

Section 4 Business opportunities for Japanese companies

1. Exports from Japan to China

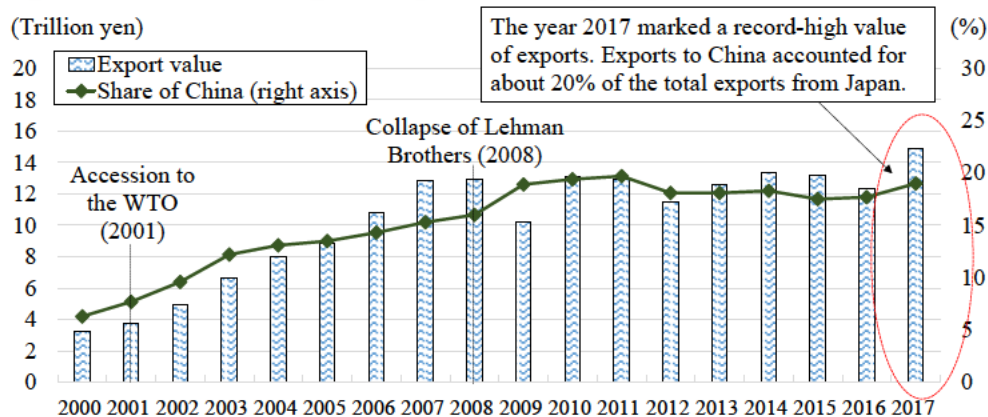
In this section, we will examine business opportunities for Japanese companies in China. First, we will provide an overview of exports from Japan and then examine the trends in the Chinese market and Japanese affiliates in China.

China's economic growth, which was already discussed, is considered to have favorable effects on exports from Japan through the expansion of the market. It should be kept in mind not only that China's economic size is growing but also that various structural changes are occurring at the same time. This suggests that not all sectors are necessarily growing equally but that the degree of growth varies from sector to sector. In particular, significant business opportunities can be expected in sectors where growth is anticipated. One of the major changes occurring in China is a rise in the income level of individuals. From the macroeconomic viewpoint, a shift from investment to consumption is a major change. It has been pointed out that in the expanding consumer market (so-called B to C market), market segments for infants, elderly people and the middle class are growing markedly. It is also said that in the market for companies (B to B market), such sectors as industrial robotics and environment-related technology are promising as China is oriented toward changes in the industrial structure, the upgrading of its industries and a green economic growth now that the working-age population has started to decline on the demographic front.

Now, let us examine growth sectors while looking at actual statistics. First, we will provide an overview of the trend in overall exports from Japan to China. In the 2000s, the value of exports to China increased considerably following the country's accession to the WTO (Figure II-3-4-1-1). Later, although exports slumped after the collapse of Lehman Brothers, the value of exports from Japan hit a record high of around 14.9 trillion yen in 2017. This figure, the second highest in that year after the value of exports to the United States, around 15.1 trillion yen, accounted for some 20% of the total value of Japanese exports. In recent years, it has also been pointed out that cross-border e-commerce has increased rapidly. In 2016, the value of cross-border e-commerce came to 1.0366 trillion yen, surpassing the 1 trillion yen mark for the first time, and in 2017, the value is estimated to have reached 1.2978 trillion yen (up 25.2% from the previous year) (Figure II-3-4-1-2).¹⁶²

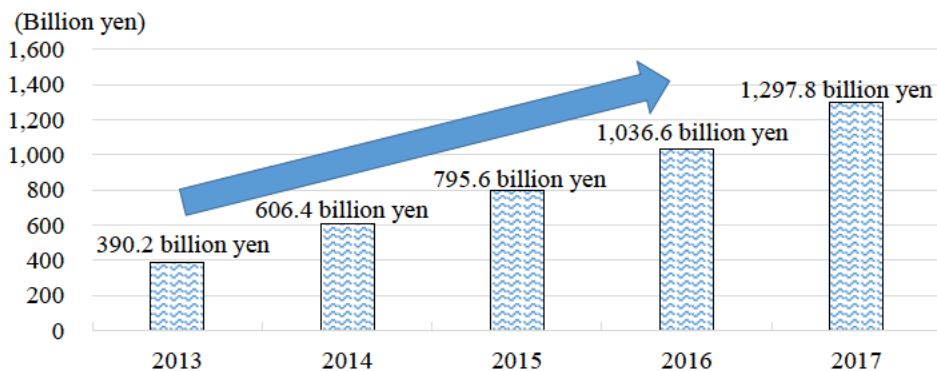
¹⁶² Indicated here is the value of purchases by Chinese consumers from Japanese business operators through cross-border e-commerce (B to C) transactions. The estimate of cross-border e-commerce covers a wider range of transactions than customs statistics covering trade in goods, including (non-digital) services, such as financial transactions and ticket sales, online social games, cloud services, and digital services, such as smartphone applications in addition to goods sales.

Figure II-3-4-1-1 Changes in exports from Japan to China



Source: Global Trade Atlas.

Figure II-3-4-1-2 Value of purchases by Chinese consumers from Japanese business operators through cross-border e-commerce



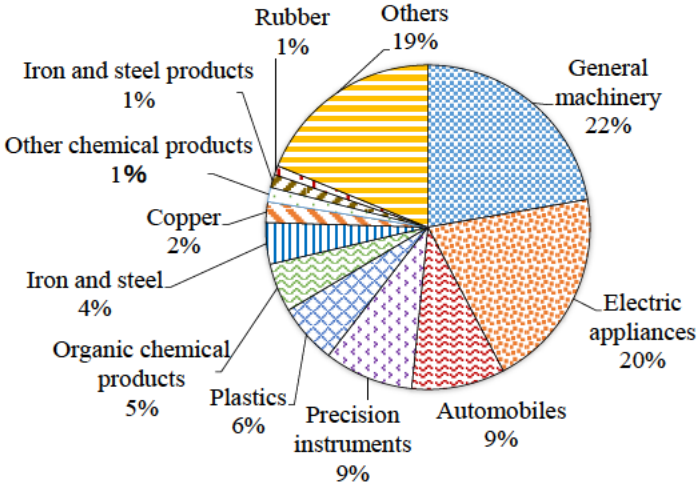
Source: *E-Commerce Market Survey (annual versions)* (METI).

We will examine items for which exports have increased recently after looking at the basic structure of exports from Japan to China. On an export value basis, the main items of export from Japan are machinery-related ones, including general machinery, electrical equipment, automobiles, precision machinery, and machinery parts, which together account for around 60% of the total, followed by materials, including plastics, organic chemicals and steel (Figure II-3-4-1-3). As was pointed out in past white papers, Japanese companies, particularly manufacturers, have actively expanded abroad and engaged in international division of production while taking advantage of the strengths of individual countries, mainly in East Asia.¹⁶³ To put it simply, the typical arrangement was to export advanced core parts and production equipment from Japan, assemble products locally and export the products to Japan and other countries. Reflecting this arrangement, the current mix of items of export from Japan to China is mostly comprised of the following items: general machinery, including production equipment such as machine tools and semiconductor manufacturing equipment, and engine and other machinery parts; electrical equipment, including integrated circuits and other electronics equipment parts; automotive

¹⁶³ This network of international division of production is called a global value chain or a global supply chain.

parts; precision machinery, including core parts and production equipment such as liquid crystal devices, optical fibers, control equipment, and testing and measuring equipment.¹⁶⁴ As the export structure is based on the Japanese manufacturing industry’s international division of production, Japanese affiliates in China have a large share as a recipient of exports from Japan, but some exports from Japan are also estimated to be shipped to Chinese and other companies in China.¹⁶⁵

Figure II-3-4-1-3 Mix of items of exports from Japan to China



Notes: This figure shows the top 10 items with a two-digit HS code that are extracted in terms of export value in 2017.

Source: Global Trade Atlas.

Now, let us look at recent trends, particularly concerning items for which the growth rate has been markedly high recently. In the machinery category, exports of machine tools¹⁶⁶ are growing significantly, presumably reflecting Chinese investments in labor saving and rationalization (Table II-

164 According to the Research Institute of Economy, Trade and Industry’s RIETI-TID database, capital goods such as machinery accounted for 24.2% of overall Chinese imports from Japan in 2016 and parts & components accounted for 33.7%, together making up around 60% of the total, while processed goods, such as steel and chemicals accounted for 30.8%. This means that intermediate goods and capital goods used for production accounted for most of Chinese imports from Japan. On the other hand, final consumption goods accounted for only 9.3% of the total.

165 According to the Ministry of Economy, Trade and Industry’s Basic Survey of Japanese Business Structure and Activities, the share of exports to affiliates in the value of exports by Japanese manufacturing companies was 55.8% (global total; fiscal 2015). According to the Basic Survey on Overseas Business Activities, the share of exports to affiliates in the value of exports by Japanese manufacturing companies which had foreign subsidiaries was 66.0% (global total; fiscal 2015). These results indicate that the share of transactions with their own foreign subsidiaries is large in Japanese manufacturing companies’ exports. However, it can also be said that Japanese manufacturing companies export some products to other Japanese companies’ affiliates, local companies and multinational companies in third countries.

166 Product item names were modified in some cases in order to make it easier for readers to understand. For example, although there is not a “machine tool” category under the HS code system, items under HS8456 to HS8466, including laser processing machines (HS8456), machining centers (HS8457), lathes (HS8458), milling machines (HS8459), and parts (HS8466) were regarded as machine tools and parts thereof and were referred to as such.

3-4-1-4). In addition, reflecting an increase in the number of internet users, demand for semiconductors is said to be growing rapidly, so the value of exports of semiconductor manufacturing equipment is large and the growth rate is high. Regarding machinery parts, exports are increasing at double-digit rates for automobile-related items, including engines and automotive parts, and electronics equipment-related items, including printed circuits, switchboards, switches, liquid crystal devices and optical fibers. The value of exports of integrated circuits is large and the growth remains stable. The trends already mentioned, including the peaking-out of the working-age population, rising personnel cost, Made in China 2025, and industrial labor saving, sophistication and electronification through the Internet Plus initiative, are considered to be providing opportunities for exports of machine tools, semiconductor manufacturing equipment and electronic equipment parts, among other items.¹⁶⁷

Exports of those machinery-category items are considered to be based on the manufacturing industry's international division of production, but exports of consumer goods have also increased recently. Regarding consumer goods, exports of cosmetics, medical products, recreation-related items, including toys and travel, and products for infants, are also growing significantly.¹⁶⁸ As was already mentioned, consumption growth associated with the rise in the income level is supporting exports of items related to everyday life. Regarding foods, exports of tea, refined sake, beer, and fruit and vegetable juice are also increasing considerably, indicating growth of gastronomy in China. It has been pointed out that one factor behind these trends is confidence in Japanese products as being safe and reliable.¹⁶⁹ With respect to consumer goods, it may be presumed that an increase in purchases through cross-border e-commerce is having an impact. There are many people who have the experience of purchasing Japanese products through cross-border e-commerce, and reasons related to travel to Japan, such as that the attraction of Japanese products was found during a trip to the country, have been cited for such purchase.¹⁷⁰ Among products ranked high as items purchased through cross-border e-commerce are cosmetics, foods and medical products. These items coincide with the items for which the export growth rate is high based on trade statistics.

