RESEARCH PAPER

Changing Landscape of FDI in Japan

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Abstract

Foreign Direct Investment (FDI) is type of investment that involves injection of funds into a business by an investor from another country. Sometimes when domestically available capital falls insufficient for overall development of the country, foreign capital is seen as a way of filling in gaps between domestic savings & investment. This foreign capital plays an integral role in the development of the country.

FDI brings an influx of wealth into a country, generate additional tax revenue, open avenues of new jobs. Depending on flow of investment, FDI is generally classified as outward FDI and inward FDI.

- Inward FDI is direct investment made by non-resident investors in the reporting country / economy and;
- Outward FDI is the value of direct investment made by the residents of the reporting country to external countries.

Objective of study

In this research paper we have focused on analysing on how investment scenario has changed over the years. As a part of the research, we have analysed current situation of FDI, supportive policies, incentives and initiatives taken by the government of Japan to promote FDI and various sectors/ industries which received maximum FDI in past years.

- Global perspective about investment in Japan
- Detailed analysis of relationship between Japan and India and their growing business transactions.

Introduction

Japan is on 34th position among 190 countries in the World Bank's 2018 Doing business report. Japan's main strength is its position as a leader in R&D sector and advanced technology. Increase in investment from foreign companies will increase the opportunities for promoting innovation, new technologies and expertise.

In spite of language barrier and difference of business culture, inward FDI in japan has grown gradually from year 2001 to 2008 however it has been flat due to financial crisis, devastating earthquake and tsunami which hit Japan in 2011 and as well as the environmental and health concerns arise after the Fukushima Daiichi nuclear power plant disaster.

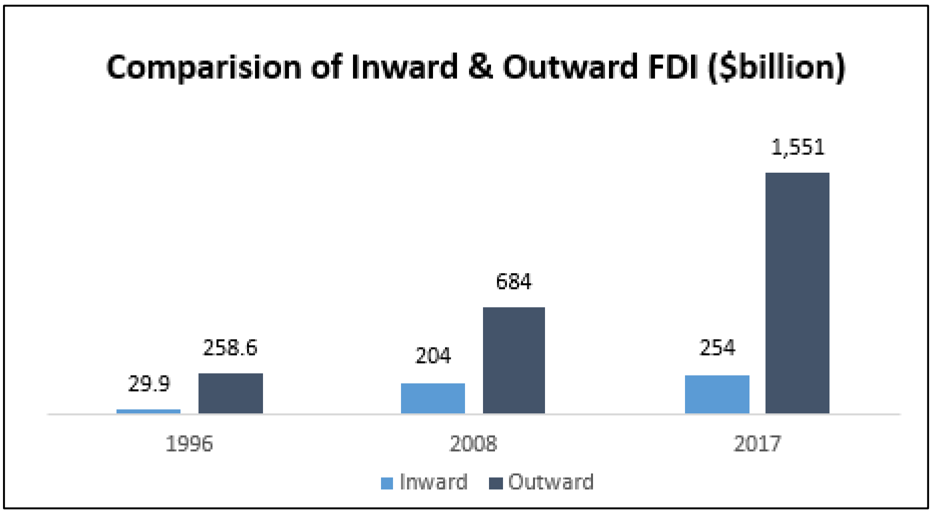
However, the Japanese government is keen to increase foreign investment and restructuring the Japanese economy to attract further investment from abroad. Prime Minister Shinzo Abe's growth strategy aims to double the value of FDI by 2020 compared to the end of 2012.

FDI Trends

Japan's level of inbound / inward foreign direct investment (FDI) has been relatively low compared with the size of outward FDI. In 2008, the value of Japan's inward FDI was USD 204.4 billion, which surged approximately 583% from USD 29.9 billion reported in 1996. In 2017, it further increased by 24% to reach USD 254 billion. On the contrary, Japan's Outward FDI was USD 258.6 billion in 1996 and grew by 164% and reached USD 683.9 billion in 2008 which further increased by 127% and reached USD 1,550.8 billion in 2017.

