



MIZUHO RESEARCH PAPER

2

*Changes in Japan's
Business Strategy in Asia
— a questionnaire survey of
Japanese manufacturers on
business in China and Asia
reveals a deepening
division of labor —*

Hironori Uchibori
Senior Economist

Hironori Uchibori is a senior economist at Mizuho Research Institute Ltd. He entered the institute in 1991 to make his career mainly in economic and industrial research and currently specializes in international management, particularly on the global strategies of multinational enterprises. His experience as research associate in the institute's London office from 1993 to 1996 provides depth to the global perspective of his field of research. He has written many articles on strategic issues of multinational enterprises in East-Asia for daily newspaper and specialist journals, and is the co-author of *Imports from and Outsourcing Production to East-Asian Countries* (Dobunkan Shuppan, 1999), *Global Supply Chain Management* (Yuhikaku Publishing, 2003), and *The Challenge of the Chinese Renminbi* (Toyo Keizai, 2004). He is also a lecturer on international trade & investment at Meiji University, Tokyo.

E-mail: hironori.uchibori@mizuho-ri.co.jp

TEL: +81-3-3201-0590

FAX: +81-3-3240-8214

*Changes in Japan's Business
Strategy in Asia
— a questionnaire survey of
Japanese manufacturers on
business in China and Asia
reveals a deepening
division of labor —*

Hironori Uchibori
Senior Economist

Published by

Mizuho Research Institute Ltd.

Tokyo, September 2004

Contents

	page
Summary	1
1. Introduction	2
2. Asia business – business strategies to obtain a larger piece of a growing pie	3
(1) The current state of Asia business	3
(2) Japanese corporate involvement in Asia business	5
3. Business strategies – categorized by geographic area and outlook on demand in Asia	9
4. The current state and future challenges regarding marketing strategies for the Chinese market	15
5. Views regarding the foreign exchange rate and the impact of the appreciation of the yuan upon overseas affiliates	18
(1) Views regarding the exchange rate of major currencies	18
(2) Exports from affiliates in China	21
(3) The impact of a stronger yuan upon overseas affiliates of Japanese corporations in China	22
6. Overseas affiliates of Japanese corporations in China are shifting their emphasis toward the reinforcement of profit bases	25
7. Concluding remarks: division of labor with the countries of Asia	29
Supplement: Overview of the Questionnaire Survey of Japanese Corporate Enterprises Regarding Business in Asia	32
Bibliography	34

Summary

1. Given the crucial importance of business in Asia for Japanese companies, the Mizuho Research Institute Ltd. (MHRI) conducted a questionnaire survey of 2,339 Japanese corporate enterprises titled the *Questionnaire Survey of Japanese Corporate Enterprises Regarding Business in Asia* to shed light upon the current state of business endeavors of Japanese companies in Asia. This report is based upon the findings in this survey.
2. In our survey, we found that 70% of the companies surveyed are involved in business of some form in Asia. In response to a question regarding the geographic area of their affiliates, nearly 80% of the companies with overseas affiliates in Asia said that they have affiliates “in China”, surpassing by far the ASEAN region and NIEs. However, we also found that 80.0% of the overseas affiliates in NIEs and 74.8% in the ASEAN region have been “in operation for more than (and including) five years”. In contrast, only 52.5% of affiliates in China fall into this category. In short, the findings suggest that the future business strategy among Japanese companies is to (1) expand in China, and (2) strive for more operational efficiency while maintaining existing affiliates in the NIEs and ASEAN region.
3. Asked how they would like to see foreign currencies such as the yuan to trade against other currencies for the benefit of their business performance, many of the respondents said that they preferred to see all foreign currencies “strengthen” against the yen, underscoring their concerns regarding exports from Japan. In contrast, an estimation of the impact of the appreciation of the yuan upon the overseas affiliates of Japanese companies in China revealed a wide gap among different industrial sectors. Going forward, Japanese companies with affiliates in China would have to engage in a strategic rebalancing of its exports and domestic sales in China in view of a comprehensive analysis of yuan risks and Chinese domestic market trends.

4. A comparison of affiliates of companies categorized by the length of their presence in China (“five years or more” and “less than five years”) revealed that the longer a company’s presence and experience is in China, there is a stronger tendency to stress qualitative improvements such as the review of production processes over quantitative expansion such as the augmentation of plant and equipment. Even in an expanding market, companies emerging out of the initial stage of launching their overseas affiliates, are striving to cut costs by upgrading their efficiency and strengthening their revenue base.
5. As a result of our survey, we found a deepening division of labor among Japanese companies with the countries of Asia including China under a process of innovative reform and improvement – a hallmark among Japanese corporations. Popular belief that China would pose an economic threat to Japan – the “Chinese threat theory” – once rampant in Japan’s industrial arena is now receding. The ebb of the Chinese threat theory stems not only from China’s emerging market potential but also from these budding endeavors and business strategies by Japanese companies.

1. Introduction

Propelled by its rapid economic expansion, China is emerging as a gargantuan final consumption market. The countries and regions of the NIES and ASEAN are also starting to show signs of recovery in personal consumption. To shed light upon the strategies and endeavors of Japanese companies to tap the dynamic Asian market, MHRI conducted a questionnaire survey in March 2003, covering 2,339 Japanese corporate enterprises titled the *Survey of Japanese Corporate Enterprises Regarding Business in Asia* (Note 1). This report is an examination of the recent approach and endeavors of Japanese companies regarding business in Asia (Note 2) on the basis of the

findings of our survey.

2. Asia business – business strategies to obtain a larger piece of a growing pie

(1) The current state of Asia business

This report starts with an account of the current state of Asia business by Japanese companies through an examination of data on Japan's trade and direct investment in Asia.

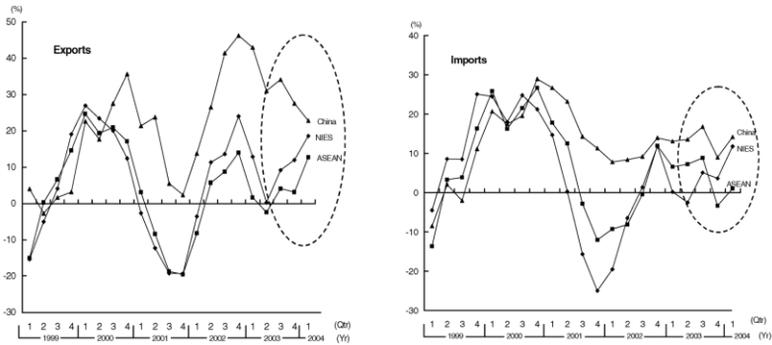
Trends in exports and imports between Japan and the nine countries/regions of Asia reveal a resurgence from the end of 2003 subsequent to a drop due to the Asian currency crisis in mid-1999, the impact of the information technology (IT) recession in late 2001, the SARS (severe acute respiratory syndrome) epidemic in early 2003 and the Iraq War. Looking at exports, China-bound exports are rising to record levels given the growing demand for intermediate goods along with the expansion of the Chinese economy. Imports are also rising due to active merchandise imports and procurement of parts from Asia (**Chart 1**).

Turning to foreign direct investment, the percentage of Japan's investment in China, NIES and ASEAN in total foreign direct investment shows a rapid rebound of investment in China after the Asian currency crisis in contrast to an ebb and flow pattern in investment in the NIES and ASEAN countries (**Chart 2**). Particularly noteworthy is the sharp rise of sales in China among Japanese companies operating in Asia. Sales results of operations in the NIES and ASEAN also started to increase above the previous year from the fourth quarter of 2003 (**Chart 3**).

The expansion of Asia business as shown above is reflected in the business results of Japanese companies. According to an article in the *Nihon Keizai Shimbun* (Note 3), current profits reported by 220 corporations listed on the Tokyo Stock Exchange for the business year ending March 31, 2004 grew 40.0% from the previous year. A

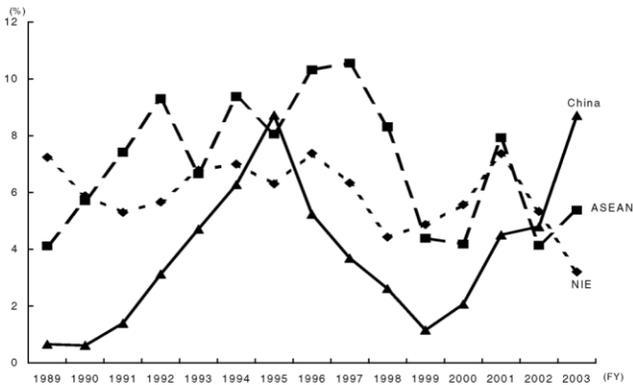
large number of companies saw their profits soar to record levels, underscoring the success of Japanese companies in tapping the growing Asia business. Given the rising contribution by Asia business to the performance of the entire company, there is a great deal of attention focused upon how a company is engaged in Asia business.