167 Among machines and equipment, exports of medical equipment (HS9018), in addition to industrial machinery, are growing steadily (the value of exports at 793 million dollars and the year-on-year growth rate at 13% in 2017).

168 In December 2017, China lowered tariffs on 187 product items, including foods, home electrical appliances and daily goods, and this is expected to have a favorable impact on future imports of consumer goods.

169 According to an internet survey conducted by JETRO with Chinese consumers in August 2017 ("CHUUGOKU NO SHOUHISHA NO NIHON SEIHIN TOU ISHIKI CHOUSHA"), Japan was ranked No. 1 (selected by 36.4% of the respondents) in terms of the perception of a country associated with eco-friendliness (energy-saving and environment friendly) among Chinese people and No. 2 (selected by 25.5%) in terms of the perception of a country associated with safety (in this survey, the respondents were asked to select one country out of the total of nine countries, including Japan, China and the United States).

170 The above survey also covered the usage of cross-border EC. Of the respondents, 67.7% had the experience of purchasing Japanese products. The frequently cited reasons for using cross-border EC included "not on sale in China" (44.4%), "found the product attractive during a trip to Japan" (40.4%), and "Japanese products are not fakes" (32.4%). Among the most popular items purchased through cross-border EC were cosmetics (48.5%), foods (41.6%) and medical products (35.5%).

Table II-3-4-1-4 Major items for which the growth rate of exports from Japan to China has been high¹⁷¹

[Industrial machinery]

(Unit: Million dollars; %)

HS	Category of item	Export value	Growth rate	
		2017	2017 (annual value)	2014-2017
8429	Civil engineering machinery (bulldozers)	214	63.4	71.0
8456	Machine tools (for laser processing)	245	60.9	45.6
8477	Rubber/plastics processing machinery	903	48.4	52.4
8486	Semiconductor manufacturing equipment	6,552	43.5	118.1
9030	Measuring instruments (for measuring quantity of electricity, e.g., oscilloscopes)	640	44.3	66.0
8457	Machine tools (machining centers)	1,359	39.0	2.4

[Consumer goods]

(Unit: Million dollars; %)

HS	Category of item	Export value	Growth rate	
		2017	2017 (annual value)	2014-2017
3304	Beauty care products and preparations for cosmetics	723.3	98.1	327.7
3305	Preparations for shampoos and other haircare products	128.4	94.2	367.1
3401	Soaps	199.2	77.4	296.1
3005	Sanitary cotton, gauze, and bandage	45.4	57.3	160.1
9503	Toys, e.g., models	21.1	42.7	240.7
4202	Travel bags, handbags, wallets, jewel cases	7.3	32.6	128.7
9619	Diaper for babies	1,220.8	25.7	121.1
2402	Tobacco	6.8	23.5	1,330.7
6111 +6209	Babies' garments and clothing accessories	1.1	-1.5	992.5

171 Indicated in the table are items exported from Japan to China in 2017 which are notable for their high growth rates on a four-digit HS basis. The growth rate for "2014-2017" refers to the growth rate recorded over the three-year period from 2015 to 2017 compared with 2014. In principle, product items indicated in Table II-3-4-1-4 were selected from among the items for which positive growth was recorded in both 2017 alone and 2014-2017. However, as growth in trade was stagnant worldwide in 2015 and 2016, the growth for many items was weak in those years although Japanese exports to China recorded high growth in 2017. For example, although double-digit growth was recorded in 2017 for products in the machine tool category, including grinders, forging machines, lathes, and machine tool parts, as well as liquid crystal devices and optical fibers, the growth was negative for them in the three-year period (2014-2017).

[Machinery parts]

(Unit: Million dollars; %)

HS	Category of item	Export value	Growth rate	
		2017	2017 (annual value)	2014-2017
8408	Engines (diesel types)	862	56.9	7.1
8534	Printed circuits	817	49.2	68.1
8412	Engines (others)	466	42.2	27.2
8501	Motors	595	37.0	20.0
8537	Switchboards	1,116	35.5	29.9
9013	Liquid crystal devices	4,029	23.3	-15.4
8536	Equipment for switching/protecting/connecting electric circuits	2,493	20.1	14.5
9001	Optical fibers	1,812	19.1	-6.3
8532	Capacitors	1,405	18.5	17.2
8407	Engines (gasoline types)	1,256	18.1	161.9
8708	Automobile parts	7,235	17.0	6.7
8542	Integrated circuits	6,996	9.6	4.1

[Foods]

(Unit: Million dollars; %)

HS	Category of item	Export value	Growth rate	
		2017	2017 (annual value)	2014-2017
902	Tea	2.4	174.6	1,113.2
2206	Fermented beverages (except wine, e.g., refined sake)	23.9	76.5	266.2
2203	Beer	1.9	70.4	799.1
2009	Fruit and vegetable juice	1.6	50.5	351.6
2005	Vegetables prepared or preserved (mashed potatoes, etc.)	3.3	28.2	823.2
901	Coffee	4.0	27.4	351.2
2202	Refreshing beverages	22.0	23.4	155.4
2101	Coffee/tea extracts	3.7	20.8	256.5
1704	Sugar confectionery	10.2	6.1	205.7
1905	Bakers' wares (Bread, pastry, cakes, etc.)	33.4	2.2	151.6

Notes: These tables show the items with a four-digit HS code that are extracted in terms of high growth rates in 2017.

Source: Global Trade Atlas.

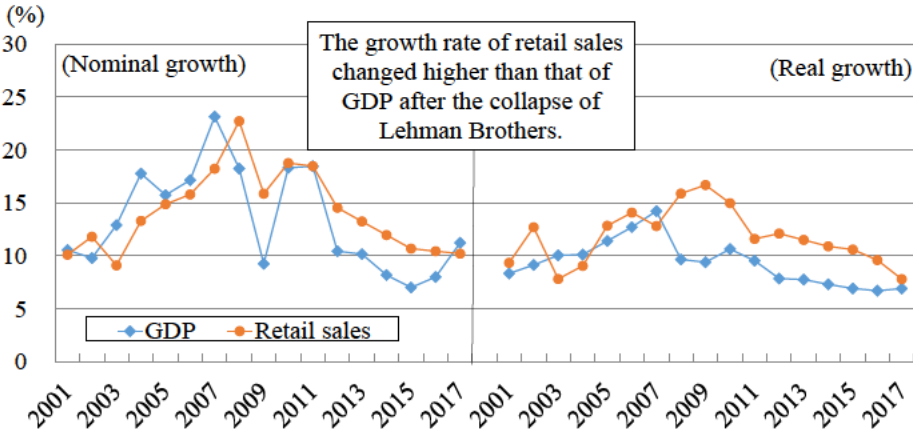
2. Chinese market and Japanese affiliates in China

(1) Trends in the Chinese market

In this section, we will look at the trends in the Chinese market and Japanese affiliates in China. In doing so, we will conduct comparison between the situations of Japanese companies and U.S. and European companies albeit based on limited data.

Regarding the Chinese market, we will examine growth market segments based on structural changes in China. As was already mentioned, one of the major recent changes in China is a shift in the demand structure from investment to consumption. For example, retail sales of social consumption products are growing at a higher rate than the whole economy in both nominal and real terms (Figure II-3-4-2-1). Sales channels are also changing, with sales via the internet growing as much as around 30% compared with the previous year¹⁷²(Figure II-3-4-2-2). We will provide an overview of the backgrounds to those changes and will point out growth sectors.

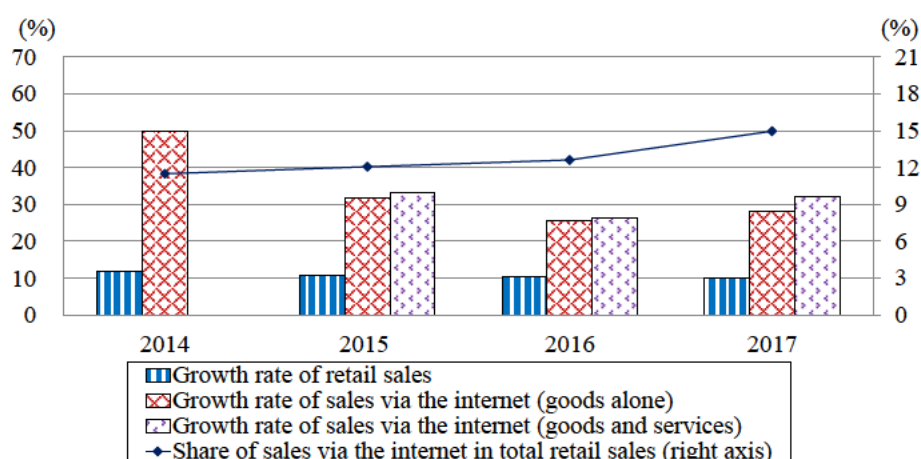
Figure II-3-4-2-1 Changes in growth rates of GDP and retail sales in China



Source: National Bureau of Statistics of China, CEIC Database.

172 It is said that while internet sales and sales at small stores, such as convenience stores, are growing, the growth in sales at large physical stores, such as department stores, are slowing. Moreover, recently, there has been a move to integrate internet sales and physical-store sales by selling products via the internet while allowing customers to experience products first-hand at physical stores.

Figure II-3-4-2-2 Growth rates of retail sales and sales via the internet in China



Notes:

1. Online retail sales refers to the sales of goods and services through a public online trading platform (including self-built websites and third-party platform).
2. As the retail sales are subject to goods alone, even the shares of online sales are the results of calculating the values of goods alone.

Source: National Bureau of Statistics of China, CEIC Database.