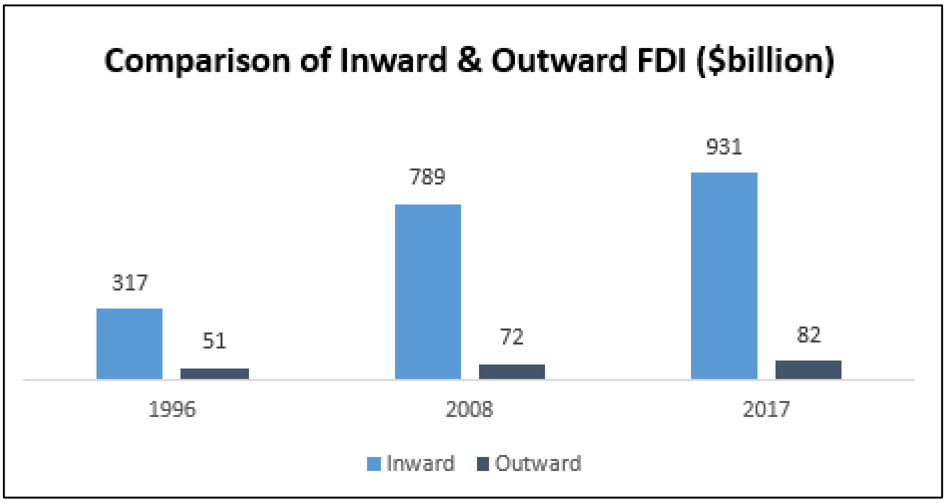
The trend seems to be opposite in the competing countries USA and Germany. The FDI inflows into these countries has increased many folds as compared to their outflows.

FDI in Figures (Japan)



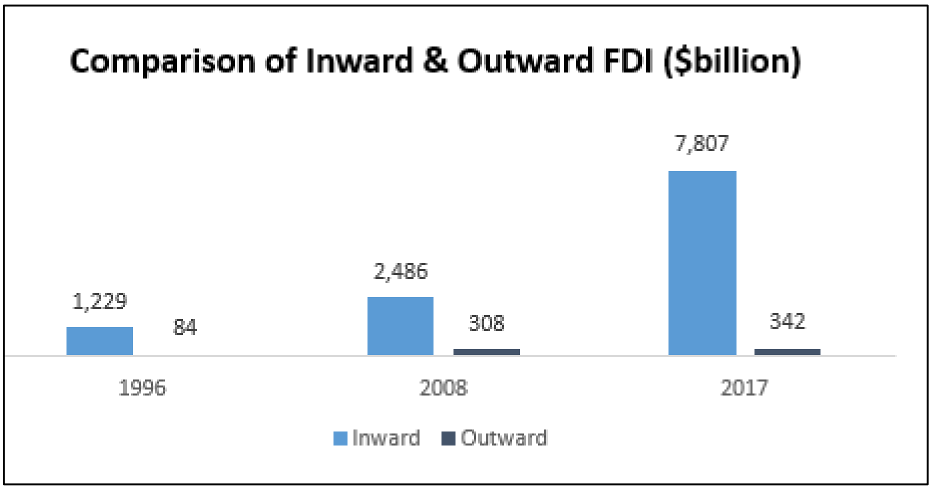
Source: NRI analysis based on data from JETRO

FDI in Figures (Germany)



Source: NRI analysis based on data from UNCTAD

FDI in Figures (United States)