Chart 1: Exports and imports with the nine countries/regions of Asia (percentage change, o-y-a)



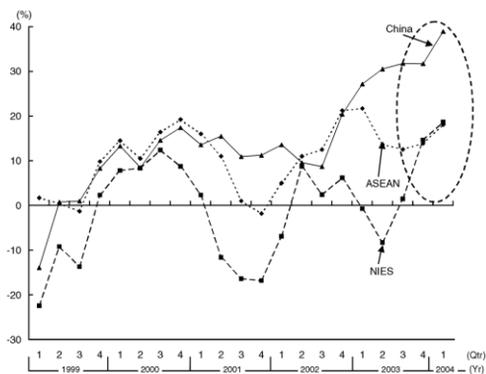
Source: CEIC.

Chart 2: Foreign direct investment in the nine countries/regions of Asia (percentage of total investment)



Source: Ministry of Finance, *Inward and Outward Direct Investment*.

Chart 3: Sales of Japanese overseas affiliates in the nine countries/regions of Asia (o-y-a)



Note: "China" includes Hong Kong and NIES refers to the three countries/regions including South Korea, Taiwan and Singapore

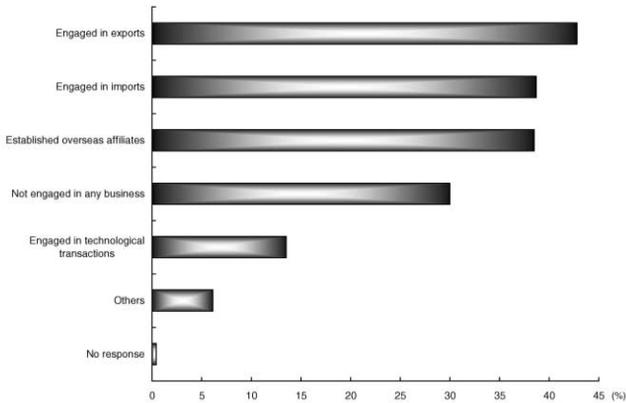
Source: Ministry of Economy, Trade and Industry, *Quarterly Survey of Overseas Subsidiaries*

(2) Japanese corporate involvement in Asia business

Given the growing importance of Asia business, this paper seeks to shed light upon how Japanese companies are engaged in Asia business. In the following pages, we shall portray Japanese companies' business endeavors in Asia on the basis of the findings of our survey.

Of the 776 companies responding to our survey, 30.0% said that they are "not engaged in any business", revealing that 70% of the companies are engaged in some form of Asia business. More specifically, 42.8% responded that they are "engaged in exports", 38.7% said that they are "engaged in imports", 38.5% reported that they have "established overseas affiliates" and 13.5% said that they are "engaged in technological transactions". The findings highlight the active involvement of many Japanese companies in Asia business through trade and overseas operations (**Chart 4**).

Chart 4: Japanese corporate involvement in Asia business

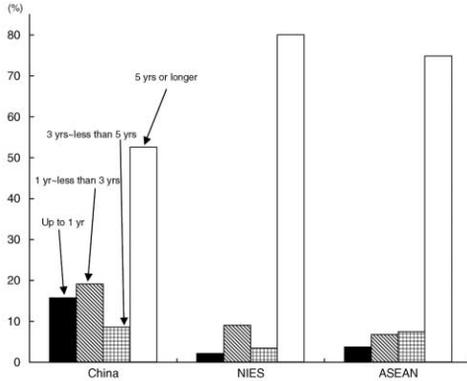


Source: Mizuho Research Institute, Ltd., *Survey of Japanese Corporate Enterprises Regarding Business in Asia*.

A geographic breakdown of the 299 companies with overseas affiliates is as follows: China (78.9%), ASEAN (54.5%), NIES (48.5%). Although China turned out to be the most popular target of overseas expansion, 80.0% of business affiliates in NIES and 74.8% of affiliates in the ASEAN region have been “in operation for more than (and including) five years” whereas only 52.5% of affiliates in China fall into this category (**Chart 5**). The length of Japanese companies’ affiliates in China is generally shorter in comparison to operations in other areas of Asia.

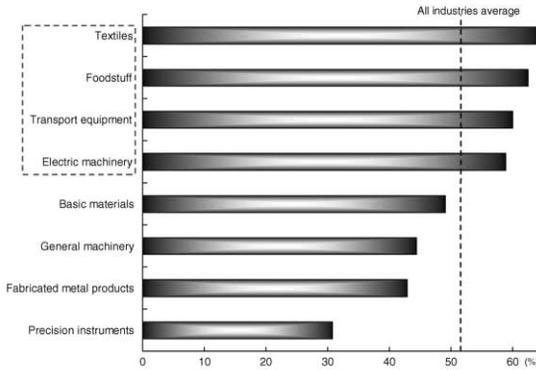
In terms of industrial sector (*Note 4*), a further breakdown of those companies which replied that the history of their affiliates in China was five years or more showed that the history of affiliates in China in the textiles, foodstuff, transportation equipment and electrical machinery industries surpassed the all-industries average. This indicates that companies in these industrial sectors made inroads into China from a relatively early stage (**Chart 6**).

Chart 5: Number of years passed since establishment of overseas affiliates – by region



Source: Mizuho Research Institute, Ltd., *Survey of Japanese Corporate Enterprises Regarding Business in Asia*.

Chart 6: Corporations possessing business affiliates operating for five years or longer in China



Note: The chart above indicates the percentage of companies which have been operating in China for “five years or longer” in the total number of companies doing business in China (by industrial sector).

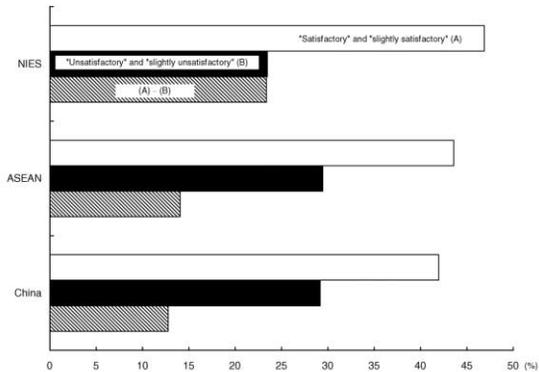
Source: Mizuho Research Institute, Ltd., *Survey of Japanese Corporate Enterprises Regarding Business in Asia*.

We then asked the respondents to evaluate their profitability on a five–point scale ranging from “satisfactory” to “unsatisfactory” in order to assess the profitability of each overseas business

establishment. In all of the geographic areas, we found that the percentage of the sum of the responses for “satisfactory” and “slightly satisfactory” outweighed the sum of responses for “unsatisfactory” and slightly unsatisfactory” (**Chart 7**). The findings suggest that the companies surveyed have a more or less positive evaluation regarding the profitability of their affiliates in Asia. Meanwhile, the difference derived by subtracting the sum of the responses for “unsatisfactory” and “slightly unsatisfactory” from the sum of the responses for “satisfactory” and “slightly satisfactory” is the smallest regarding affiliates in China. From the perspective of profitability, affiliates in the NIES and ASEAN regions have a higher evaluation than those in China.