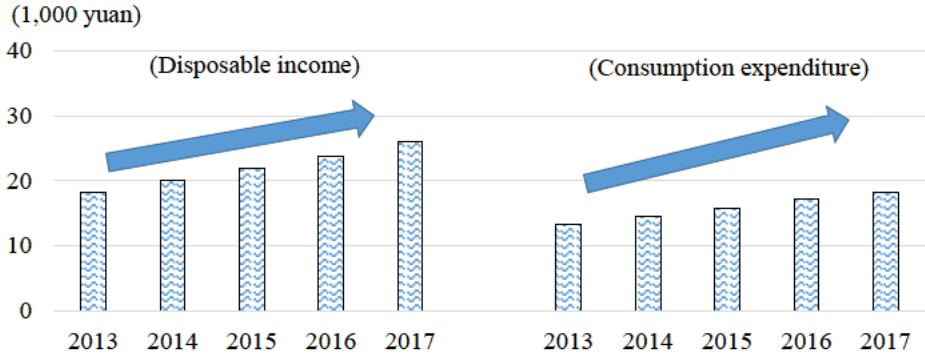
In Chapter 1, we pointed out the rising wage level in China as a macroeconomic challenge, but if looked at from the other side, it means that the income level has been rising.¹⁷³ In response to the rising income level, consumption is also increasing. Looking at changes in per-capita disposable income and consumption expenditure in China, disposable income increased some 40%, from around 18,300 yuan to 26,000 yuan, and accordingly, consumption expenditure grew also some 40%, from 13,200 yuan to 18,300 yuan (Figure II-3-4-2-3).¹⁷⁴ If we examine how the additional consumption was spent by looking at changes in the composition of consumption, we can see that the share of mandatory expenditures, which are equivalent to expenditures on clothing, food and housing, remained almost flat or declined. On the other hand, the shares of expenditures on transportation, communication, education, culture, recreation, health and medical care (Figure II-3-4-2-4) grew. This trend appears to indicate that amid the rise in the income level and the aging of society, Chinese people are paying attention to health and shifting priority to improving the quality of life and enjoying life. It has also been pointed out that if looked at from another angle, this trend means that Chinese people are increasingly interested in experience-based consumption whereby they enjoy life, rather than simple purchase of goods.¹⁷⁵

173 The estimated ratio of employee compensation to GDP rose from 45.0% in 2010 to 47.5% in 2016.

174 Previously, in Chinese income statistics, different income yardsticks were used to measure income in urban and rural areas: income in urban areas was measured in terms of disposable income and income in rural areas was measured in terms of cash income. However, since 2013, income statistics on a nationwide basis have been published in terms of disposable income. Here, the nationwide total amount of income, including income in both urban and rural areas, is indicated. Although income is rising as a trend in both urban and rural areas, it should be kept in mind that the income level is different. For example, in 2017, disposable income in urban areas was around 36,000 yuan compared with around 13,000 yuan in rural areas.

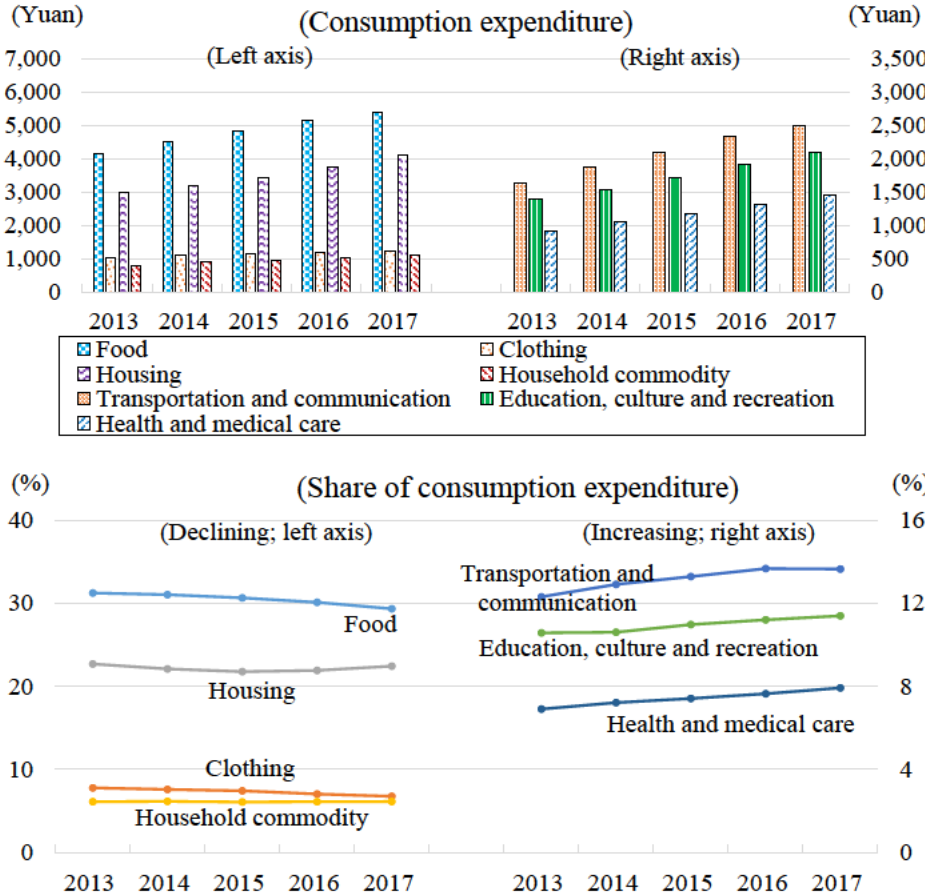
175 Also called “experience consumption” as opposed to the purchase of goods. For example, shopping

Figure II-3-4-2-3 Changes in per-capita disposable income and consumption expenditure in China



Source: National Bureau of Statistics of China, CEIC Database.

Figure II-3-4-2-4 Changes in composition of per-capita consumption expenditure in China



Source: National Bureau of Statistics of China, CEIC Database.

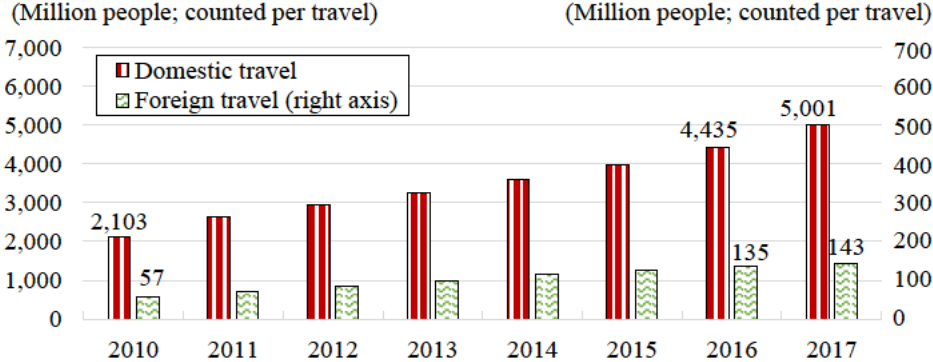
As an example of the recent growth of consumption and recreation in China, increases in the numbers of tourists and moviegoers are often cited. With respect to travel, the number of Chinese tourists

malls not only have sales shops but also provide a variety of services through cinema complexes, fitness gyms and English conversation schools. Those services as well as entertainment provided by theme parks and travel are included in the service consumption category.

has been steadily increasing for both domestic and foreign travel (Figure II-3-4-2-5).¹⁷⁶ The number of Chinese tourists to Japan is increasing. Chinese tourists account for around a quarter of the total number of foreign tourists to Japan and around 40% of the total consumption by foreign tourists, making significant contributions to “in-bound consumption” (consumption by foreign tourists) in Japan (Figure II-3-4-2-6). Although cases of “bakugai” (buying explosion), a phenomenon in which Chinese tourists buy massive amounts of Japanese products at a time while visiting Japan, decreased, it has been pointed out that some Chinese tourists become repeat buyers of Japanese products using e-commerce after returning from Japan. The increase in the number of Chinese tourists is a factor behind the increase in e-commerce between Japan and China that was mentioned at the beginning of this section.

In China, the cultural and recreational industries, including movies and television programs, are expanding. For example, movie box-office revenue in China has been increasing for both domestic and imported movies¹⁷⁷ (Figure II-3-4-2-7). As a result, movie box-office revenue in China was the second largest in the world in 2016, after the revenue in the United States, and it was triple the value of revenue in Japan, the third largest movie market (Figure II-3-4-2-8).¹⁷⁸

Figure II-3-4-2-5 Changes in the number of Chinese tourists



Notes: The number of tourists refers to the total number. If a single person makes a single travel, this is counted as one travel by one person.

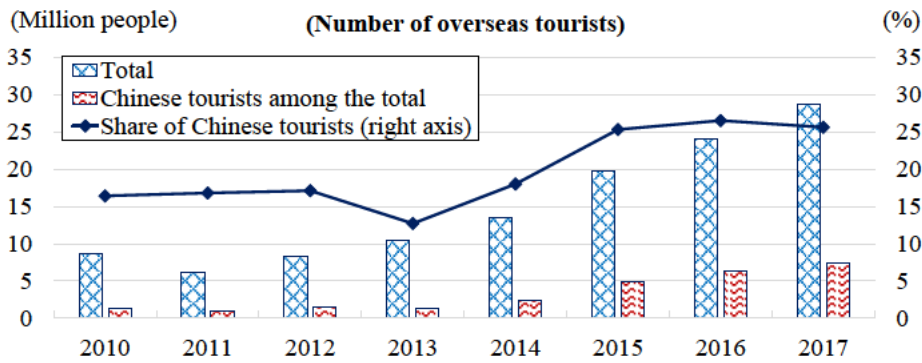
Source: National Tourism Administration of China, CEIC Database.

176 According to reference materials prepared by the Japanese Chamber of Commerce and Industry in China (JCCI), travel companies wholly owned by foreign capital are banned from handling foreign travel by Chinese tourists, and the JCCI is requesting the easing of the ban.

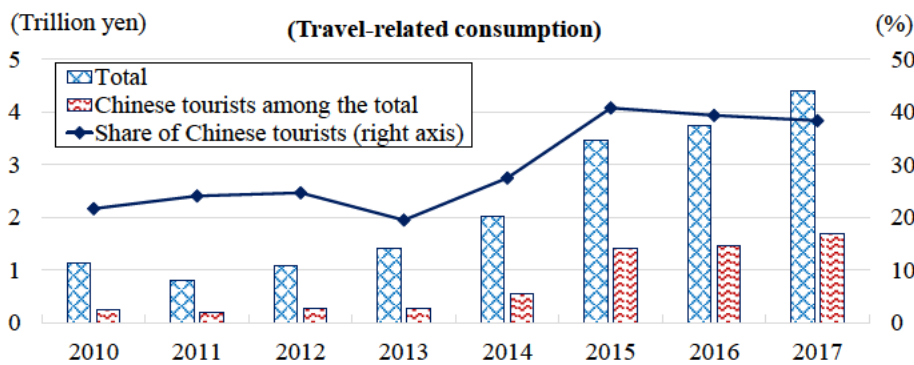
177 According to the 2017 Japanese Business in China White Paper by the JCCI, there are barriers to entry by foreign companies (e.g., a ban on establishment of movie theaters by companies wholly owned by foreign capital), a restriction on the number of foreign movies that are allowed to be shown (64 movies per year), a restriction on the time of day when foreign movies and dramas that may be aired on TV (airing is prohibited from 7 to 10 p.m.), and a strict contract practice (a rights purchase arrangement, rather than a profit-sharing arrangement, is applied to non U.S. foreign movies). The JCCI is requesting the easing of these restrictive measures.

178 The governments of Japan and China held negotiations on an agreement on joint movie production from 2016 and reached a broad agreement in September 2017.

Figure II-3-4-2-6 Changes in the number of overseas tourists in Japan

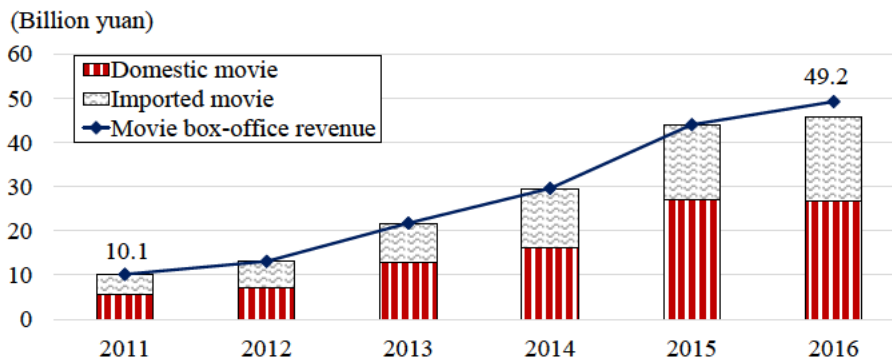


Source: Japan National Tourism Organization (JNTO), CEIC Database.