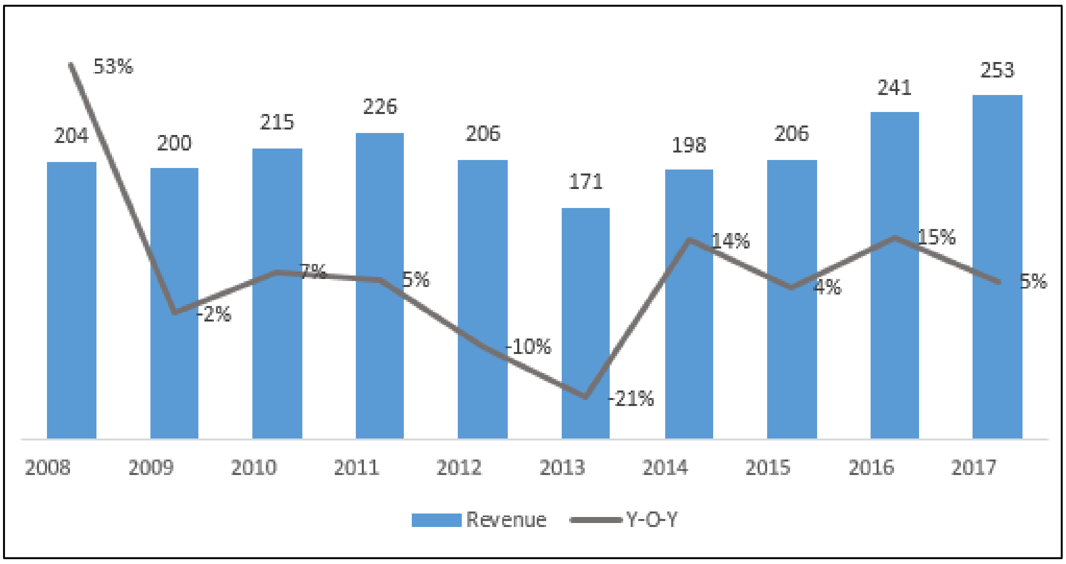


Source: NRI analysis based on data from UNCTAD

FDI inflows in Japan

FDI inflows are relatively unstable in Japan, and have grown at a CAGR of 2.17% in last 10 years. FDI in Japan has been about USD 253 billion in 2017, representing an increase of 5% in comparison with 2016.

Inward FDI trend of last 10 years (In USD billion)



Source: NRI analysis based on data from JETRO

FDI Region wise

By region, Europe has the largest direct investment in Japan at USD 969.5 billion (46%) followed by North America (USD 656.5 billion, 31%) and Asia (USD 94.2 billion, 14%).

Inward FDI Stock by Region (USD billion)

Year/Country	Asia	North America	Oceania	Europe	Others
2008	16.8	75.7	1.1	87	21.4
2009	17.3	76.2	1.1	83.9	21.4
2010	23.3	73.9	1.2	92.2	24.1
2011	26.7	72.9	1.4	101.9	23.3
2012	27.9	63.5	1.5	95.2	18.1
2013	24.5	53.9	1.6	79.0	11.6
2014	30.7	59.1	3.5	92.3	12.6
2015	35.7	58.2	2.6	96.3	12.9
2016	44.3	62.3	3.4	116.7	14.5
2017	47.0	60.8	3.7	125.1	16.8
Total	294.2	656.5	21.1	969.5	176.9

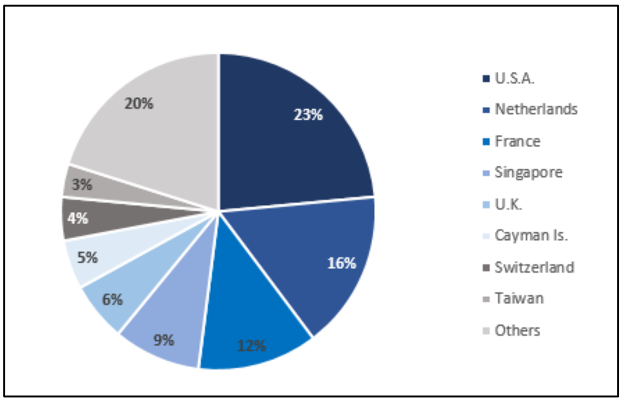
Source: NRI analysis based on data from JETRO

FDI Inflow by Country and Industry

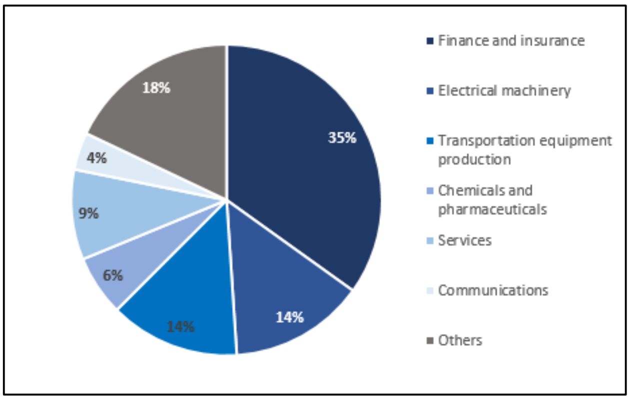
In 2017, the United States, Netherlands, France, Singapore, UK, the Cayman Islands, Switzerland and Taiwan were the main investing countries and represent almost 80% of the FDI inflows in Japan.