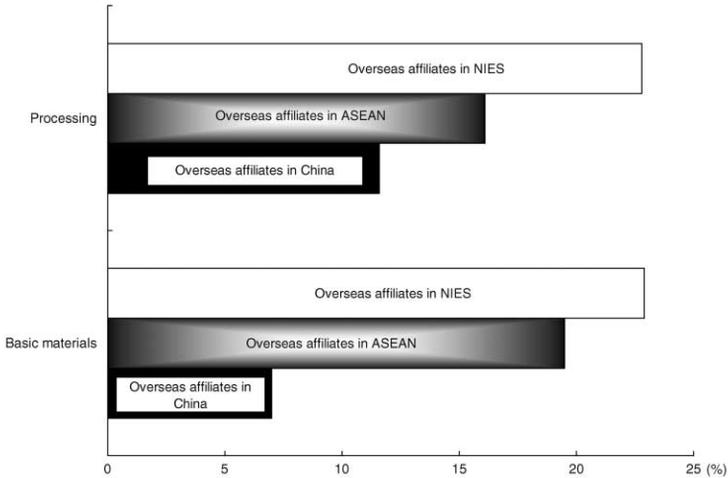
Comparing companies in the assembly & processing industry with those in the basic materials industry, we found a similar ranking pattern in evaluation (NIES ASEAN China). However, we also came across a characteristic that basic materials companies in the ASEAN region and companies in the assembly & processing industry in China tended to have a higher level of satisfaction regarding profitability (**Chart 8**).

Chart 7: Degree of satisfaction regarding profitability of overseas affiliates



Source: Mizuho Research Institute, Ltd., *Survey of Japanese Corporate Enterprises Regarding Business in Asia*.

Chart 8: Evaluation of profitability in the assembly & processing industry and the basic materials industry



Note: The value derived by subtracting the responses for “unsatisfactory + slightly unsatisfactory” from “satisfactory + slightly satisfactory” regarding profitability in each of the assembly & processing and basic materials industries indicates the percentage to the total.

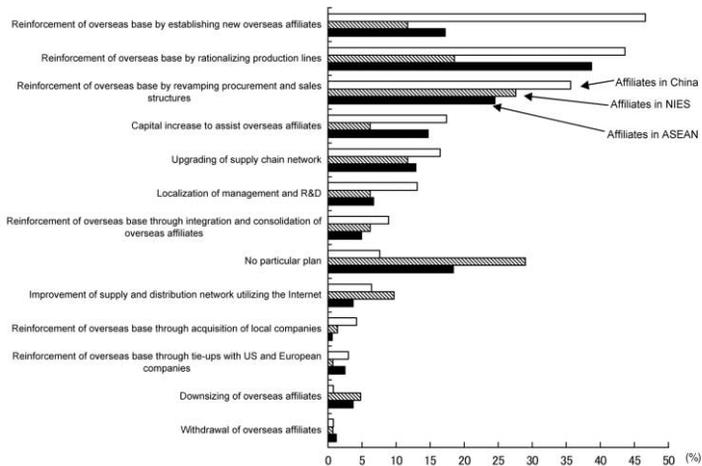
Source: Mizuho Research Institute, Ltd., *Survey of Japanese Corporate Enterprises Regarding Business in Asia*.

3. Business strategies – categorized by geographic area and outlook on demand in Asia

Given Asia’s rapidly changing business environment, we turn to the “next step” contemplated by Japanese companies for their affiliates in Asia. In our survey, we found that 299 companies have plans for some form of business in Asia. We asked each of these companies their “planned endeavors in the coming two to three year period”. The responses ranking high in priority among affiliates in China were as follows: “the reinforcement of overseas base by setting up new affiliates” and “the reinforcement of overseas base by

rationalization of production lines”. Meanwhile, the responses ranking high among affiliates in the ASEAN region were: “the reinforcement of overseas base by rationalization of production lines” and “the reinforcement of overseas base by revamping procurement and sales structures”. Among the frequent responses of affiliates in the NIES were that they have “no particular plan” and “the reinforcement of overseas base by revamping procurement and sales structures” (**Chart 9**). The responses portray affiliates in China striving to expand the size of their operations in contrast to affiliates in the NIES and ASEAN regions seeking to upgrade the efficiency of their operations while maintaining their current network of affiliates.

Chart 9: Future business plans (in two to three years) in Asia



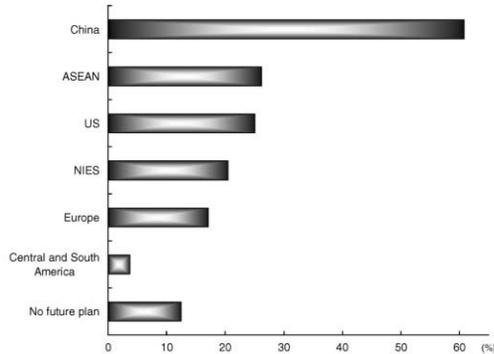
Source: Mizuho Research Institute, Ltd., *Survey of Japanese Corporate Enterprises Regarding Business in Asia*.

The proactive stance toward business in China is not only limited to companies possessing affiliates in China. We asked the companies, regardless of the current state of their business in Asia, to cite the geographic area they intend to focus upon in future global business. Of all the 776 companies responding to our survey, 60.8% cited “China”. Further down the list were “ASEAN (26.2%)”, “US

(25.1%)”, “NIES (20.5%)”, “Europe (17.1%)” and “Central and South America (3.7%). (Chart 10)

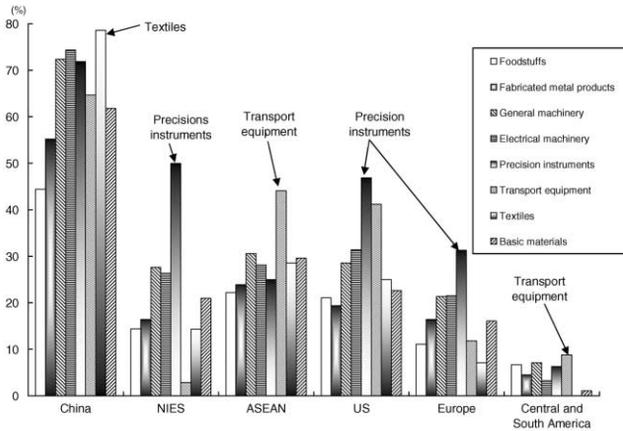
Chart 11 sets forth the survey results by industrial sector. The chart shows that companies in the textiles industries are most enthusiastic about business in China. The precision instruments makers are the most interested in business in the NIES, US and Europe and manufacturers of transport equipment lead the list regarding ASEAN and Central and South America. However, it should be noted that the percentage of responses citing “China” was the highest in all of the industrial sectors.

Chart 10: Which geographic area do you intend to focus upon in future global business operations?



Source: Mizuho Research Institute, Ltd., *Survey of Japanese Corporate Enterprises Regarding Business in Asia*.

Chart 11: Which geographic area do you intend to focus upon in future global business operations – by industrial sector



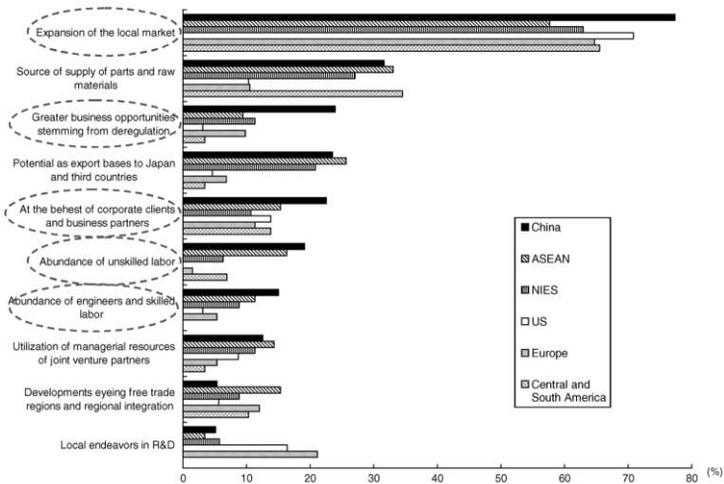
Note: The chart above sets forth the percentage of companies which plan business operations in the geographic areas on the horizontal axis.

Source: Mizuho Research Institute, Ltd., *Survey of Japanese Corporate Enterprises Regarding Business in Asia*.