Source: *Survey on the Consumption Trends of International Visitors to Japan* (Japan Tourism Agency).

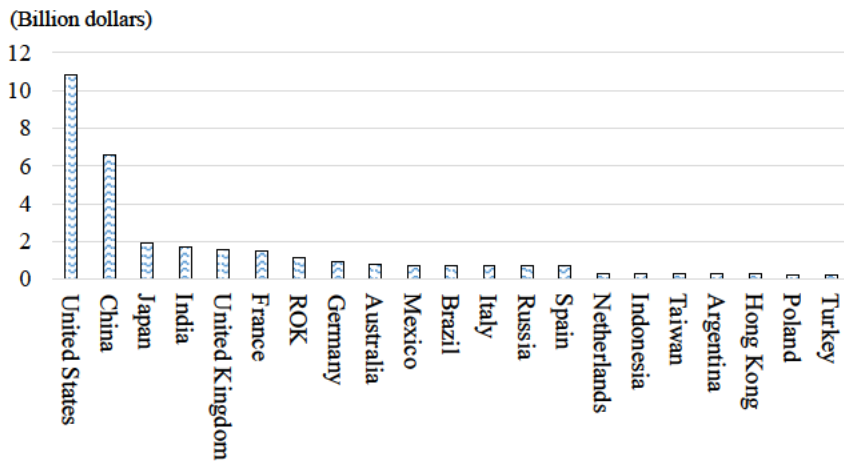
Figure II-3-4-2-7 Changes in movie box-office revenues in China



Notes: As for the data in 2017, China only released 5.59 billion yuan as the total revenues of movies.

Source: State Administration of Press, Publication, Radio, Film and Television, CEIC Database.

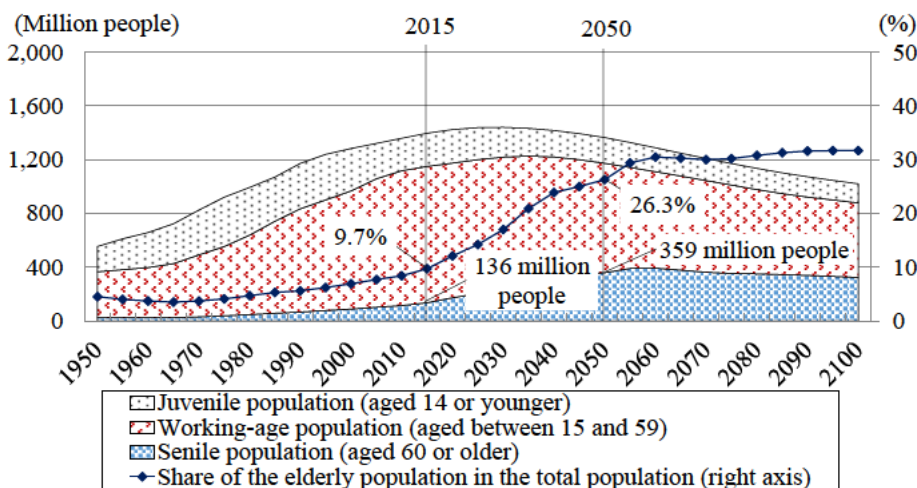
Figure II-3-4-2-8 Movie box-office revenues in major economies (2016)



Source: *Theatrical Market Statistics 2016* (Motion Picture Association of America).

As factors behind the increase in the fields of health and medical care, growing interest in healthcare and the effects of the aging of society have been pointed out.¹⁷⁹ While we pointed out the start of the decline in China’s working-age population in Section 1, this demographic trend also suggests the arrival of an aging society. If calculated based on an estimate by the UN, the share of the elderly population¹⁸⁰ in China’s total population was 9.7% in 2015, which means that there were around 136 million elderly people, and this figure is almost as large as Japan’s total population. By 2050, the share of the elderly population is forecast to rise to 26.3% and the number of elderly people is forecast to grow to around 359 million people (Figure II-3-4-2-9).

Figure II-3-4-2-9 Forecast of an increase in the number of elderly people in China



Notes: The values are UN estimates. There are several assumptions for birth rates, and the values show median estimates.

Source: *World Population Prospects 2017* (UN).

179 As was already mentioned, cosmetics and medical products were cited as items for which exports from Japan to China are recording high growth. Exports of medical equipment are also steadily increasing.
 180 Here, the elderly population refers to people aged 60 or older.

With respect to education, it can be pointed out that the number of students who advance to higher education institutions is rapidly increasing in China (Figure II-3-4-2-10). Against the backdrop of the rising higher education enrollment rate, interest in education is presumed to be growing as parents wish to provide high-quality education to children who were born during the period of the one-child policy. The fact that the rising income level has made Chinese families affluent enough to spend money on education is also considered to be contributing to the growing interest in education.¹⁸¹

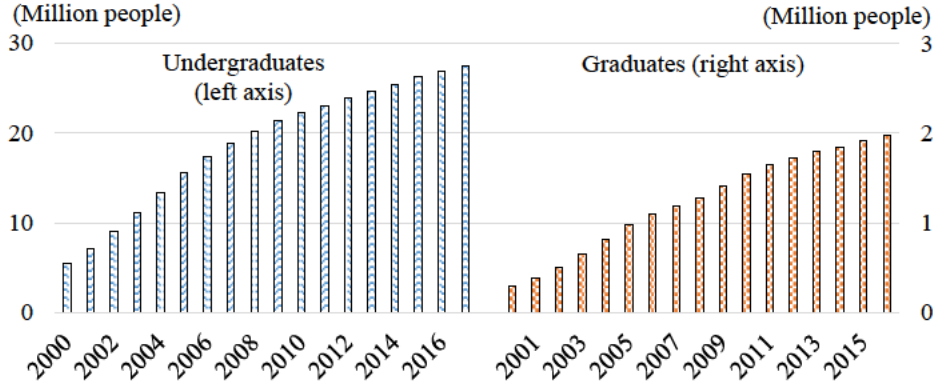
Japan proposed the establishment of the Japan-China Services Cooperation Mechanism as a framework of bilateral cooperation in the services industry, and an agreement was reached and a memorandum of understanding on the proposal was signed on the occasion of the Japan-China-Republic of Korea summit in May this year. As the first step of this cooperation, Japan has proposed to hold a symposium concerning preventive care, nursing care and living-support services in the field of aging of society within this year. Next year and beyond, Japan and China will promote cooperation activities, including symposiums, business matching and political dialogue in a broad range of fields, including the education industry, under this framework.

As was already mentioned, dealing with environmental problems has become a major challenge in China. Japanese companies are also required to comply with environmental regulations, and at the same time, this may create business opportunities for companies possessing superior environmental technology. Looking at the value of investments in measures to control environmental pollution announced by the government of China, which is a benchmark of the scale of the market, investments have been increasing as a trend although the investment value varies from year to year¹⁸² (Figure II-3-4-2-11). As the government of China has indicated a policy of placing emphasis on the preservation of the environment, environment-related investments are widely expected to increase.

181 As is indicated by the presence of around 150 million users of e-learning as shown by the status of usage of internet applications described in Section 2 of this chapter, interest in education is strong (Figure II-3-2-8).

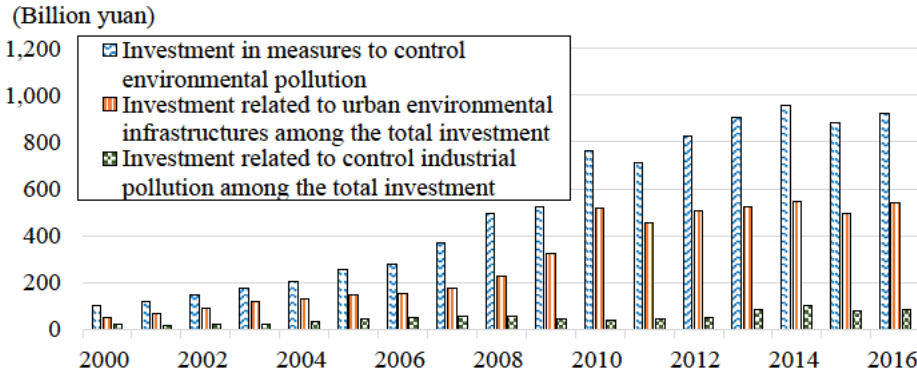
182 In 2016, the total value of investments in measures to control environmental pollution amounted to around 920 billion yuan, of which around 540 billion yuan was invested in urban environmental infrastructure and around 82 billion yuan was invested in measures to control industrial pollution. Of the investments in urban infrastructure investments, greening (40% of the investments in urban environmental infrastructure) and waste water treatment (27%) accounted for large shares. Of the investments in measures to control industrial pollution, air quality control (69% of the investments in measures to control industrial pollutions), water quality control (13%), soil quality control (6%) and other control measures (12%) were major investment items.

Figure II-3-4-2-10 Changes in the number of undergraduates and graduates (enrolled at a university) in China



Source: Ministry of Education of China, CEIC Database.

Figure II-3-4-2-11 Changes in the values of China’s investment in measures to control environmental pollution



Source: Ministry of Environmental Protection of China, CEIC Database.

(2) Trends concerning Japanese affiliates in China

Next, we will look at the trends concerning Japanese affiliates in China. First, we will look at the position of China in Japanese companies’ overseas business expansion around the world. According to a survey conducted by the Ministry of Foreign Affairs, there are around 32,000 Japanese business facilities in China (a global share of 45%), three to four times as high as the number in U.S. or in ASEAN, making China the largest host country (Table II-3-4-2-12). Among the factors behind this are China’s economic scale and high growth rate and the country’s proximity to Japan. In terms of the number of Japanese overseas affiliates and the number of employees, China has the largest share among all host countries, 25% and 27%, respectively. In terms of sales and ordinary profits of Japanese overseas affiliates, China has the second largest share, 16% and 20%, respectively, after the United States, whose GDP is the world’s largest. Thus, China is an important place of business activity for Japanese companies (Figure II-3-4-2-13). An international comparison of the ratio of ordinary profits to sales for Japanese overseas affiliates in recent years shows that the ratio is higher in China than in the United States and the EU (Table II-3-4-2-14).