Sectors which received maximum inward foreign investment include finance and assurance, electric machinery, transportation equipment production, chemical and pharmaceuticals, services and communication. Stock by industry is the largest for finance and insurance reaching USD 70.73 billion (the share of 35.0%) followed by electric machinery manufacturing by USD 28.11 billion (14.1%) and transportation equipment manufacturing by USD 27.20 billion (13.6%)

Inward FDI stock in Japan by country and region



Inward FDI stock in Japan by Industry



Source: NRI analysis based on data from JETRO

Government Policies & Initiatives

<u>Policy</u>

Japan, which has long been an investor, has gradually evolved itself to one of the investment attractive destination. The inward FDI flow has seen an increasing trend with hitting its record high in 2017.

It has been seen that the FDI landscape in Japan is transforming, triggered by Government policies to promote foreign businesses invest in the country.

Prime Minister Shinzo Abe's pro-global business policy known as Abenomics coupled with government initiatives, is creating a conducive environment for overseas investors.

Abenomics

This comprehensive policy package was unveiled in 2012 by the Prime Minister Shinzo Abe and his government. It was launched with the objective of reviving the Japanese economy from two decades of deflation while maintaining the fiscal discipline.

Initially launched as a stimulus measure based on "three arrows" of monetary easing, fiscal stimulus and structural reforms has evolved into a broader blueprint for pro-growth socioeconomic change that aims to lead Japan in tackling today's challenges head-on.

Since the launch Abenomics has been working to overcome deflation and it is expected that it would continue to boost the Japanese economy.

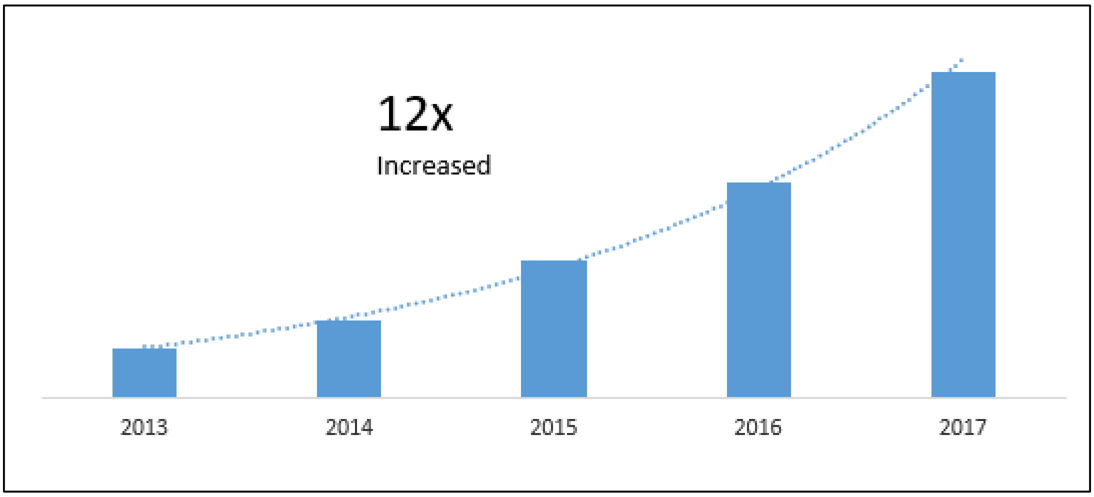
Initiatives

Japan has a target of achieving USD 315 billion of FDI by 2020. The Government is taking a variety of initiatives to reach its FDI target of 2020. Out of several initiatives, we have highlighted 5 initiatives which have major impact, in the below section:

1. Ease of Visa Issuance Rule for Foreign Professionals

With ageing population, a growing concern in the country, the Japanese Government in April 2017, announced that it has relaxed the requirements for permanent residency for foreign individuals who are seeking to get employment in the country. Before the relaxation, skilled non-Japanese workers had to stay in Japan for at least five years before applying for permanent residency which has now been reduced to one year.
The number of foreign working professionals have increased by 12x from 2013 and reached to 10,572 in 2017.

