Section 2 Main factors promoting global expansion of service sector

The process of providing many services requires producers and consumers to meet. Thus for service sector, differences in language and customs at the business location in a foreign country are substantial barriers of entry.

Also, due to diversity of consumer preferences resulting from differences in income level, culture, and environment of each country and region, the need often arises to provide different services to each country and region. For these reasons, carrying out business activities suitable for regional characteristics originally became an important source of competitive strength for service sector.

Until now, in many countries and regions, these kinds of regional bonds could mainly be found in service providers from domestic industry. Also, government enterprises are still seen to exist in many countries and regions in the public service sector, such as telecommunications and transportation. Further, in the service sector where small to medium enterprises dominate with high proportion and high employment, there are many examples protected by regulations restricting competition, such as regulatory barriers to entry and pricing regulations to protect and promote domestic industry and to secure employment.

On the other hand, special qualities of services including these kinds of regional bonds and business environments with restricted competition are thought to have been large factors making global expansion of the service sector difficult until now. But as mentioned in the previous section, it is also a reality that the world's service sector have rapidly pushed forward with global expansion in recent years.

This section clarifies that the difficulties in which the service sector faced for its global expansion have been overcome by the following factors: (a) Acquisition of competitive strength which does not rely on regional bonds, but by advanced IT utilization, (b) Progress in deregulation and system developments in each country and region, (c) Progress in internationalization of service transactions, etc. This section also focuses on activities of global services companies which effectively make these kinds of changes in the business environment, and aim at boosting their competitive strength by active global expansion.

1. Advanced IT utilization

(1) Globalization by advanced IT utilization

The increasing speed and popularization of network environments such as the Internet and Intranets enables real-time sharing of information between multiple business locations including overseas, allowing faster decision making, more efficient operations, advanced inventory management technologies, and improved customer service, etc. Also, technologies such as the spread of high speed search systems and large capacity databases, and introduction of POS systems and smart tags, are enabling quick and appropriate business responses to changes in customer needs. Global scale networks built through the Internet provide new ways for companies and customers to make contact, and also contribute to eliminating the asymmetry in information between customers and companies.

As a result, IT utilization skills have become directly connected to companies' competitive strengths, as they pursue higher efficiency and cost reductions through IT utilization. There are also demands on companies to utilize IT more actively as a means to gain advantage over other companies, such as in development of new products and services.

For companies which are pushing forward with global expansion, the IT utilization contributes to secure competitive strength in global markets not only by strengthening the cost competitiveness through improved business efficiency, but also through overcoming the typical restrictive requirements in the service sector such as regional bonding. Further, IT utilization such as introduction of POS systems, smart tags, etc., is enabling companies to achieve business expansion through fast and accurate understanding of customer needs, based on characteristics of local markets.

(2) Examples of advanced IT utilization by global service companies to support oversea market development

As mentioned above, advanced utilization of IT enables service companies to obtain a source of competitiveness against local companies, by working to build advantages over competitors through increased price competitiveness, and fast and accurate response to customer needs.

For example, U.S. retail “company A” prioritized implementation of IT utilization as investments for company development since the late 1980s, and actively invested in IT aiming to increase efficiency of its supply chain.

As a specific example, manufacturers, retailers, distributors, and others cross organizational barriers through networks to share information and achieve CPFR (Collaborative Planning Forecasting and Replenishment), which carries out sales planning, demand forecasting, and replenishment activities. These work to raise operating efficiencies for the company, such as optimization of inventories, reduction of merchandise cost, procurement, and distribution, in addition to achieving operating efficiencies for other companies linked to the company’s own supply chain. This also enables reductions in defective goods, and expansion and improvement of customer service at the same time.

The company also began utilizing RFID (Radio Frequency Identification) tag systems in January 2005. This aims to increase operating efficiency and precision by attaching RFID tags to incoming and outgoing pallets and cases in delivery centers, etc., using automated reading to reduce the amount of incoming and outgoing work and ensure traceability of goods.

