands out particularly in the area of production. For Thailand, the combined responses of "Establish new plants", "Bolster existing plants", and "Outsource to others" total 209 respondent companies, making it the 2nd most popular, next to Eastern China, which at 219 is No. 1 in this category.

■ Companies seek "partnerships" in India and Korea
 • In the current survey, in addition to the production and sales facets of intentions to bolster businesses, "Partnerships with other companies" was added as a response choice. There were 129 companies this year that chose this response, among which were: 18 with India, 13 with Korea, 12 with Eastern China, and 11 with Brazil. 5 in general machinery chose India and 5 companies in chemicals chose Korea.

Figure 44: Medium-term prospects for overseas operations (Americas/Europe/Middle East/Africa)



Note1: The number above the bar graph indicates the number of respondent companies to each region/country.
 Note2: The percentage in the bar graph indicate the percentage share of the companies answering "strengthen/expand"

■ The "strengthen/expand" attitude is growing in Brazil year after year

- Regions with the highest response ratios for "strengthen/expand" were Brazil (81.2%) and Russia (74.1%). The recovery of "strengthen/expand" responses has been slow for Russia since the "Lehman Shock", but the figures are finally on the rise. Meanwhile, Brazil has seen a phenomenally rapid rise in attention in this category in recent years, going from 57.0% (FY2009) to 72.0% (FY2010) to 81.2% (FY2011). (Figure 44)
- In Latin America, the ratio of companies indicating they would "strengthen or expand" has risen in Mexico. In the cases of Mexico and Brazil, there is an apparent increase in companies wishing to bolster not only their sales but also their productions.

■ North America and EU15 noteworthy for M&A projects

- For North America, the number of companies responding "strengthen/expand" was roughly the same as those responding "maintain current levels", but as the economy recovers, there is a growing trend toward bolstering existing manufacturing bases. (Figure 45) As for EU15, more companies are looking at strengthening sales bases rather than manufacturing bases, just as last year. (Figure 46)
- As demonstrated in Figure 37 above, North America and the EU are notable for the presence of companies pursuing M&A there.

Note: Figure 45 and 46 shows how the companies which answered "Strengthen/expand" in Figure 44 expands its facilities. Multiple responses were possible.

Figure 45: How to strengthen/expand by areas (production)

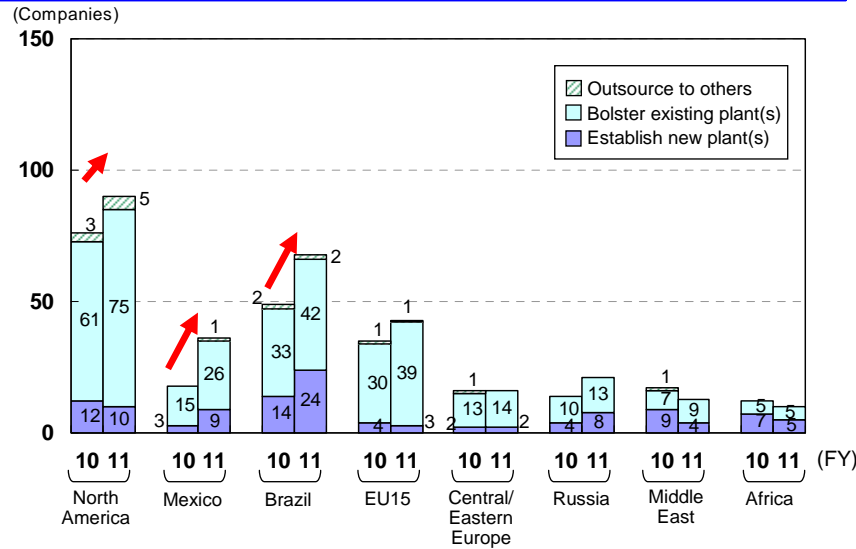


Figure 46 : How to strengthen/expand by areas (sales)