<u>No of Foreign working professional</u>



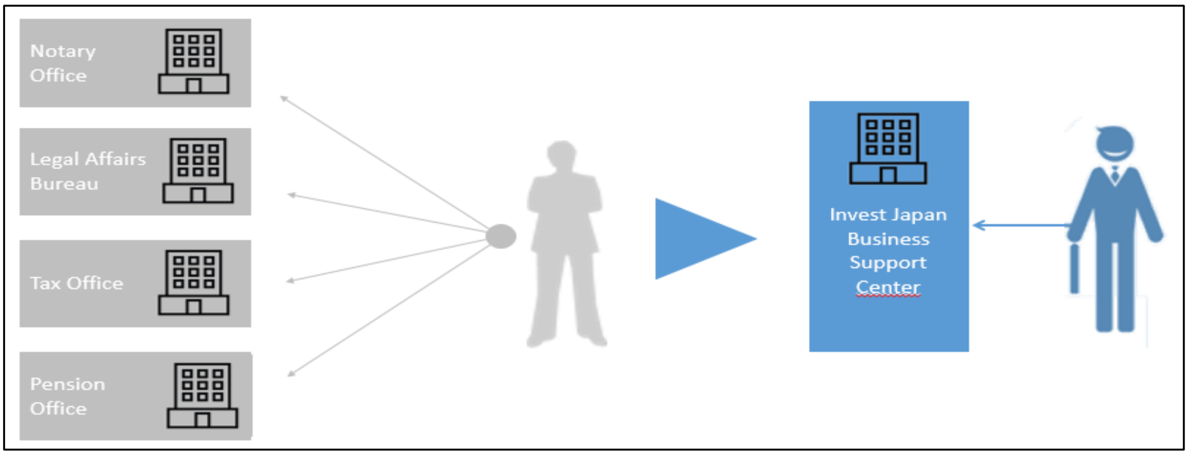
Source: NRI analysis based on data from JETRO

2. Establishment of Invest Japan Business Support Center (IBSC) – a One stop service for investors

Initially, due to the absence of a single platform, the foreign businesses had to approach individual offices for getting necessary approvals, thereby, leading to increased time and cost.

The Japanese Government, in order to reduce time and cost of administrative procedure, thought of developing a one stop window for these procedures.

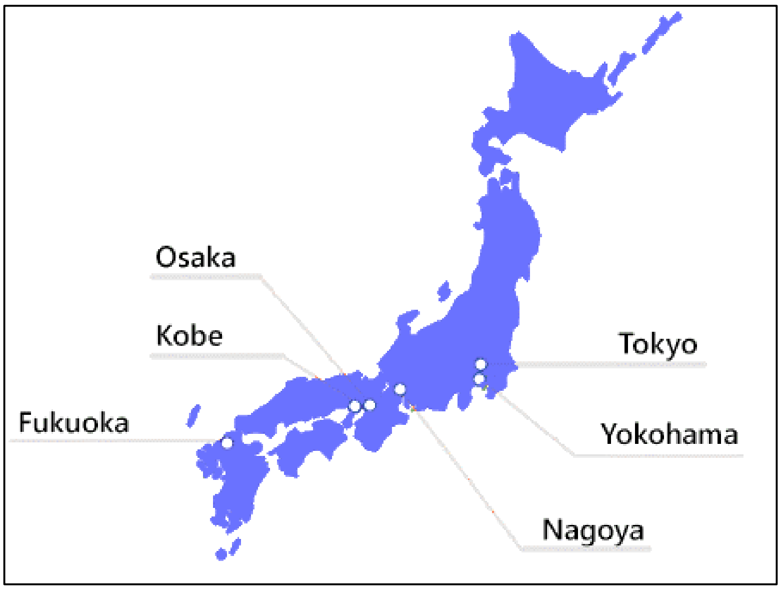
One stop window for FDI in Japan



Source: JETRO

The Japanese government has simplified administrative procedures by establishing a unified support environment for the all the foreign investors. The "Invest Japan Investor Support Center (IBSC)" acts as a one stop provider to all the foreign businesses who are willing to collaborate or invest in the country.