This company took a capital participation in a Japanese retail company in 2002. It is moving forward with business expansion in Japan, and is working on efficient and effective utilization of IT. For example, the cash register system of all stores has now been moved to a common global specification and all POS data are processed at its data processing center in the U.S., the company’s home country.

It is thought that increased operating efficiency and customer service from the aforementioned advanced IT utilization led to superior price competitiveness and customer convenience in countries and regions entered by companies, as a main factor guiding each company to success in its global expansion.

2. Advancing deregulation and system developments in each country and region

As mentioned above, service sector in many countries and regions were regarded as domestic industries for many years due to reasons such as the simultaneousness and regional bonding of services. Government enterprises still exist in many countries and regions in their public service sector, such as telecommunications and transportation. Thus service sector have been protected by regulations restricting competition, such as regulations on market development and pricing, from the viewpoint of protection and implementation of domestic industries, and ensuring employment.

However, a variety of deregulation has occurred since the 1990s, greatly changing the business environments for service sector. Efforts to actively attract foreign service companies can also be seen in East Asian countries to develop their own economies.

The following describes changes in the global business environment for service sector in recent years, and considers the impacts on the globalization of service sector.

(1) Globalization by deregulation

(Progress in deregulation of service sector)

Since the 1990s, amid a change in regulatory methods from *ex-ante* regulation to *ex-post* regulation, there were changes towards more pro-competitive policies along with privatization of government enterprises, etc. Many kinds of deregulation were also pushed forward, such as easing of investment related regulations and of regulations restricting competition, greatly changing the business environment for service sector.

(Verification by Indicators of Product Market Regulation)[7]

In this section, the OECD’s Indicators of Product Market Regulation are used to check the regulatory situation of service sector in various countries throughout the world, to see the status of progress in deregulation of service sector.

The Indicators of Product Market Regulation (below, “PMR”) show the degree of impact on competition caused by regulations in each industry. Each industry is evaluated based on the rate of regulations on market entry, the share of government enterprises, regulations on prices and business hours, etc., and combine them into one indicator.