Chart 12 sets forth the respondents’ reasons for citing the geographic areas in their responses. Of the ten alternative responses provided, China scored the highest in five of the following reasons: (1) “expansion of the local market”, (2) “greater business opportunities stemming from deregulation”, (3) “at the behest of corporate clients and business partners”, (4) “abundance of unskilled labor”, and (5) “abundance of engineers and skilled labor”. Moreover, the percentage of responses citing the expansion of local markets and deregulation surpassed the percentage of responses citing the abundance of skilled and unskilled labor, indicating that many of the companies are trying to permeate China’s domestic market. The large number of responses citing requests by business partners also suggests that manufacturers of parts and basic materials are drawn to China, following in the steps of assembly industries such as electronic appliance and auto makers making inroads into China. Under the current structure of Japan’s corporate expansion into China, we found that investment is generating even

more investment.

Chart 12: Reasons for Doing in Business in Each of the Respective Geographic Areas

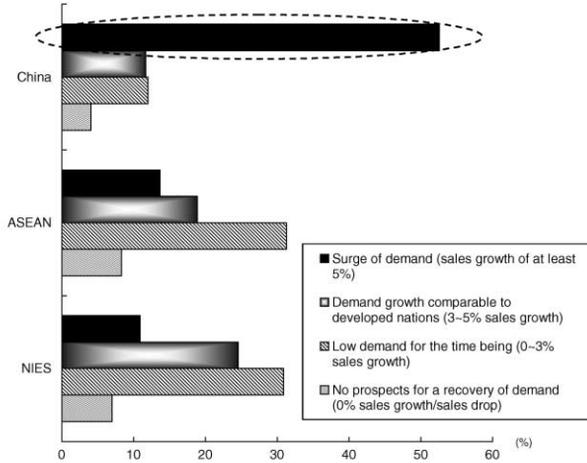


Note: The chart above sets forth the percentage of corporations citing the reasons on the vertical axis among corporations planning business operations in the geographic regions above.

Source: Mizuho Research Institute, Ltd., *Survey of Japanese Corporate Enterprises Regarding Business in Asia*.

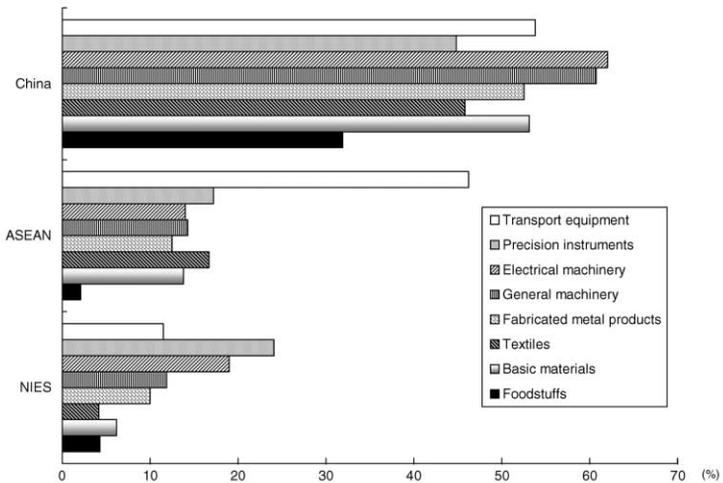
We also questioned 540 companies with business operations in East Asia regarding their outlook on demand for their products in China, the NIES and ASEAN in the coming two to three year period. In contrast to a large number of responses that the companies only expect “low demand for the time being (0~3% sales growth) in the NIES (30.9%) and ASEAN (31.1%) regions, we found that 52.5% expect a “surge of demand (sales growth over 5%) in China (**Chart 13**). Categorizing the responses for the “surge of demand” in terms of industrial sector (excluding transport equipment manufacturers in ASEAN), we found an overwhelming number citing “China” (**Chart 14**). These findings also point to the rising expectations among Japanese companies toward China’s rapidly expanding market.

Chart 13: Outlook on demand for in Asia in the coming 2~3-yr period



Source: Mizuho Research Institute, Ltd., *Survey of Japanese Corporate Enterprises Regarding Business in Asia*.

Chart 14: Companies expecting a “surge of demand” (categorized by industrial sector)



Note: The chart above sets forth the percentage of corporations responding that they “expect a surge of demand” in each of the respective industrial sectors.

Source: Mizuho Research Institute, Ltd., *Survey of Japanese Corporate Enterprises Regarding Business in Asia*.

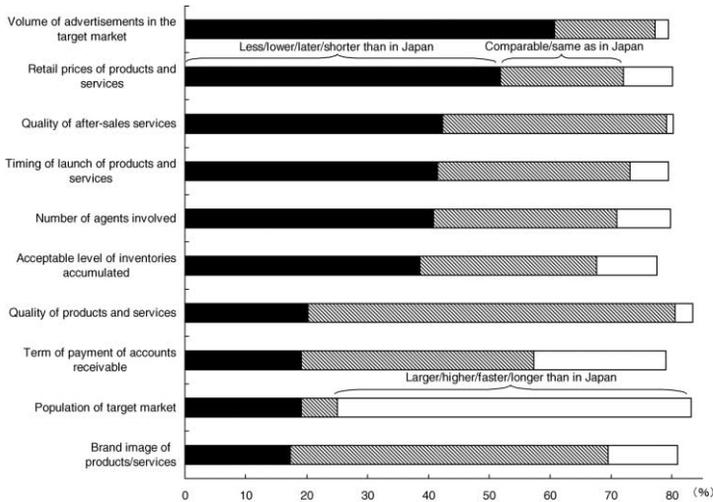
4. The current state and future challenges regarding marketing strategies for the Chinese market

In the light of the growing challenges for Japanese companies to permeate China's domestic market, we turned to the marketing strategies of Japanese companies designed for the Chinese market.

The formation of a meticulous marketing strategy is crucial for success in the fierce competition for the Chinese market. To enter a target market, a company must devise a concrete strategy by utilizing various marketing tools. The optimum combination of these tools is the key to success. Success depends upon the right combination of the so-called "4 Ps of marketing" – namely "(P)roduct", "(P)rice", "(P)lace", and "(P)romotion. For a perspective view of the marketing strategies of Japanese companies for the Chinese market, we highlighted the marketing strategies regarding each of the 4 Ps by comparing them with the strategies taken in Japan (**Chart 15**).

According to responses from 272 companies either doing business in or exporting to China, we found that the level of their efforts in China is equivalent to or greater than their efforts in Japan regarding the "brand image of products/services", "population of target market", "term of payment of accounts receivable" and "quality of products and services". However, we found that "retail prices of products and services" are lower in China. Furthermore, many of the respondents said that the level of their efforts for the "volume of advertisements in the target market", "quality of after-sales services" and "timing of launch of products and services" is lower in China in comparison to Japan. In summary, the foregoing responses indicate that companies are trying to sell products possessing the same quality and brand image as those in Japan at a relatively lower price to a far larger market than Japan.

Chart 15: Marketing activities in the Chinese market in comparison to marketing activities in Japan



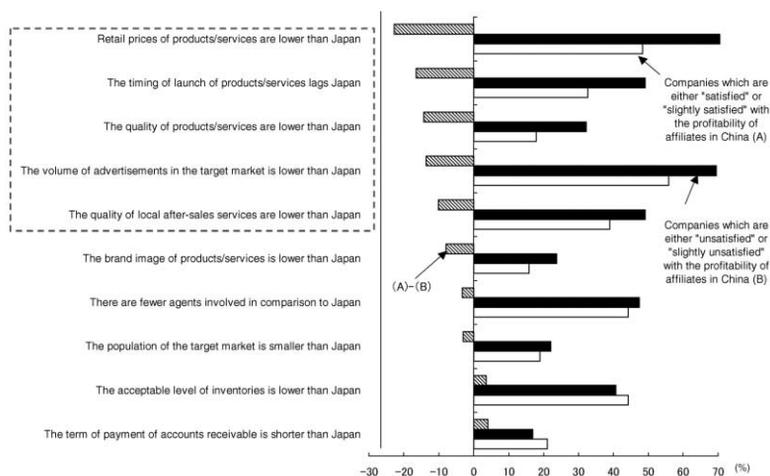
Note: The total does not add up to 100% because some corporations have not responded to certain questions.
 Source: Mizuho Research Institute, Ltd., *Survey of Japanese Corporate Enterprises Regarding Business in Asia*.

In our next step, we juxtaposed these marketing strategies to the profitability of the affiliates in China. **Chart 16** compares and looks at the difference between companies which are either “satisfied” or “slightly satisfied” with their profitability (the “Satisfied”) and companies which are either “slightly unsatisfied” or “unsatisfied” (the “Unsatisfied”).