IBSCs location in Japan



Source: JETRO

3. Reduction in Administrative cost

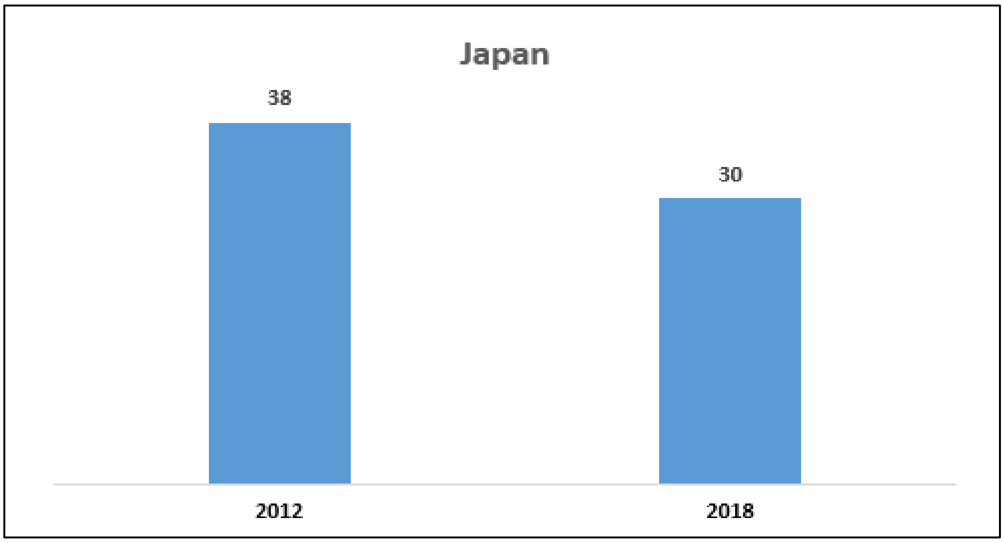
The Japanese government aims to reduce the administrative costs by 20% (as compared to 2017) by 2020 in areas that are considered to generate the heaviest burdens, such as business approvals, licenses and social insurance.

4. Decline in Corporate Tax Rate

The high corporate tax rate in Japan acted as one of the main barriers that had refrained the foreign companies to operate in Japan.
The corporate tax rate stood at 38% in 2012, however after Minister Shinzo Abe administration efforts have been made to reduce the corporate tax rate. The corporate tax rate has reached 30% in 2018. Though the corporate tax rate in Japan has decreased, however, the decline is still low as compared to competing countries. Therefore, the Japanese government further plans to reduce the corporate tax rate in the future in order attract more investments from foreign countries.

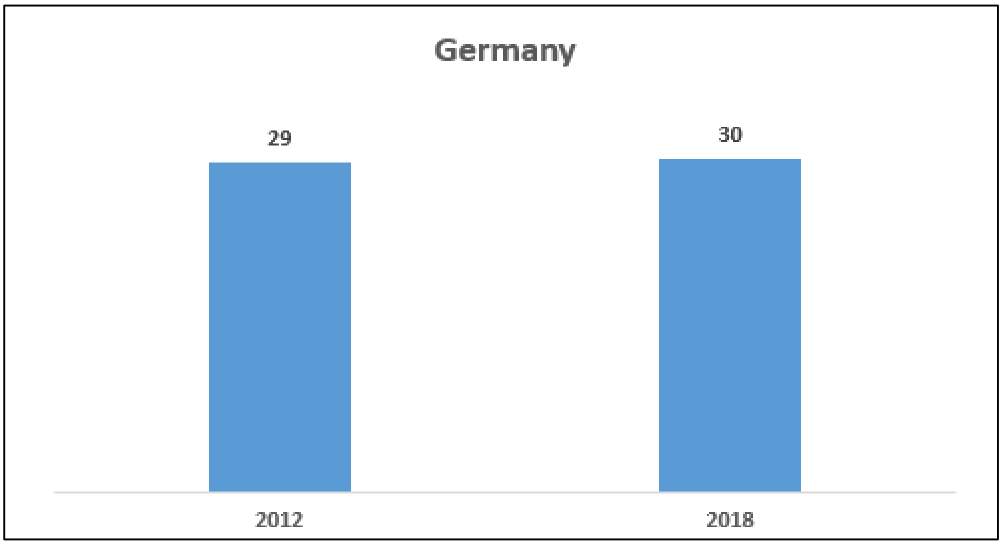
In December 2017, the Japanese Government announced that it has approved new carrot-and-stick tax measures to bring corporate taxes down to 25% for companies who will raise wages by 3%, and to as low as 20% for those invest in new technologies, communications and internet-of-things.