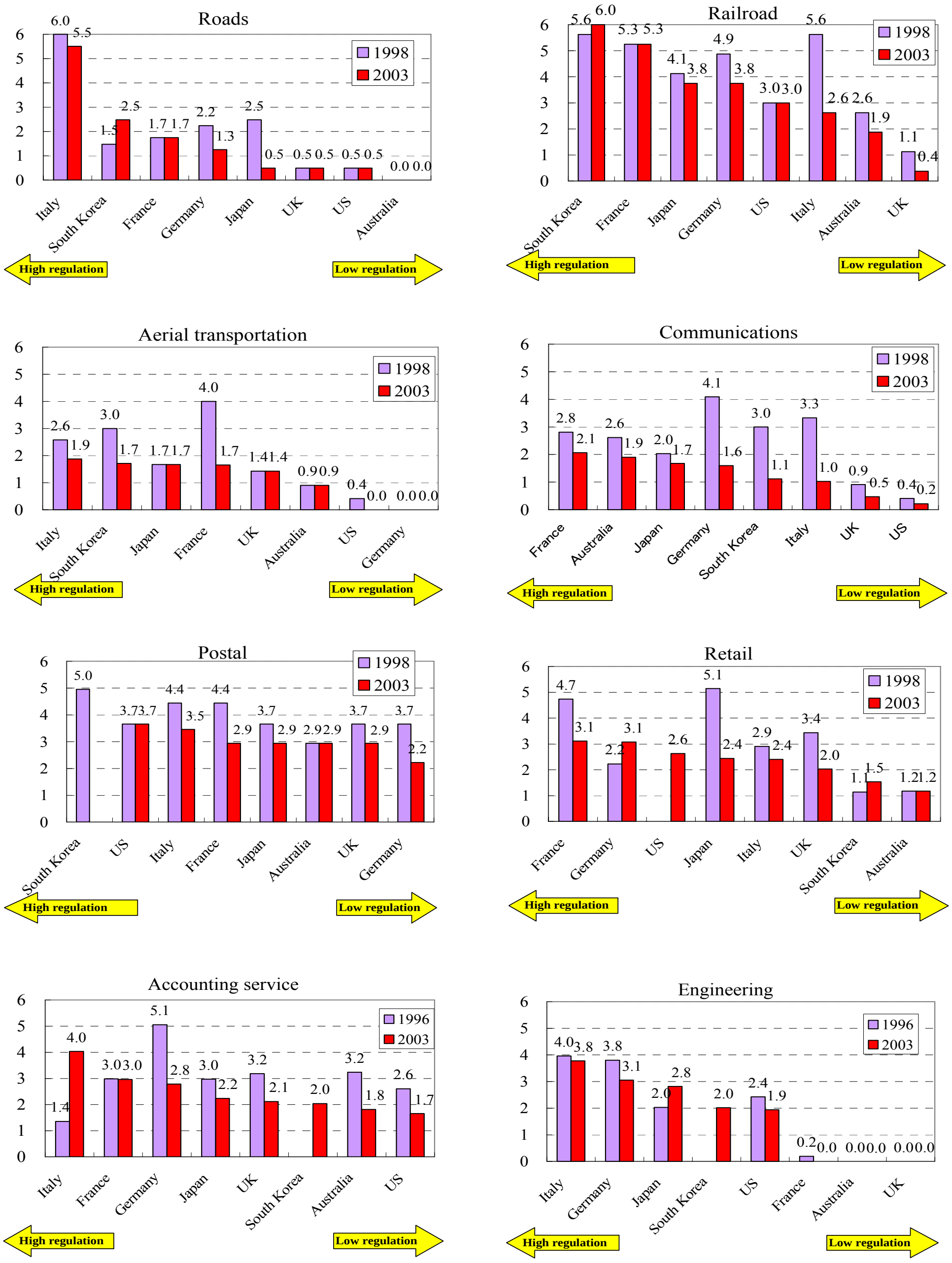
By looking at each, it is clear that PMRs for service sector are falling in general. Moreover, comparing each country in its PMRs from 2003, it is clear that many lightly regulated industries are in the U.S. and the UK.

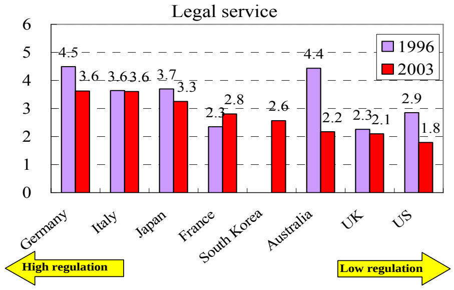
Looking at the situation of Japan by industry, it is clear that in the telecommunication sector Japan made a small reduction of PMR compared to other countries. In particular, Germany, South Korea, and Italy had higher PMRs than Japan as of 1998, but thereafter greatly reduced their PMRs, and were lower than Japan in 2003. Also, Japan greatly reduced its PMR in the retail sector, but it is still ranked almost average among PMRs of each country, therefore further deregulation can be expected. Also, in the engineering industry, while deregulation has advanced in each country, Japan’s PMR has

[7] For details on the Indicators of Product Market Regulation, refer to the OECD (2006).

increased. Although Japan is moving forward with deregulation in more than a small number of industries, further deregulation is expected (Figure 3-2-1).

'igure 3-2-1 Major countries' Indicators of Product Market Regulation by industr





Notes: 1.Indicators of Product Market Regulation close to 0 indicates low degree of regulation and 6 indicates high degree of regulation.