Between the Satisfied and Unsatisfied groups, we found a gap of more than (and including) 10 points regarding “low retail price of products and services”, “lag in launch of products and services” and “low quality of products and services”. Comparing companies resorting to a marketing mix of “holding retail prices lower than in Japan, lag in launch of products and services, and keeping the quality of products and services low” with those which do not, we found that such companies were generally unsatisfied with their profitability. Although by a narrow margin, we found more companies in the Satisfied group saying that the acceptable level of inventories and

term of payment of accounts receivable were “low/short”. In other words, we found a tendency among companies satisfied with their profitability to set the retail price of products at a relatively high level and strive for standards comparable to those in Japan regarding promptness of product delivery and quality. Companies in the Satisfied group also tend to follow strict Japan-level standards regarding inventories and accounts receivable.

Chart 16: Difference in marketing strategy from the perspective of satisfaction regarding profitability



Notes:

1. The chart above indicates the percentage of companies feeling "satisfied", "slightly satisfied", "unsatisfied", "slightly unsatisfied" regarding their Chinese affiliate's profitability among those companies which responded "less/lower/later/shorter than" in Chart 15.
2. The items enclosed in the broken line are items where we found a gap of more than (and including) 10 points between companies feeling either "satisfied" or "slightly satisfied" with companies feeling either "unsatisfied" or "slightly unsatisfied".

Source: Mizuho Research Institute, Ltd., *Survey of Japanese Corporate Enterprises Regarding Business in Asia*.

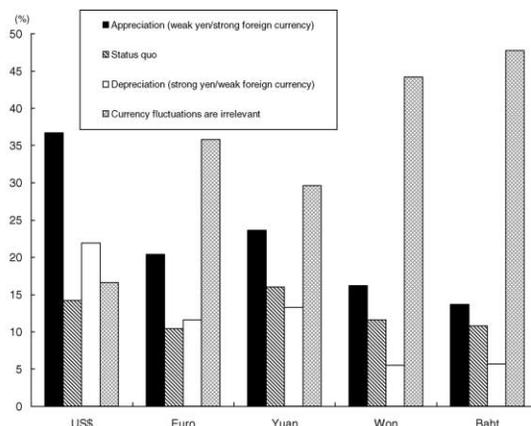
Marketing refers to the act or process aiming to fulfill the needs of customers while ensuring a steady flow of profits. The findings indicate that companies with a high degree of satisfaction regarding profitability are applying a marketing mix of (1) scrutinizing their competitive edge, (2) wielding their competitiveness in the most effective manner, and thereby (3) reaping an appropriate level of profits acceptable to customers.

5. Views regarding the foreign exchange rate and the impact of the appreciation of the yuan upon overseas affiliates

(1) Views regarding the exchange rates of major currencies

In the following section, we shall look at the views held by each of the companies with respect to the foreign exchange rate. We asked all the 776 responding companies the following question, “in the light of your overseas business endeavors and financing positions, how would you like to see the dollar, euro, yuan, South Korean won and Thai baht move against the yen so as to render a favorable impact upon your business results”. With respect to all the currencies above, responses saying that they wish to see the yen’s value weaken outnumbered those favoring the appreciation (strengthening) of the yen (**Chart 17**). The survey results, we believe, reflects the respondents’ concerns regarding exports from Japan. Furthermore, as for the yuan – under mounting pressure to remove the dollar peg and thus appreciate – 23.6% of the companies said that they wished to see the yuan strengthen. Nevertheless, it should be noted that the most popular response was that “currency fluctuations are irrelevant upon business” with respect to all the currencies except for the US dollar. The findings portray a generally low level of interest in foreign exchange rate fluctuations of currencies other than the US dollar.

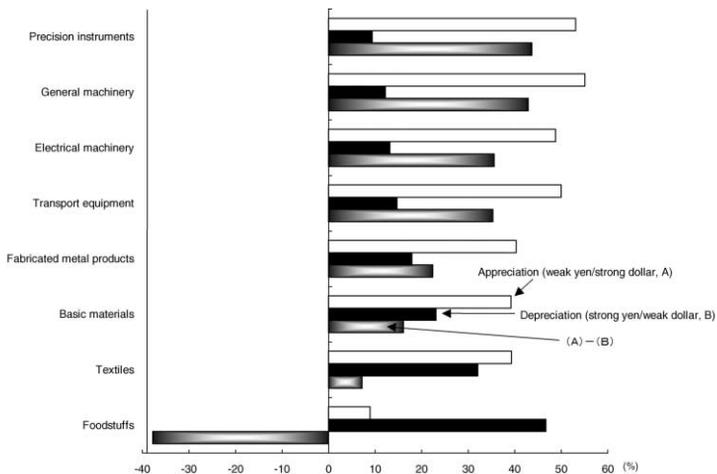
Chart 17: Views on the foreign exchange rate



Source: Mizuho Research Institute, Ltd., *Survey of Japanese Corporate Enterprises Regarding Business in Asia*.

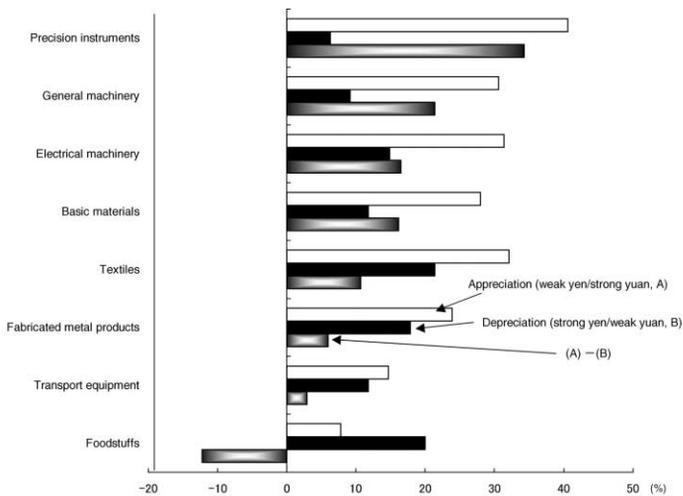
In a perusal of the responses regarding the US dollar and the yuan in terms of industrial sector, we found that only among foodstuff manufacturers, companies wishing to see both the US dollar and the yuan to depreciate against the yen outnumbered those wishing to see their appreciation (**Charts 18, 19**). The findings most likely result from the foodstuff industry's comparatively high degree of dependence upon imports for raw materials and thus a large number of responding companies wishing to see the fall of import prices.

Chart 18: Views regarding the exchange rate level of the US dollar – categorized by industry



Note: The chart above indicates the percentage of companies wishing to see the dollar “appreciate”/“depreciate”.
 Source: Mizuho Research Institute, Ltd., *Survey of Japanese Corporate Enterprises Regarding Business in Asia*.

Chart 19: Views regarding the exchange rate level of the yuan – categorized by industry



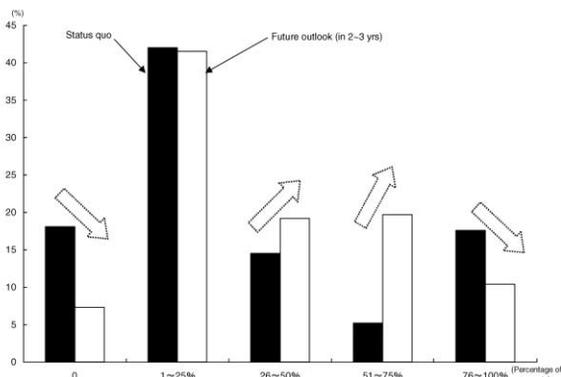
Note: The chart above indicates the percentage of companies wishing to see the yuan “appreciate”/“depreciate”.
 Source: Mizuho Research Institute, Ltd., *Survey of Japanese Corporate Enterprises Regarding Business in Asia*.