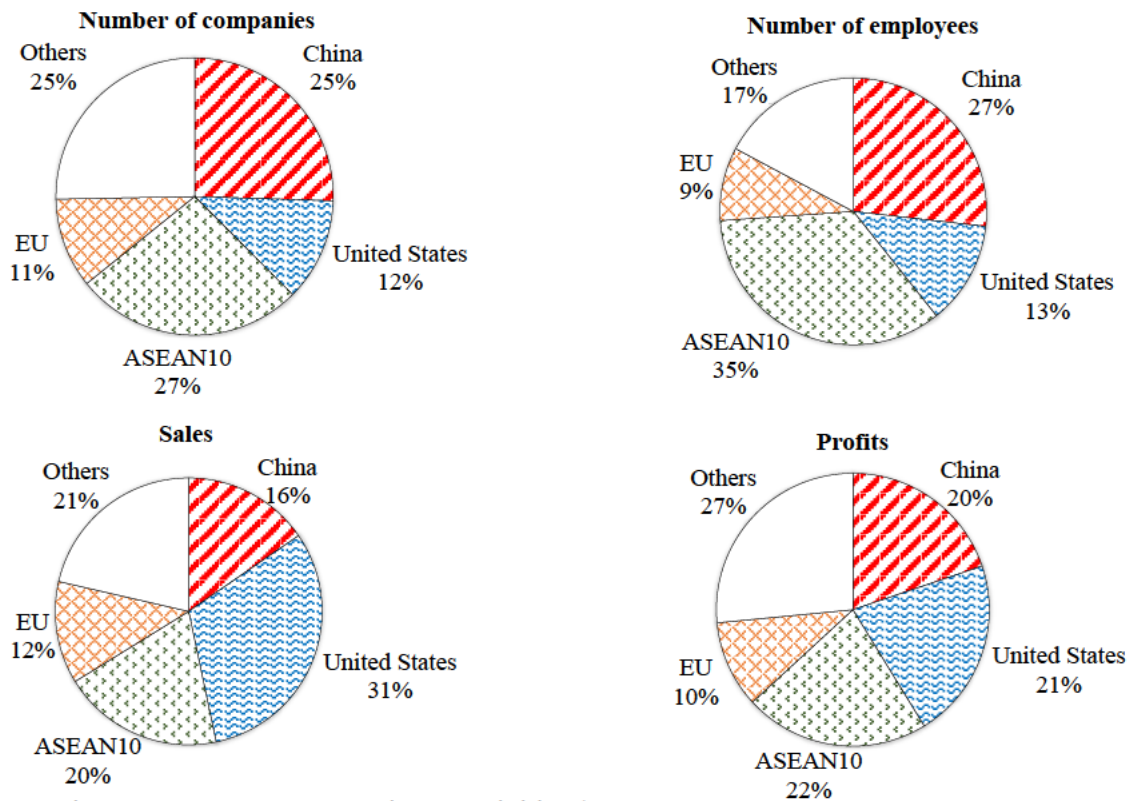
**Table II-3-4-2-12 Number of Japanese business facilities in major economies
(2016 / top 10 economies)**

(Number of facilities; %)

Ranking	Country/region	Number of bases	Share
1	China	32,313	45.0
2	United States	8,422	11.7
3	India	4,590	6.4
4	Germany	1,811	2.5
5	Indonesia	1,810	2.5
6	Thailand	1,783	2.5
7	Viet Nam	1,687	2.3
8	Philippines	1,440	2.0
9	Malaysia	1,362	1.9
10	Taiwan	1,152	1.6
-	ASEAN	10,033	14.0
-	World total	71,820	100.0

Source: *Annual Report of Statistics on Japanese Nationals Overseas* (Ministry of Foreign Affairs).

Figure II-3-4-2-13 Japanese overseas affiliates (2016)



Source: Basic Survey on Overseas Business Activities (METI).

Table II-3-4-2-14 Ratios of ordinary profits of Japanese overseas affiliates

(Unit: %)

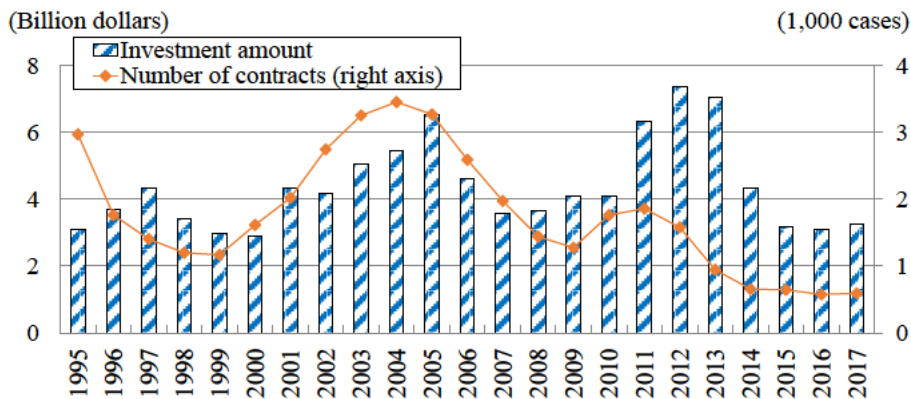
Country/region of business location	2015	2016
China	6.0	6.4
United States	3.3	3.4
ASEAN 10	5.0	5.6
EU	2.9	3.6
World	4.0	4.9

Notes: The ratios of ordinary profits are the calculation results based on the data on the respondent companies that have presented both their sales and ordinary profits.

Source: Basic Survey on Overseas Business Activities (METI).

As described above, China has a large share in the total value of foreign direct investments by Japan. However, recently, the annual value of new or additional Japanese direct investments in China has been declining after peaking in 2012, and the value in 2017 was half the peak level (Figure II-3-4-2-15). China has the second largest economy in the world, and although its growth has slowed down from the previous growth rate of higher than 10%, the country has maintained a relatively high growth rate compared with advanced economies such as the United States and European countries. Therefore, it is necessary to consider business opportunities in China as an expanding market.

Figure II-3-4-2-15 Changes in Japanese direct investment in China

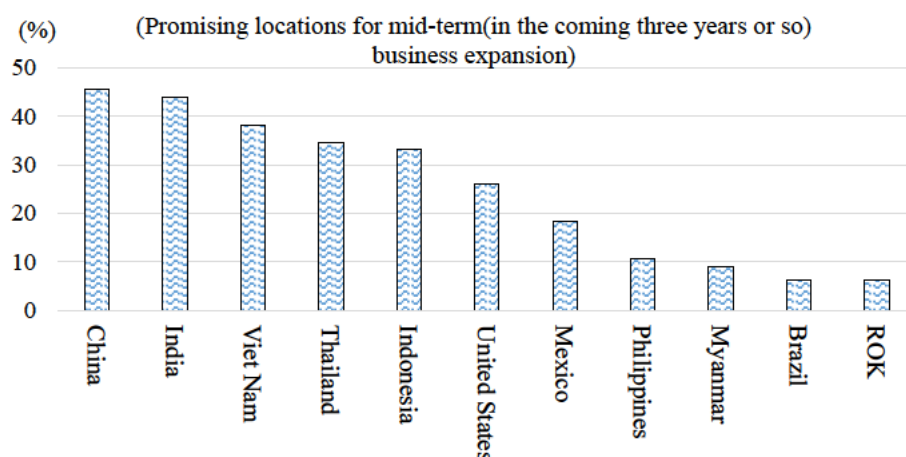


Source: Ministry of Commerce of China, CEIC Database.

According to a questionnaire survey that asked Japanese companies which countries were promising as locations for international business expansion, many companies cited China as the most promising country because of the scale of its market and growth potential (Figure II-3-4-2-16).¹⁸³

¹⁸³ This survey, conducted by the Japan Bank for International Cooperation, covered the manufacturing industry.

Figure II-3-4-2-16 Promising countries as locations for international business expansion for Japanese companies



(Reasons why they consider China as a promising location and challenges faced by them)

Reason	Rate	Challenge	Rate
Expected growth of markets	68.5	Increase in labor costs	64.7
Current market scales	61.4	Severe competition with other companies	57.4
Supply locations to assembly manufacturers	26.9	Unclear operation of legal systems	54.2
Operation of industrial clusters	22.3	Insufficient protection of IP rights	40.0
Inexpensive labor force	14.2	Exchange or remittance restrictions	35.8

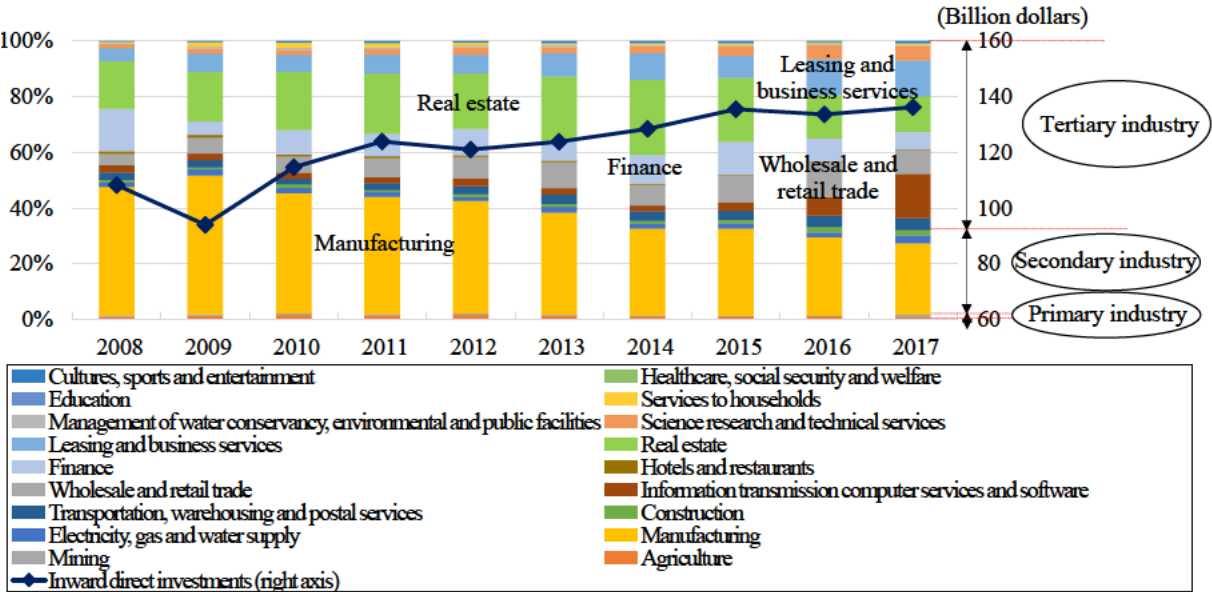
Notes:

1. As for the questionnaire for business locations overseas, each respondent company was eligible to fill in up to five countries. The percentage share = (number of respondents citing country) / (total number of respondent companies).
2. As for the questionnaire on reasons why respondent companies consider China as a promising location and challenges faced by them, the rate refers to the number of companies that cited reasons or issues divided by the total number of respondent companies.

Source: *Survey Report on Overseas Business Operations by Japanese Manufacturing Companies-- Results of the JBIC FY2017 Survey: Outlook for Japanese Foreign Direct Investment (29th Annual Survey)*-- (Japan Bank for International Cooperation).

Until now, we have looked at the trend in Japanese investments in China. Below, we will also look at it on an industry-by-industry basis. According to Chinese statistics, inward foreign direct investments received by China from the rest of the world have been increasing as a trend over the long term, with emphasis in investment shifting from the secondary to tertiary industry. In 2017, the share of the manufacturing industry in inward foreign direct investments in China was around 30% (Figure II-3-4-2-17).