2. Data not displayed in graphs are data that have not been announced.

Source: OECD (2006), "Product market regulation in the non-manufacturing sectors of OECD Countries: measurement and highlights," OECD Economics Department Working Papers, No.530

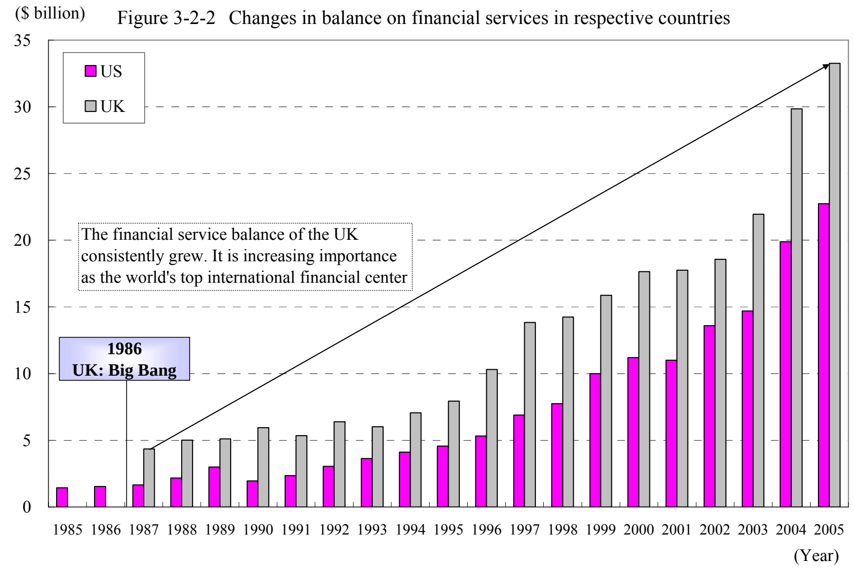
(Globalization of domestic industry through deregulation)

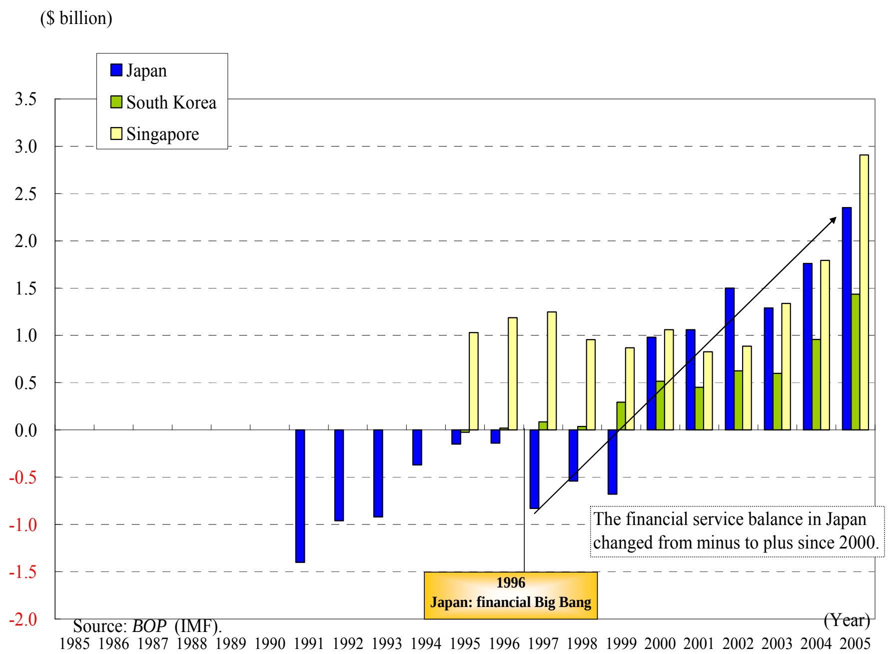
Creating a market environment through deregulation of investment-related restrictions that allow opening the domestic market for foreign companies and deregulation on limited competition among domestic industries also broadens the possibilities of new business expansion by domestic companies, including global expansion.

The UK's "Big Bang" (stock market reform led by the London Stock Exchange) implemented in 1986 is an example which achieved domestic economic growth through deregulation and internationalization of domestic industry. This reform implemented financial liberalization, such as deregulation of securities trading commissions, elimination of the single qualification system (removal of restrictions on the same business acting as both a jobber trading on its own account, and as a broker intermediary for customer orders), and elimination of restrictions on investments through external capital in stock exchange members. This led to active entry into the UK market by foreign financial institutions such as U.S. investment banks, along with progressive mergers and acquisitions of UK financial institutions by foreign financial institutions. As a result, services earnings of the UK's finance and insurance sectors have been in a continual growth trend since 1986, with the "City" achieving a revival in both name and reality as an international financial center, leading globally in its competitive strength.