Corporate Tax Rate (Japan) (in %)



Source: NRI analysis based on data from JETRO

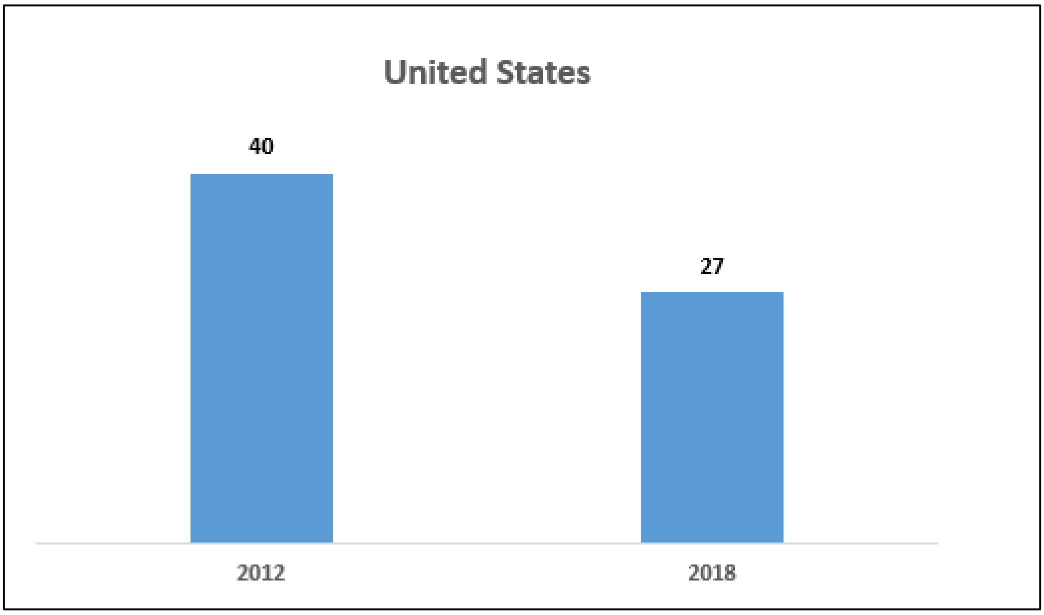
Corporate Tax Rate (Germany) (in %)



Source: NRI Analysis based on data from Germany Trade & invest

*Note: The overall corporate tax rate can range approximately between 22.83-36.83% due to local trade tax rates. The overall income tax rate for corporations includes corporate income tax at a rate of 15%, a solidarity surcharge at a rate of 0.825% (5.5% of the corporate income tax), and local trade tax. The local trade tax generally varies between 7% and 21%, with rates determined by municipalities

Corporate Tax Rate (United States) (in %)



Source: NRI Analysis based on data from Invest in America

Note: * The federal corporate income tax rate is 21%, for taxable years beginning after December 31, 2017. Most state and many local governments impose net income taxes. The top marginal rate generally ranges from 0% to 12%, with the mean of the top state tax rates being roughly 7.5%. In addition, many states and localities also impose gross receipts taxes, capital-based taxes, and other taxes that are not reflected in the rates provided. A corporation may deduct its state and local income tax expense when computing its federal taxable income, generally resulting in a net effective rate of approximately 27%

5. **Change in regulatory framework to attract investment**

The reformation of fundamental regulations in the sectors such as Healthcare and energy is acting as a one of the major drivers for attracting investment into the Japanese market.

Healthcare system

- Speedy and efficient approval review of advanced medical products (regenerative medicine, medical devices)
- Promoting practical use of regenerative medicine for medical care

Energy market

- Implementing a drastic reform of electric power and gas system for the first time in 60 years
- Full liberalization of retail market of electricity (April 2016)
- Full liberalization of retail market of gas (April 2017)

People Voice: Perspective about Japan

With regards to the perception of people throughout the globe, Japan is seen as an investment friendly country owing to the diversity of skill sets and technical development. The following have been observed as the common pros and cons, basis industry expert opinions:

Pros observed:

- **Skilled technical manpower**, **equipped with latest technologies** – Japan has been observed to be in the forefront of technological development.
- **Maintains high quality standards** - It is considered to be a test market. The product once qualified in the Japanese market is accepted as a quality brand by all other nations.
- **Branded itself as an R&D hub** – Japan is perceived to be a country that invests heavily in R&D for continuous product development.
- **Availability of advanced infrastructure facilities** – Government supports infrastructural development, hence, a large amount is spent on it.
- **Government's evolving investment support policies** – Government of Japan actively seeks to re-design its investment promotion policies to attract the interest of foreign investors.