Figure II-3-4-2-17 Changes in China’s domestic direct investment and its composition by industry

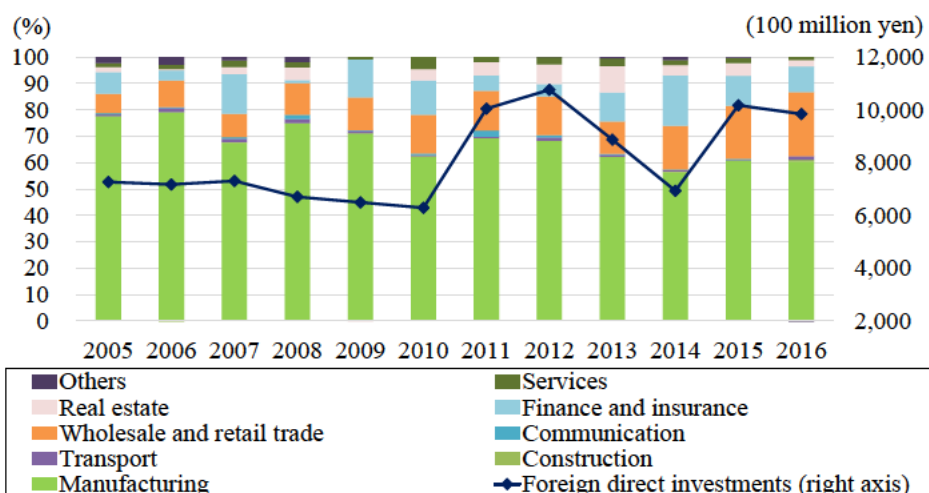


Source: Ministry of Commerce of China, CEIC Database.

On the other hand, according to Japanese international balance of payments statistics, although the share of the manufacturing industry in Japanese direct investments in China has been declining, it is still around 60%, compared with the shares of around 30% for wholesale and retail trade and around 10% for other industries (Figure II-3-4-2-18).¹⁸⁴ It may be said that while China has been transforming itself from the world’s factory into the world’s market against the backdrop of the rising wage level (increasing income) in China, Japan has lagged behind in investments in non-manufacturing sectors in China. However, at the same time, this situation may be taken to indicate that there is room for further expansion by Japanese companies into China and that there are more business opportunities.

¹⁸⁴ It should be kept in mind that reinvested earnings are included in the increase in foreign direct investments because the figures are based on international balance of payment statistics. Reinvested earnings represent the increased portion of overseas affiliates’ retained earnings that is deemed, for the statistical purpose, to be provisionally paid out to investors as dividends and be immediately reinvested. The presence of reinvested earnings does not necessarily mean that actual investment has been made.

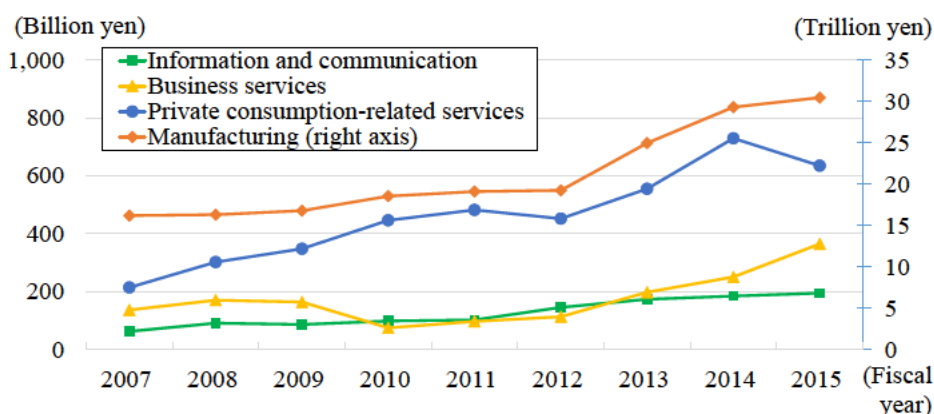
Figure II-3-4-2-18 Changes in Japan's direct investment in China



Source: Balance of Payments (Ministry of Finance).

We will look at the situation of Japanese affiliates in China based on an annual survey conducted by the Ministry of Economy, Trade and Industry with respect to Japanese overseas affiliates instead of international balance of payments statistics. Looking at changes in sales of Japanese affiliates in China, it is notable that the share of the manufacturing industry is large. Japanese affiliates are increasing both sales and profits by capturing robust demand within and outside China. Although sales of services related to private consumption-related services¹⁸⁵ are also growing, the sales value is small, around 600 billion yen, compared with approximately 30 trillion yen for the manufacturing industry (Figure II-3-4-2-19).¹⁸⁶

Figure II-3-4-2-19 Changes in sales of Japanese companies operating in China by major industry



185 Here, for the sake of convenience, retail trade and services for individuals (e.g., living-related services, leisure, accommodations, eateries, education, medical care and welfare services), which are considered to be closely related to private consumption, are referred to as private consumption-related services.

186 The value of sales includes not only sales in China but also exports, so the impact of services related to private consumption, which are mainly targeted at domestic demand, may tend to be limited.

Notes: The category “Business services” includes the consulting, advertising, professional and technical services, while the category “Private consumption-related services” includes the retail trade, accommodation, eateries, education, medical care, welfare services and leisure.

Source: Basic Survey on Overseas Business Activities (METI).

Let us look at the situation of business activity by Japanese affiliates in China in more detail on an industry-by-industry basis. Table II-3-4-2-20 shows the numbers of Japanese affiliates in various industries in China, including sectors related to private consumption. The table also shows a comparison with Japanese affiliates in the United States. From this table, it is clear that Japanese affiliates in China belong mainly to the manufacturing industry. The shares of retail trade and services for individuals, such as everyday life-related services, recreation, lodging and eateries, education, and medical care and welfare, remain small. Among Japanese affiliates in the United States, the share of service sectors related to private consumption is not necessarily large, but it is still larger than the share of those sectors among Japanese affiliates in China.

Table II-3-4-2-20 Comparison of Japanese companies operating in China and those in the United States (FY2015)

(Unit: company, %)

Type of industry	In China		In the United States	World total
	Number of companies	Share	Share	Share
All industries	6,670	100.0	100.0	100.0
Manufacturing	3,930	58.9	36.6	43.9
Non-manufacturing	2,740	41.1	63.4	56.1
Agriculture, forestry and fisheries	12	0.2	0.3	0.4
Mining	1	0.0	0.7	0.8
Construction	61	0.9	1.0	1.5
Information and communication	252	3.8	4.8	3.3
Transport	222	3.3	3.1	5.5
Wholesale trade	1,480	22.2	29.2	28.2
* Retail trade	169	2.5	3.1	2.7
Services	445	6.7	15.3	9.5
Management consulting services and pure holding companies	92	1.4	7.2	3.2
Advertising	38	0.6	0.2	0.5

Academic research and professional and technology services	112	1.7	2.7	1.7
* Living-related or leisure services	14	0.2	1.2	0.7
Other services	189	2.8	4.0	3.3
Other non-manufacturing industries	98	1.5	5.9	4.0
Electricity, gas, heat and water supply	12	0.2	0.7	0.5
Finance and insurance	10	0.1	2.3	1.3
Real estate	23	0.3	1.5	0.7
Goods rental and leasing	18	0.3	0.2	0.8
* Accommodations and eateries	24	0.4	0.9	0.6
* Education, medical care and welfare	11	0.2	0.3	0.2
Total of types of industries estimated to be related to private consumption*	218	3.3	5.6	4.3

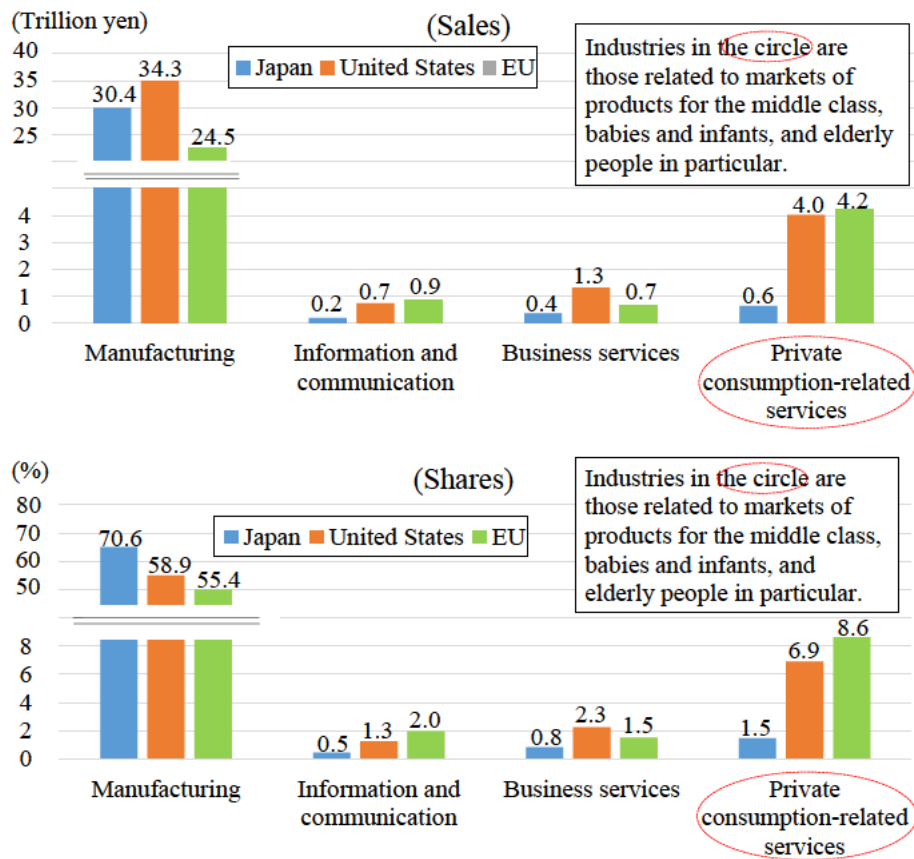
Notes: The subdivisions of these categories are the aggregated results of microdata.

Source: Basic Survey on Overseas Business Activities (METI).

Is a small share of services sectors related to private consumption among affiliates in China a phenomenon common to foreign companies regardless of nationality? Or it is a unique feature of Japanese companies? If we compare the value of sales of affiliates of Japanese, U.S. and European companies based on data compiled by the U.S. Department of Commerce and Eurostat, the value of sales of services related to private consumption is small in Japan and the share of those services on an all-industry basis is also small (Figure II-3-4-2-21). While U.S. and European companies have already expanded into China and are generating sales in those sectors amid the expansion of market segments for the middle class, infants and elderly people, Japanese companies may be lagging behind in these sectors.

Regarding Japanese companies' assessment of the Chinese market on an industry-by-industry basis, around half of them are considering expanding business operations, with the proportion of companies considering business expansion particularly large in the wholesale and retail trade sectors (Figure II-3-4-2-22).