A series of deregulations were also implemented for the financial industry even in Japan, through its 1996 "Japan Big Bang". It finally encouraged an active market environment in Japan's financial industry, and entry by foreign companies increased. Japan's financial services which suffered a consistent deficit since 1991 turned to a surplus since 2000, showing certain results for internationalization of its domestic industry and growth of domestic economy (Figure 3-2-2). However, the rate of profitability on Japan's securities investments has remained low overall (Japan 2.8%, U.S. 3.8%, UK 3.6%: 2004). Main causes pointed out are that about 75% of global investments are going to U.S. and European advanced countries, not to Asia which is achieving rapid growth, and Japan's market is not contributing sufficiently to capital raising by foreign companies. Also, to support advanced risk management by companies, it is pointed out that more efforts are required in utilization of risk finance techniques, such as the need to facilitate an environment that is equal to the international standard.

Figure 3-2-2 Changes in balance on financial services in respective countries





Source: *BOP* (IMF).

(2) Efforts towards service-based economies seen in East Asian countries

Governments of various countries including East Asian countries are also working to strengthen service sector by active introduction of foreign capital, and thereby achieve economic growth in their countries. These efforts are also thought to be fulfilling a certain role in the globalization of service sector.

The following section describes the approach of the Singapore government, as an example of efforts to strengthen service sector.

(Singapore's efforts)

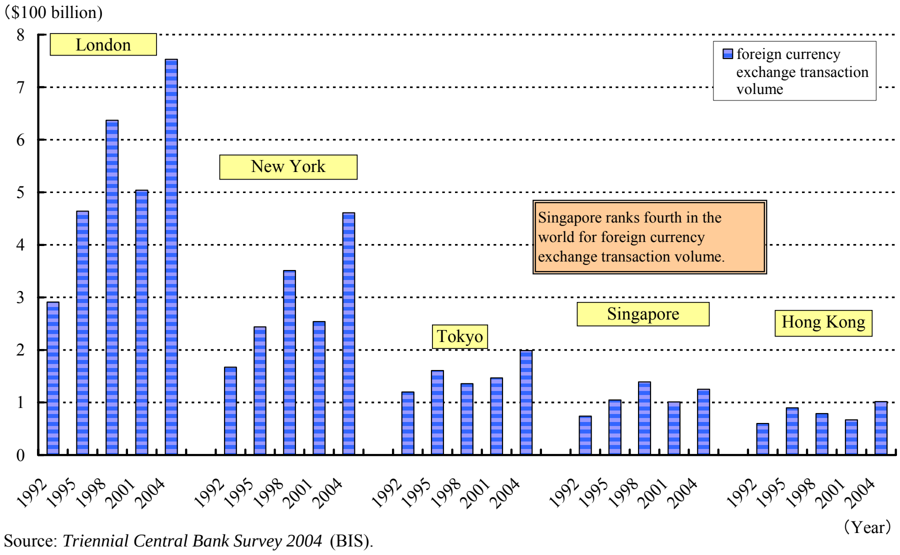
Compared with other countries, Singapore has disadvantageous conditions for attracting manufacturing bases, due to its limited territory, small population of about 4 million people, lack of natural resources, etc. Then it carried out a variety of efforts described below to actively attract foreign capital to become a base for international business in Asia.

From the financial aspect, Singapore provided incentives starting about 1970, such as favorable tax treatment for foreign financial institutions, deregulation of capital and currency transactions, etc., thereby developing its foreign currency market and offshore market.[8]

On the other hand, since the 1980s, competition with Hong Kong as well as the surrounding countries including Thailand and Malaysia intensified over the position as Asia's financial center, forcing Singapore into harsh competition. In order to survive as Asia's financial center, it engaged in many reforms, such as establishing the Singapore Exchange in 1999 by integrating its stock market and financial futures market. As a result, Singapore has grown in size to 4th place globally in foreign currency trading volume in recent years following London, New York, and Tokyo, with a higher percentage of foreign companies than in London and Tokyo (Figure 3-2-3 and Table 3-2-4).