(2) Exports from affiliates in China

We then questioned our respondents on their strategies for exports from their production affiliates in China. Despite the ongoing expansion of China's domestic market, we found out that the companies surveyed are not necessarily focused exclusively upon domestic sales in China. We questioned 193 companies engaging in production activities in China, on the current state and future outlook (in two to three years time) on percentage of exports of their production sites in China on a five-point scale from "0%" to "76-100%". The results revealed a downward assessment of the future outlook on the percentage of exports among companies in the "lowest" and "highest" groups while those in the middle range expect the percentage of exports to rise in the future (**Chart 20**). In short, the results indicate a deepening trend among companies to seek a balance between the domestic and export markets instead of a disproportionate focus upon either market.

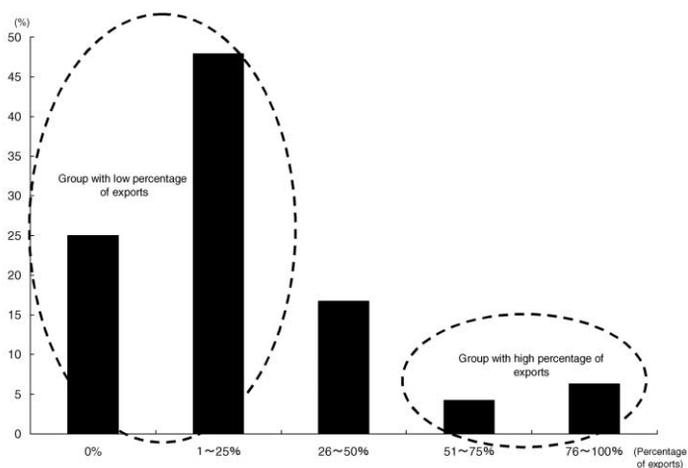
We also found a large number of responses that "business performance will improve as a result of a stronger yuan" among the group of companies with a low percentage of exports (**Chart 21**). The results imply that a stronger yuan will most likely serve as a blow upon export-oriented affiliates in China.

Chart 20: The current state and future outlook regarding the percentage of exports of production affiliates in China



Source: Mizuho Research Institute, Ltd., *Survey of Japanese Corporate Enterprises Regarding Business in Asia*.

Chart 21: Percentage of exports of companies responding that “business performance will improve as a result of a stronger yuan”



Note: The chart above sets forth the current percentage of exports of the 48 companies which responded that their “business performance would improve in the event of an appreciation of the yuan in consideration of present overseas business operations and capital positions”.

Source: Mizuho Research Institute, Ltd., *Survey of Japanese Corporate Enterprises Regarding Business in Asia*.

(3) The impact of a stronger yuan upon overseas affiliates of Japanese corporations in China

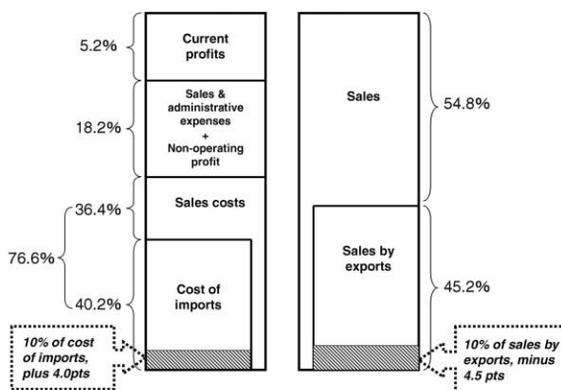
In the event the yuan strengthens, how will the stronger Chinese currency affect Japanese manufacturers with manufacturing affiliates in China? The following is an estimation of the direct impact resulting from a 10% appreciation of the yuan, based upon the cost and sales structures of overseas affiliates of Japanese companies in China. **Chart 22** sets forth a model of the average cost–sales structure of Japanese manufacturers in China in FY2000. The cost structure is represented by the bar graph on the left. The components of total costs (100) would be as follows: cost of goods sold (sales costs) 76.6%, sale & administrative expenses plus non–operating profit (18.2%), and current profits (5.2%). Given that 52.4% of the total value of parts and raw materials of Japanese manufacturers in China depend upon imports, we assume that 52.4%

of sales costs are comprised of imports. Based upon this assumption, we deduce that 40.2% of the cost structure is comprised of imported goods and raw materials. Therefore, in the event of a 10% appreciation of the yuan upon the assumption that there is no change in the volume of imports, 10% of 40.2% (the cost of imports), namely 4.0 pt would be accounted for as the foreign exchange gain. Turn now to the sales structure represented by the bar graph on the right. Expressing total sales as 100, 45.2% is dependent upon exports. Thus, in the event of a 10% appreciation of the yuan and assuming no change in export volume, 10% of 45.2%, or 4.5 pt of total sales would be accounted for as foreign exchange losses.

On the basis of the foregoing cost–sales structure, the foreign exchange gain/loss (after offsetting losses against gains) stemming from a 10% appreciation of the yuan would be – 0.5%, indicating that a stronger yuan would have a slightly negative impact. (Note 5)

As shown above, the short–term impact of a stronger yuan upon a company may be calculated to some extent by looking at the proportion of exports and imports in the cost and sales structures of each company’s operations in China.

Chart 22: Cost and sales structures of overseas affiliates of Japanese manufacturers in China



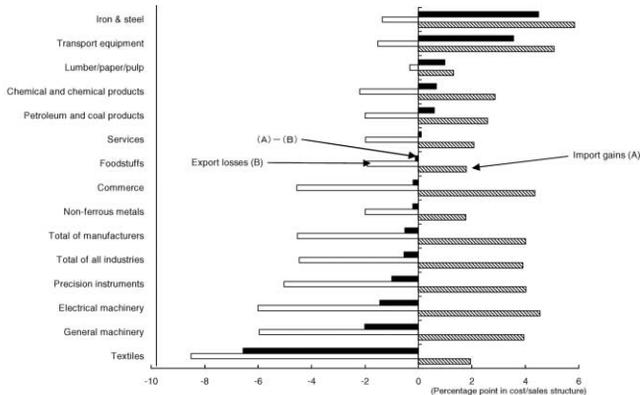
Notes:

1. Based upon "China excluding Hong Kong".
2. Based upon data pertaining to FY2000.

Source: Ministry of Economy, Trade and Industry, 31st Survey of Overseas Business Activities.

Chart 23 sets forth the results of the foregoing estimation on different industrial sectors. In the chart, we subtracted foreign exchange losses arising from the proportion of exports in sales (denoted by “B”) from foreign exchange gains stemming from the percentage of imported parts and raw materials in sales costs (denoted by “A”) for each industrial sector. The difference between A and B indicates that industrial sectors such as iron & steel (4.5 pt), transport equipment (3.6 pt), lumber & paper pulp (1.0 pt) and chemicals (0.7 pt) are affected positively while industrial sectors such as textiles (-6.6 pt), general machinery (-2.0 pt), electrical machinery (-1.4 pt) and precision instruments (-1.0 pt) are negatively affected by the appreciation of the yuan. There is a great diversity in the direct impact of a 10% appreciation of the yuan, depending upon industrial sector, implying that the negative impact is larger in an industrial sector with a higher export percentage. These findings are consistent with the results of our survey that many of those companies saying that “a stronger yuan would benefit business results” belonged to the group with a low percentage of exports.

Chart 23: The impact of a 10% appreciation of the yuan (by industrial sector)



Notes:

1. Based upon "China excluding Hong Kong".
2. Based upon data pertaining to FY2000.

Source: Ministry of Economy, Trade and Industry, 31st Survey of Overseas Business Activities.

Despite the ongoing expansion of China's domestic market, we are inclined toward the view that efforts to cope with the risks stemming from the ebb and flow of macroeconomic cycles will become increasingly important as capitalism sinks into China's corporate managerial culture. For example, even though China's real GDP grew at a blistering pace above 9% y-o-y during the period from the third quarter of 2003 to the first quarter of 2004, there was an alarming rise of investment activity in certain sectors such as iron & steel and cement. This prompted the Chinese government to tighten its regulatory controls from September 2003. New loans toward certain industries were temporarily suspended through administrative guidance and restrictions, leading to the market contraction of the targeted industries. The events were telling that a similar story could unfold in any industrial sector – that the growth of certain markets could be stymied far below initial expectations as a result of government controls.

To stand on a long-term perspective regarding business in China, one must also consider the risks accompanying the fluctuation of the yuan exchange rate in addition to the risks stemming from macroeconomic cycles. Companies doing business in China must be able to reconfigure a strategic balance between exports and domestic sales through an accurate perception and analysis the forgoing changes.