Figure II-3-4-2-21 Sales of Japanese, US and European companies operating in China by major industries (2015)

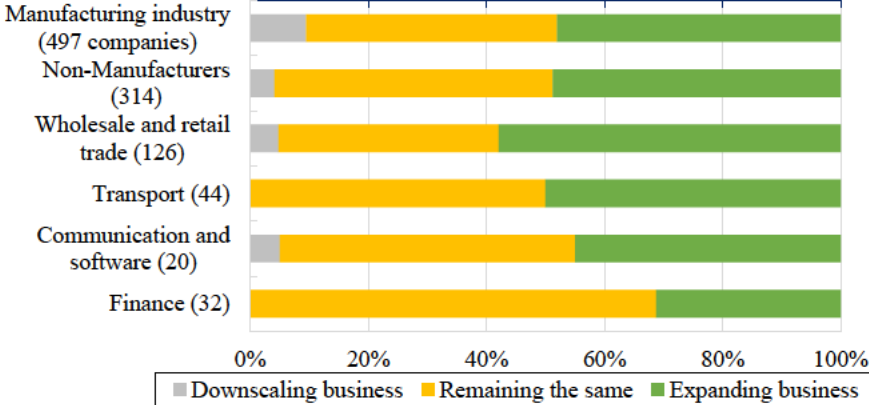


Notes:

1. Sales of U.S. and EU companies were converted on the basis of the annual average exchange rates in 2015 (1 dollar = 121 yen; 1 euro = 134 yen).
2. The tabulation was made with respect to business categories which are presumed to cover similar businesses in Japan, the United States and Europe. For example, the “private consumption-related services” category covers retail trade, accommodations, eateries, education, medical care, welfare and leisure, while the “business services” category covers consulting, advertising, and professional and technical services. Automobile sales and repair in the EU were included in wholesale trade.

Source: Basic Survey on Overseas Business Activities (METI), official website (Bureau of Economic Analysis, Department of Commerce, United States), *Eurostat* (EU).

Figure II-3-4-2-22 Japanese companies considering business expansion in China for the coming one or two years



Notes: This figure shows the number of respondent companies of the survey. The number of companies in the wholesale and retail trade, transport, communication and software and finance sectors are the breakdowns of companies in the non-manufacturing industry.

Source: 2017 Survey on Business Conditions of Japanese Companies in Asia and Oceania (JETRO).

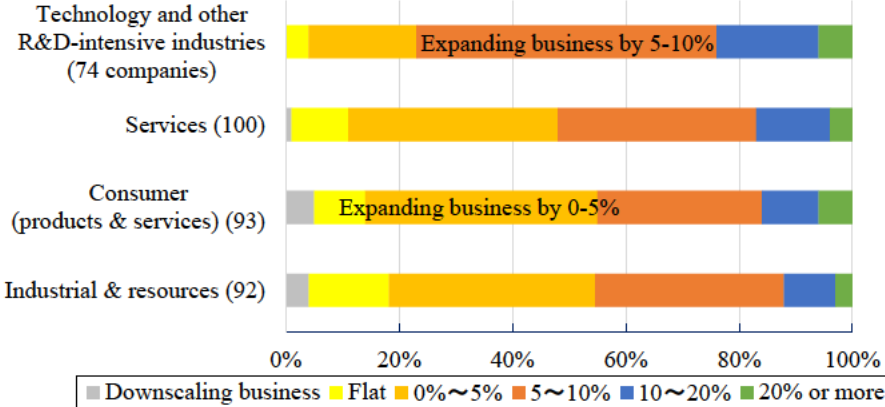
As for how non-Japanese foreign companies view the Chinese market, for example, U.S. companies, including not only those belonging to the manufacturing industry but also those belonging to consumption-related industries and services industry, expect an expansion of the market (Figure II-3-4-2-23).

Now, we will look at the actual situation and profile of Japanese companies belonging to services industries related to private consumption (retail trade and consumption-related services industries) that have advanced into China. What types of Japanese companies have advanced into the Chinese market? By company size in terms of the number of employees, relatively small companies account for a large share. For example, while companies with a workforce of less than 10 employees have a share of lower than 20% on an all-industry basis and a share of lower than 10% in the manufacturing industry, such companies' share is higher than 30% in the retail trade industry and higher than 20% in consumption-related services industries (Figure II-3-4-2-24).¹⁸⁷ By longevity of operation, relatively young companies have a large share. For example, while companies less than 10 years old have a share of around 40% on an all-industry basis and a share of around 30% in the manufacturing industry, such companies have a share of around 70% in the retail trade industry and a share of around 60% in consumption-related services industries. Presumably because of the large share of small and young companies, companies with a small sales scale also have a larger share in these industries than in other industries. Companies which have not yet turned profitable in terms of ordinary profit also have a large share. On the other hand, by Japanese investment ratio, companies with a Japanese investment ratio of

¹⁸⁷ However, the profile may differ from industry to industry. For example, when small and medium-size enterprises (SMEs) are defined in terms of the workforce size in Japan, the workforce size is relatively large in the manufacturing industry and is relatively small in the retail trade industry. According to the definition, the workforce size of SMEs is 300 or less employees in the manufacturing industry, 100 or less employees in the wholesale trade and services industries and 50 or less employees in the retail trade industry.

100% have a share of around 70% on an all industry basis and a share of higher than 80% in consumption-related industries.¹⁸⁸ In the case of a Japanese investment ratio of 100%, the main advantage is a high degree of management freedom. However, some experts point out the need to cooperate with local personnel and companies familiar with local market trends and business practices.¹⁸⁹

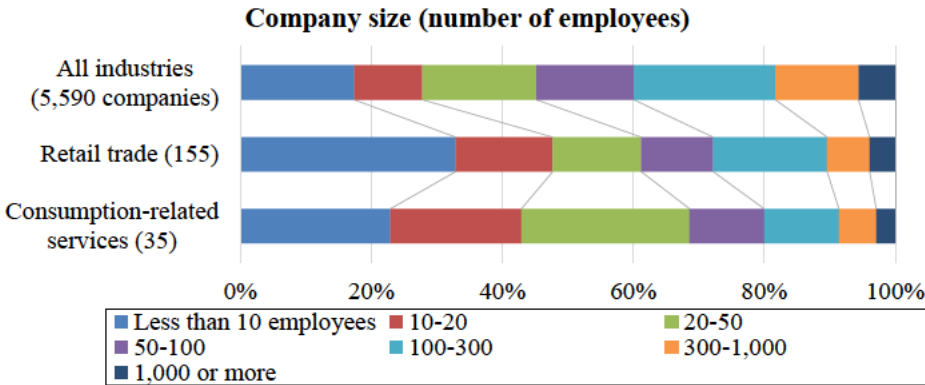
Figure II-3-4-2-23 How U.S. companies view the Chinese market of their industries (forecast of growth rates in 2018)



Notes: As the numbers of responses to respective questionnaires are not released, this figure shows the number of companies that have responded to the questionnaires per se for reference.

Source: 2018 China Business Climate Survey Report (American Chamber of Commerce in the People’s Republic of China).

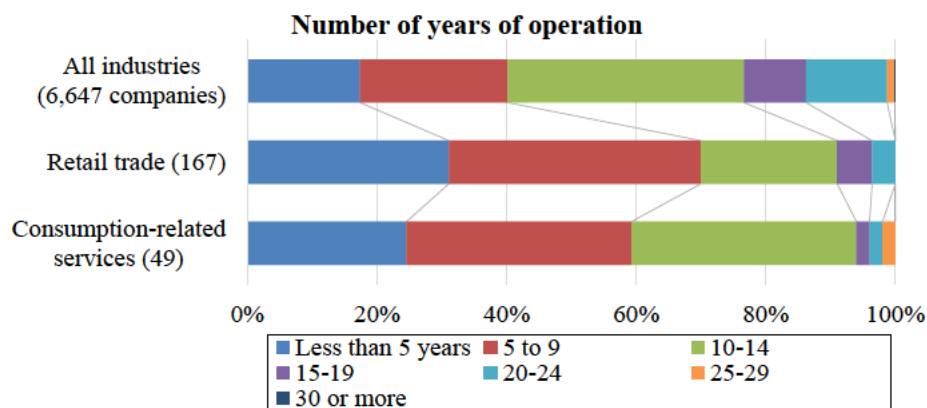
Figure II-3-4-2-24 Profiles of Japanese companies operating in China (2015)



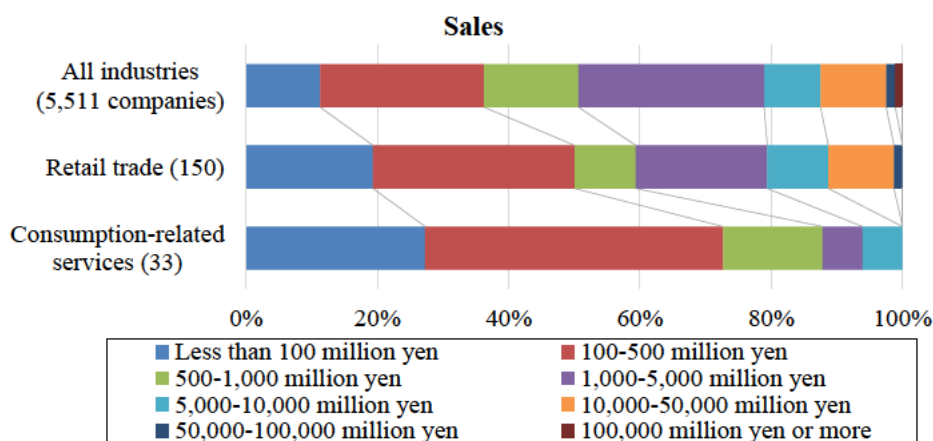
188 Attention should be paid to the presence of restrictions concerning the investment ratio in some industries.

189 Use of public services is also useful for grasping the local circumstances. For example, JETRO supports Japanese companies’ overseas expansion. Regarding business startup, JETRO, in partnership with major local startup accelerators (startup support companies and organizations), launched a project to support Japanese companies’ business expansion in the local market and major local startup companies’ advance into Japan, among other activities. Specifically, in China, JETRO has established support hubs in Shenzhen and Shanghai and is conducting support activities, including organizing briefings by partner accelerators’ experts on the local situation, giving advice on business strategy planning, and providing co-working spaces.

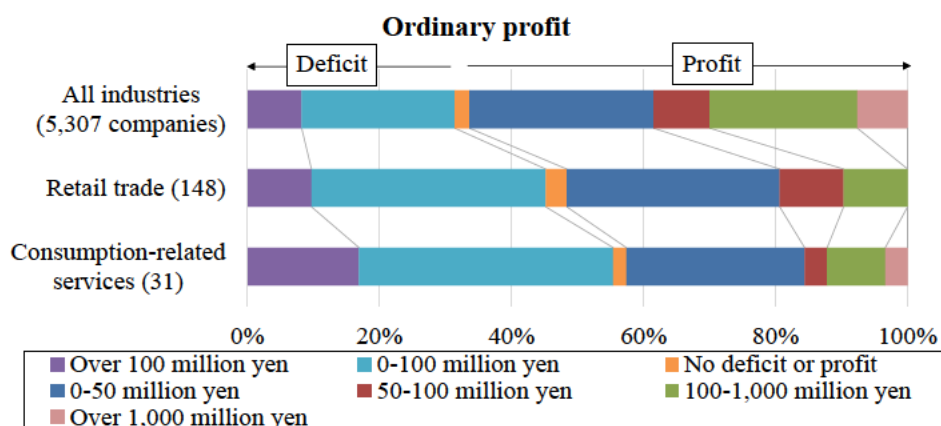
Notes and source: This figure shows the data aggregated based only on the responses in terms of the number of employees collected in the Basic Survey on Overseas Business Activities (METI).