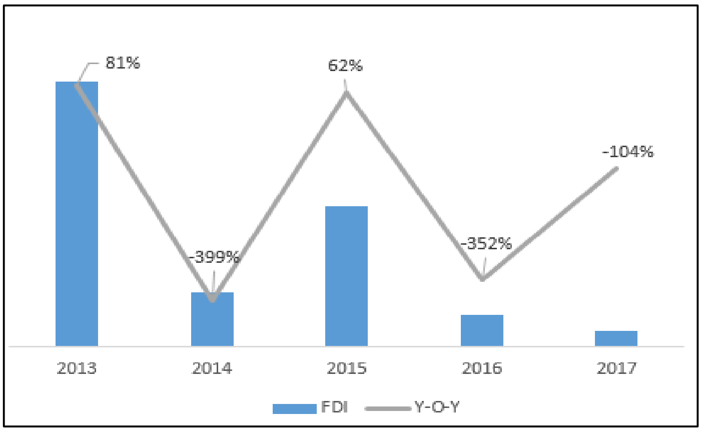
Cons observed:

- **High Operational Cost**: The rising cost of construction and maintenance is a concern for the business in Japan. The cost of setting up the plant is high as compared to China and US.
- **Cultural & Language Barrier:** The Japanese businesses are not very open to work with companies outside of the domestic territories. Therefore, it is difficult to gain the trust of Japanese business partner because of their restricted nature. Smooth communication also tends to be hindrance because most of the people are not well versed with English.
- **Conservative Nature:** The Japanese people are very conservative when it comes to spending. They tend to save more in order to secure their future.
- **Risk Averse Attitude:** As compared to other similar economies, Japanese businesses take a lot of time in taking investment decisions making it difficult for the foreign companies to function smoothly.
- **Rapidly Aging Population**: Working age population is declining leading to a shrinkage in the size of labour force.

India Perspective

Over the years, it has been observed that the overall FDI outflow from India to Japan has been on the lower end. However, speaking in relative terms India's investment in Japan has decreased rapidly between 2013 to 2017.

Outward FDI from India to Japan (USD million)



Source: NRI Analysis based on data from RBI

The year 2013 and 2015 were exceptions wherein the investment increased drastically owing to two major M&A deals.

Indian investment deals with Japan

Year	Indian Company	Japan Company	Deal Size (USD million)	Strategy
2013	Reliance Big Entertainment Pvt. Ltd.	Reliance Big Entertainment Japan Co. Ltd	16.84	Expand in Japan
2015	Mahindra & Mahindra Ltd	Mitsubishi Agricultural Machinery Co Ltd	24.9	Seek access to technology and brand power of MHI to strengthen its competitiveness in Japan and global markets

Source: NRI Analysis based on data from RBI

It has been seen that Outward FDI from India to developed countries has been mainly through mergers and acquisitions for expanding into the countries. In case of Japan, Indian companies primarily focus on acquiring technical skills in order to strengthen their technological base.

Key reasons attributed to declining investment

The perception of the people in Japan towards Indian products is acting as one of the key hindrance of Indian investment into the Japanese nation. The Japanese people are of the view that Indian products are low in quality, therefore, they do not look forward to import items from the Indian markets.

Other reasons include: stringent FDI policies, high corporate tax rate, non-accepting culture of Japan.

Future Perspective

We understand that the situation would change further, as the Government of India and Government of Japan have signed numerous bilateral agreements for investment promotion activities. The Japanese government also expect the quality of products in India to go up in order to build the trust in Japanese market.

Conclusion

After analysing all the facts, it may be concluded that Japan is a viable country for investment. However, the country needs to work on simplifying its traditional business practices which is restricting them to collaborate with foreign companies.