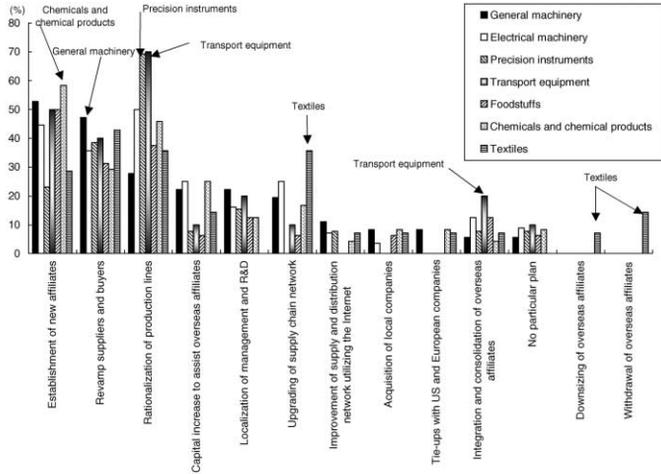
6. Overseas affiliates of Japanese corporations in China are shifting their emphasis toward the reinforcement of profit bases

Lastly, we shall elaborate on the efforts and endeavors of overseas affiliates in China. We extracted 236 companies possessing affiliates in China from the companies surveyed on “future business plans in Asia” (refer to **Chart 9**) and examined the resulting group

according to industrial sector (**Chart 24**). The findings in **Chart 24** reveal a high percentage of affirmative responses for “reinforcement of overseas operations bases by setting up new overseas affiliates” among companies in the chemicals industry, “reinforcement of overseas base by revamping procurement and sales structures” among general machinery manufacturers, and “reinforcement of overseas base by rationalization of production lines” among manufacturers of precision instruments and transportation equipment. Furthermore, responses among companies in the textile industry that they intend to “downsize overseas affiliates” and “withdraw overseas operations” are worthy of attention despite the small number of such responses.

We then compared the business operations of companies having affiliates in China for “five or more years” with those companies with affiliates having a history of “less than five years” in China (**Chart 25**). Here, we found a gap of 10 points or more between the two groups in responses toward the following survey questions: “reinforcement of overseas base by rationalization of production lines”, “upgrading of supply chain network”, “localization of management and research & development at overseas affiliates”, “reinforcement of overseas base by revamping procurement and sales structures”, and “reinforcement of overseas base through integration and consolidation of overseas affiliates”. On the contrary, we found slightly more responses among companies in the “less than five years” category saying that they would “set up new overseas affiliates” and enter into “business tie-ups with American and European corporations”. In short, we found that companies have a stronger tendency to seek qualitative improvements through, for example, reviewing production processes rather than quantitative expansion such as the augmentation of plant and equipment, as their experience and history in China grows longer. This may be interpreted as signs that companies emerging out of the initial stages of its entry into China are striving to reinforce their profit bases through cost cuts by seeking greater efficiency even in an expanding market.

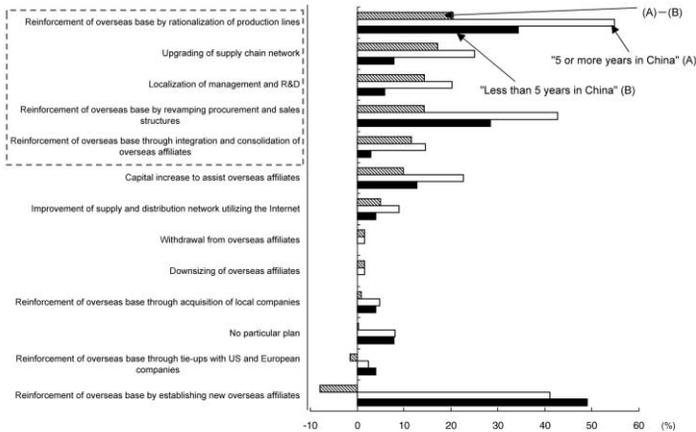
Chart 24: Future business plans in China –by industrial sector



Note: The chart above indicates the percentage of companies for each of the responses.

Source: Mizuho Research Institute, Ltd., *Survey of Japanese Corporate Enterprises Regarding Business in Asia*.

Chart 25: A Comparison of Business Endeavors Among Overseas Affiliates in China – by the number of years since establishment



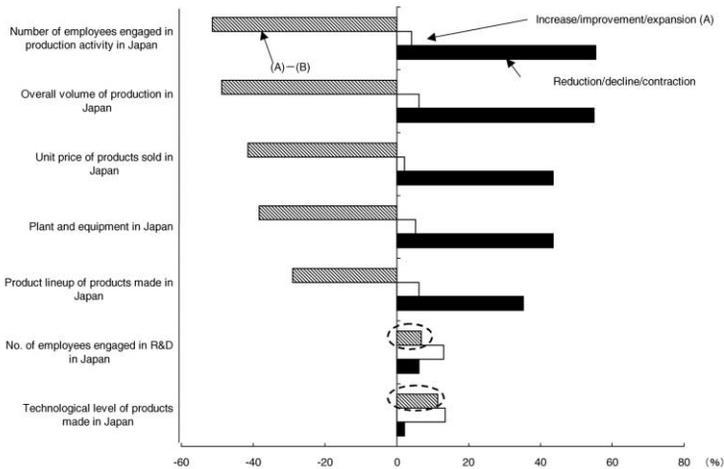
Notes:

- The chart above indicates the percentage of companies for each of the respective responses among companies which have been in China for "five or more years" and "less than five years".
- The items enclosed in the broken line are items where we found a gap of 10 points or more between companies which have been in China for "five or more years" and in China for "less than five years".

Source: Mizuho Research Institute, Ltd., *Survey of Japanese Corporate Enterprises Regarding Business in Asia*.

Next, we attempted to discern the impact upon production sites in Japan stemming from the endeavors to reinforce business operations in China. We asked 193 companies engaged in production activities in China to cite how their business strategies within Japan have changed since the commencement of production activities in China (**Chart 26**). As a result, we found that responses citing a reduction/decline/contraction exceeded those citing an increase/improvement/expansion to queries regarding the “number of employees engaging in production activities”, “overall volume of production”, “unit price of products sold”, “plant and equipment” and “product lineup”. In contrast, we found the opposite results for questions regarding the “number of employees engaging in research & development” and “technological level of products”. Despite the tendency among companies to reduce or downsize quantitative aspects directly related to production, the results indicate the reinforcement of qualitative aspects such as research & development and technological finesse as a result of the increase of production activity in China.

Chart 26: Changes in Business Strategies in Japan Since Commencement of Production Activities in China



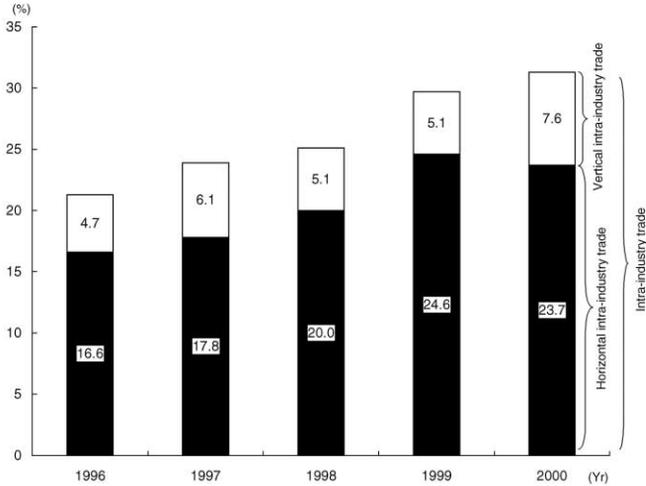
Source: Mizuho Research Institute, Ltd., *Survey of Japanese Corporate Enterprises Regarding Business in Asia*.

7. Concluding remarks: division of labor with the countries of Asia

Summarizing the business endeavors of Japanese corporations in Asia through the results of our questionnaire survey, we found that affiliates in the NIES and ASEAN region and affiliates in China which have been in operation for a certain number of years are striving to streamline their operations by upgrading the efficiency of their operations. Meanwhile, domestic production sites in Japan are shifting toward areas with higher added value through efforts to upgrade their technological finesse.