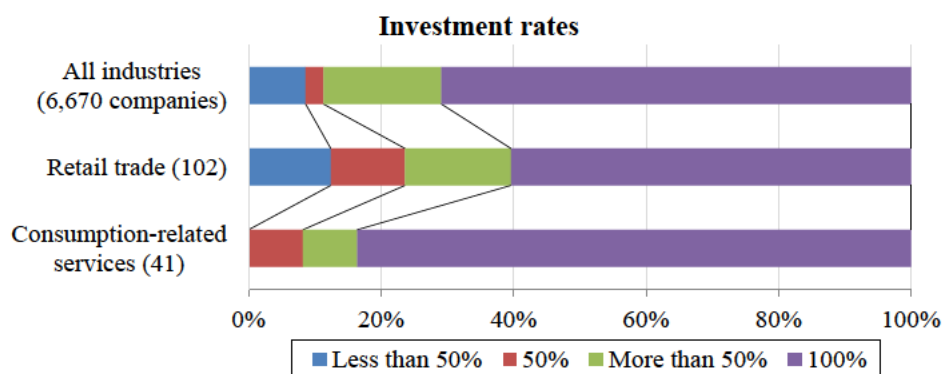
Notes and source: This figure shows the data aggregated based only on the responses in terms of the year of establishment collected in the Basic Survey on Overseas Business Activities (METI).



Notes and source: This figure shows the data aggregated based only on the responses in terms of sales collected in the Basic Survey on Overseas Business Activities (METI).



Notes and source: This figure shows the data aggregated based only on the responses in terms of ordinary profits collected in the Basic Survey on Overseas Business Activities (METI).

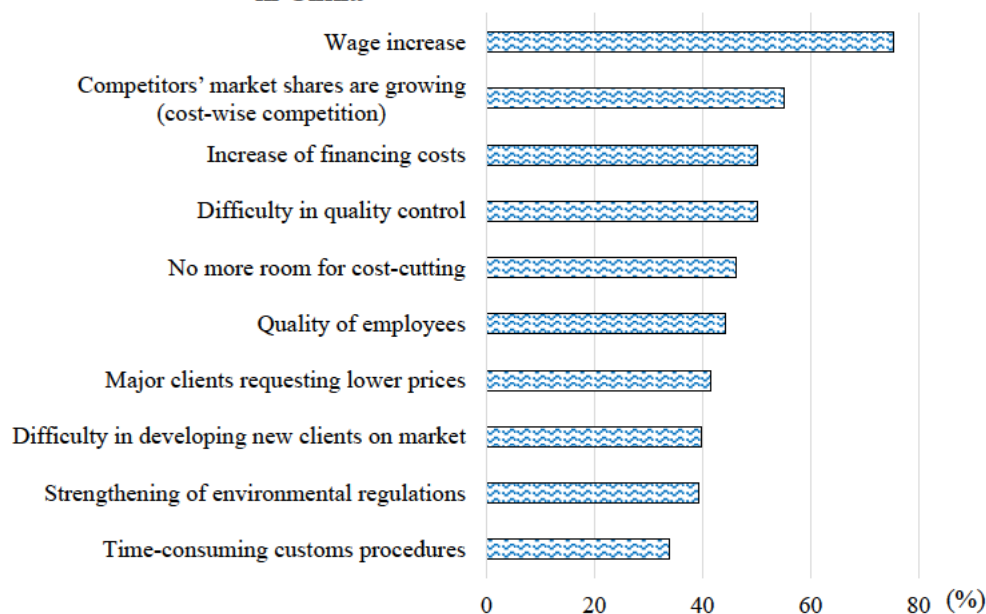


Notes and source: This figure shows the data aggregated based only on the responses in terms of investment ratios collected in the Basic Survey on Overseas Business Activities (METI).

Until now, we have looked at the promising potential of the Chinese market, but some challenges related to doing business in China have also been pointed out. A wide range of challenges have been cited by Japanese companies operating in China, including the rising wage level for employees, the rise of competitors, the increase of financing cost and difficulty in quality control¹⁹⁰ (Figure II-3-4-2-25). Another survey pointed out that the protection of intellectual property rights is insufficient.¹⁹¹

When asked about business-related challenges in China, many non-Japanese foreign companies cited a lack of transparency over regulations and regulatory compliance risks in addition to the rising labor costs (Figure II-3-4-2-26).

Figure II-3-4-2-25 Challenges in business management faced by Japanese companies operating in China

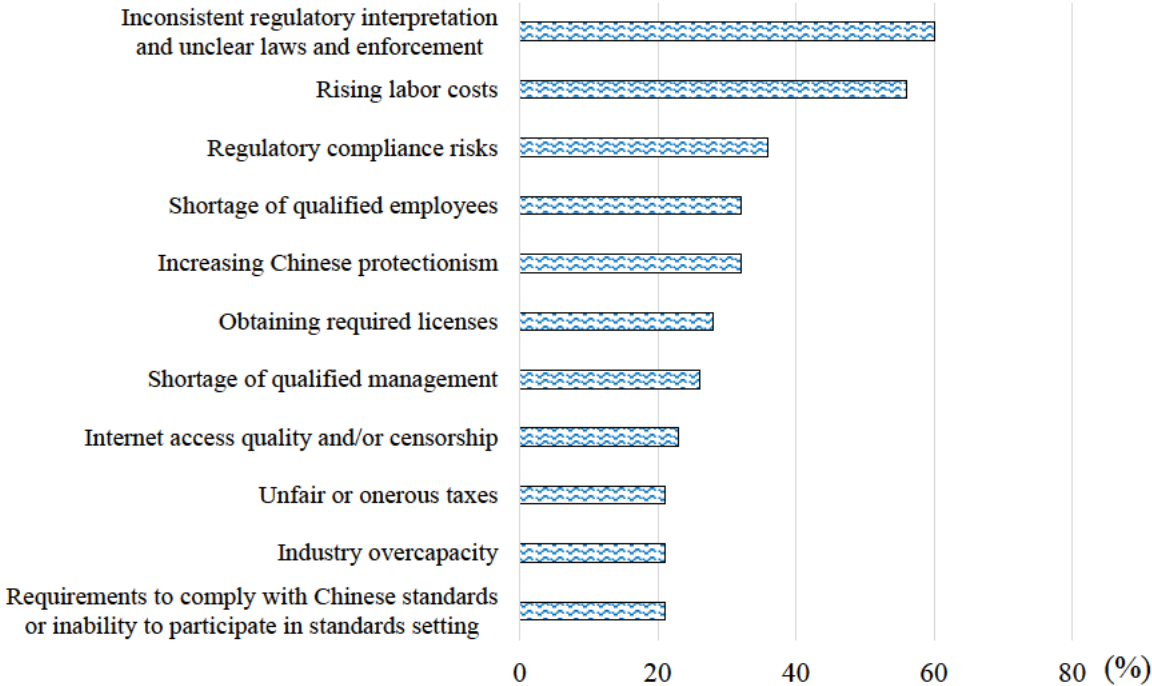


190 In addition, on the employment front, the wage rise was cited by more than 70% of the respondent companies, and various other issues, including employee quality, and difficulty in securing workers and engineers, were also frequently cited.

191 See Figure II-3-4-2-16.

Notes: This figure show the shares of respondent companies that have chosen the items above.
 Source: 2017 Survey on Business Conditions of Japanese Companies in Asia and Oceania (JETRO).

Figure II-3-4-2-26 Business-related challenges in China faced by U.S. companies



Notes: This figure shows the shares of the respondent companies that have chosen the items above.
 Source: 2018 China Business Climate Survey Report (American Chamber of Commerce in the People’s Republic of China).

So far in this section, we have looked at business opportunities in the Chinese market. In third countries as well, it is useful for Japanese and Chinese private companies to seize business opportunities in cooperation with each other.

Generally speaking, promoting cooperation in third countries has significance in the following points from the perspective of business in addition to diplomatic significance: (A) strengthening cost competitiveness through partnership with competitive foreign companies; (B) increasing business opportunities through participation as a supplier in projects promoted by foreign companies; and (C) reducing political and diplomatic risks through cooperation with third-country companies having strong connections with partner countries.¹⁹²

Against this backdrop, the governments of Japan and China are making efforts to promote cooperation between Japanese and Chinese companies in third countries. First, at the Japan-China summit meeting in November 2017, the two countries agreed that in order to build an open, rules-based “win-win” relationship, promoting business cooperation between private companies and expanding

¹⁹² From a similar viewpoint, Japan is promoting cooperation in third countries with the United States, India and China. Regarding Japan-U.S. cooperation in third countries, see Part III, Chapter 1, Section 3.1.

Japanese and Chinese businesses in third countries will be beneficial for the development of the two countries and partner countries. At the Japan-China Energy Conservation and Environment Forum, which was held in Tokyo in December 2017, the two countries newly established a working group on the development of third-country markets and exchanged opinions about the possibility of Japan-China cooperation in such fields as the development of green power sources, including solar and hydroelectric power, gas-fired thermal power generation, and industrial sophistication, including the modernization of oil refineries. It was also pointed out by companies that it is necessary to create a forum in which Japanese and Chinese companies not only in the fields of energy conservation and the environment but also in a broad range of other fields participate and exchange opinions. Furthermore, at the Japan-China summit meeting in May 2018 (between Prime Minister Abe and Premier Li Keqiang), the two leaders agreed to (A) establish a new committee on the promotion of expansion of Japanese and Chinese private businesses in third countries for discussions between the private and public sectors and across ministries and agencies under the Japan-China High-Level Economic Dialogue in order to discuss specific projects and (B) hold a forum for cooperation in third-country markets as an opportunity for exchange between Japanese and Chinese private companies during Prime Minister Abe's visit to China. Japan and China will use the above two frameworks to promote dialogue and exchange and formulate specific projects for cooperation between Japanese and Chinese companies in third countries.

Until now, China has been viewed as a production base, as is suggested by the "world's factory" label, and as a result, many manufacturing companies related to supply chains are located in the country. However, the personnel cost in China has risen and the consumption market has expanded, so the country is transforming itself into the "world's market." China has various structural problems, but if it succeeds in overcoming them and shifts to consumption-led growth, it will become important to continue considering business opportunities in China as a promising market. While Chinese companies are actively expanding abroad, it has also been pointed out that cooperation between Japanese and Chinese companies in third countries is useful. It is necessary to take advantage of the vibrancy of China, a country which continues to grow, in order to make Japan more vibrant.