The progress of division of labor with the countries of Asia is also evident from trade statistics. According to an empirical study by Hikaru Ishido, Keiko Ito, Kyoji Fukao and Yoshimasa Furuike (*Vertical Industry Trade and Foreign Direct Investment in East Asia*, REITI Discussion Paper Series 03-J-009, 2003), the percentage of intra-industry trade (Note 6) is growing rapidly in East Asian intra-regional trade. Particularly noteworthy is the growing proportion of vertical intra-industry trade (Note 7) (**Chart 27**). Exports and imports of commodities of different added value are increasing even though, at a glance, they are categorized all under the same category of trade within Asia. According to this study, of the top ten products (ranked in order of export/import value) in Japan-China trade data on electrical machinery in 2000, six are categorized as vertical intra-industry trade. In all these items, the unit price of products exported from Japan are higher than those imported from China.

Chart 27: The Percentage of Intra-industry Trade in East Asian Intra-regional Trade



Notes: The graph above pertains to China, ASEAN4 (Indonesia, Malaysia, Thailand, Philippines), NIES3 (Hong Kong, South Korea, Singapore) and Japan.

Source: Hikaru Ishido, Keiko Ito, Kyoji Fukao and Yoshimasa Furuike, *Vertical Industry Trade and Foreign Direct Investment in East Asia*, p. 7.

Currently, the typical pattern of Japan’s production activity in the digital consumer electronics industry – the driver of Japan’s economic recovery – is to carry out the overall product design and manufacture of key customized components of products in Japan and to carry out the final assembling in the countries of Asia including China. The findings of our questionnaire survey provide evidence that this pattern is spreading from the digital consumer electronics industry to the entire manufacturing sector.

The results of the questionnaire survey indicate a progressing division of labor within the countries of Asia including China under a process of innovative reformation – a hallmark of Japanese corporations. The ebb of the Chinese threat theory stems not only from China’s emerging market potential but also from these budding endeavors and business strategies by Japanese companies.

* * * * *

Notes:

1. This paper is a summary of a questionnaire survey of 2,339 corporate members of the Mizuho Research Institute, Ltd. I would like to take this opportunity to thank all those who kindly cooperated in this questionnaire survey. An overview of the questionnaire survey is set forth in the supplement.
2. In this paper, exports and imports, all technological transactions such as license agreements and production and sales activities through overseas operations in and with the countries of Asia are referred to collectively as “Asia business”. Furthermore, the term “Asia” in this paper refers to the nine countries/regions including the NIES4 (South Korea, Taiwan, Hong Kong and Singapore), ASEAN4 (Indonesia, Thailand, Malaysia and the Philippines) and China.
3. An article in the Nihon Keizai Shimbun (May 8, 2004)
4. The industrial sectors in this paper are categorized and tabulated in the following manner. “Processing”: the total of fabricated metal products, general machinery, electrical machinery, precision instruments, transport equipment. “Basic materials”: the total of textiles, lumber and lumber products, pulp/paper/paper products, chemicals and chemical products, petroleum and coal products, nonmetallic mineral products, iron & steel, non-ferrous metals. “Textiles”: the total of “textiles”, clothing and other textile products.
5. This estimation provides a fundamental direction based upon a simplified model based upon the following premises: (1) yuan-based accounting by the overseas establishment in China, (2) dollar-denominated exports and imports, and (3) exclusion of any changes in trade volume accompanying currency fluctuations.
6. “Intra-industry trade” refers to bi-directional exports and imports of commodities in the same industry or production group. There is also a form of intra-industry trade involving exports and imports of commodities of different industry or production groups.
7. “Vertical intra-industry trade” refers to bi-directional exports and imports of commodities in the same industry or production group where the quality (to be more precise, the unit price) of the commodity is different. On the contrary, bi-directional exports and imports of commodities in the same industry or production group where there is no qualitative difference is referred to as “horizontal intra-industry trade”.

Supplement: Overview of the Questionnaire Survey of Japanese Corporate Enterprises Regarding Business in Asia

Period of survey: March 8~29, 2004

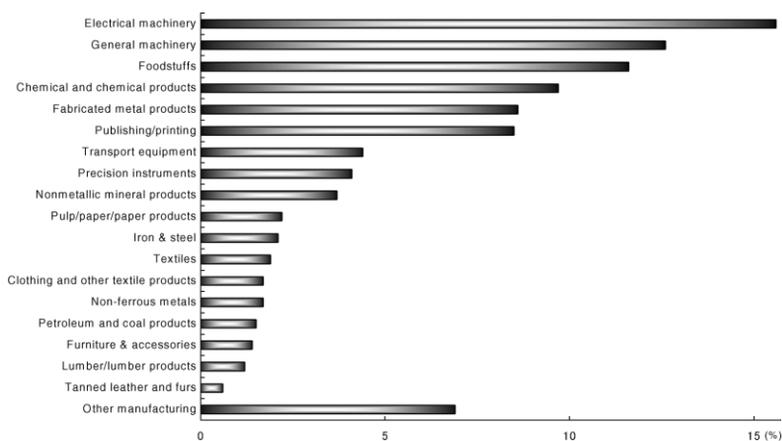
Coverage of survey: Manufacturers with capital over 50 million yen among member corporations of Mizuho Research Institute, Ltd.

Questionnaire surveys sent to: 2,339 companies

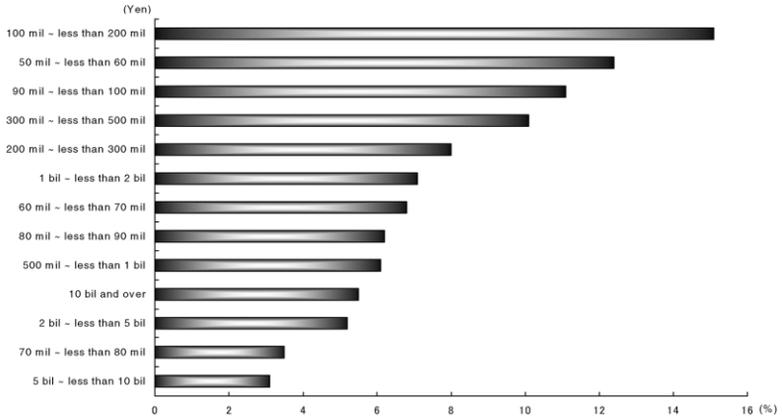
Effective responses: 776 companies (percentage of responses 33.2%)

Survey method: Dispatch and collection of questionnaires by postal mail

Component Ratio by Industry



Component Ratio by Capital



Bibliography

Fujimoto, Takahiro, Takeishi, Akira, and Aoshima, Yaichi, *Business Architecture: Strategic Design of Products, Organizations, and Processes*, Yuhikaku Publishing Co., Ltd., 2001.

Ishido, Hikaru, Ito, Keiko, Fukao, Kyoji and Furuike, Yoshimasa, *Vertical Industry Trade and Foreign Direct Investment in East Asia*, REITI Discussion Paper Series 03-J-009, 2003).

Kotler, Philip, *Marketing Management: Millennium Edition*, Prentice-Hall, 2000.

Kuroda, Atsuro, *Made in China*, Toyo Keizai Inc., 2001.

Morita, Matsutarō, *Keieibunseki Nyumon*, Nihon Keizai Shimbun, Inc., 1990.

New Dynamics of Multinationals in the 21st Century, Edited by The Workshop for the Study of Multinational Enterprises, Diamond Inc., 2003.

Maie, Yoichi, *Jinmingen Reto no Doukou to Kawase Risuku Taisaku no Genjo*, “Chugoku Keizai”, November 2003, JETRO.

Takeda, Shiro, *Takokuseki-kigyo no Shintenkai – Shinshutsu to Tettai no Riron*, Moriyama Shoten, 1987.

Yamashita, Hiroshi, Morokami, Shigeto and Murata, Kiyoshi, *Global Supply Chain Management*, Yuhikaku Publishing Co., Ltd., 2003.

Mizuho Research Institute Ltd.

5-5, Otemachi 1-chome, Chiyoda-ku,

Tokyo 100-0004, Japan

TEL: (03) 3201-0519

FAX: (03) 3240-8223

<http://www.mizuho-ri.co.jp/english/>