[8] A market recognized as having free transactions with few restrictions from the system, in a form separated from the domestic financial market, to raise capital from non-residents and invest capital in non-residents.

Figure 3-2-3 Changes in foreign currency exchange transaction volume in each major transaction site



Source: *Triennial Central Bank Survey 2004* (BIS).

Table 3-2-4 Number of listed foreign companies (2005)

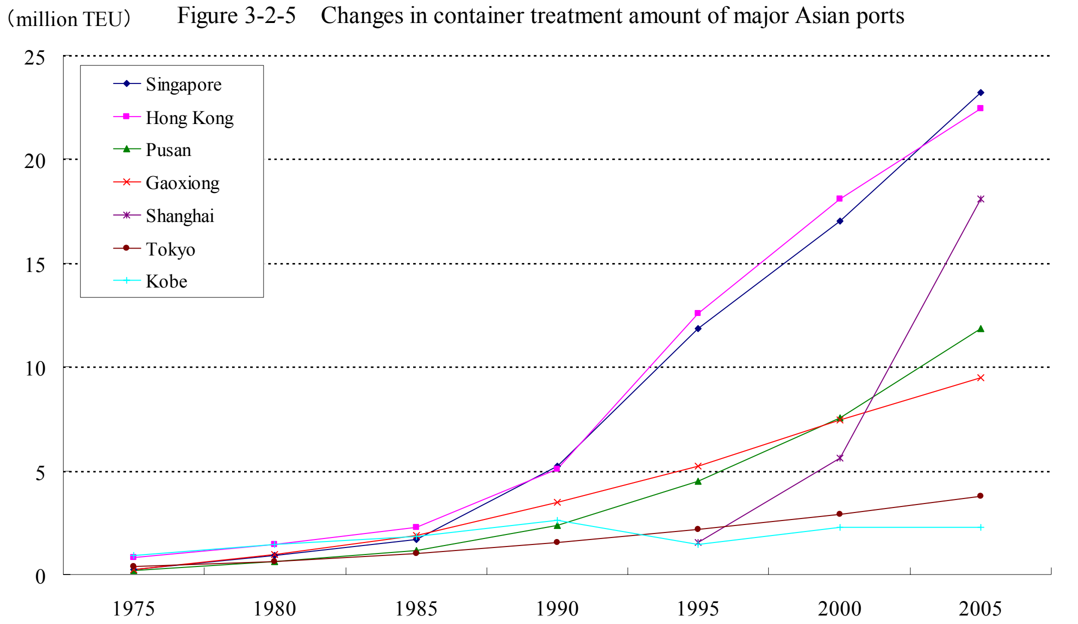
	Foreign Company	Total	Percentage of foreign Company
New York	452	2,270	19.9
London	334	3,091	10.8
Nasdaq	332	3,164	10.5
Singapore	**122**	**686**	**17.8**
Tokyo	28	2,351	1.2
Hong Kong	9	1,135	0.8
Taiwan	5	696	0.7
Malaysia	4	1,019	0.4
Osaka	1	1,064	0.1
South Korea	0	1,616	0.0
Shanghai	0	833	0.0
Shenzhen	0	544	0.0

Notes: The total of Tokyo is first and section of the Tokyo stock exchange group, the total number companies listed on Mothers.
Source: *Annual Report and Statistics 2005* (World Federation of Exchanges).

Also, in the logistics industry, the Singapore government has actively pushed forward development of port and airport infrastructure, and both port infrastructure and airport infrastructure in Singapore received high appraisals as number one in the world (Japan is 12th) (Figure 3-2-5).[9]

[9] World Economic Forum (2005), "The Global Competitiveness 2005-2006".

Figure 3-2-5 Changes in container treatment amount of major Asian ports



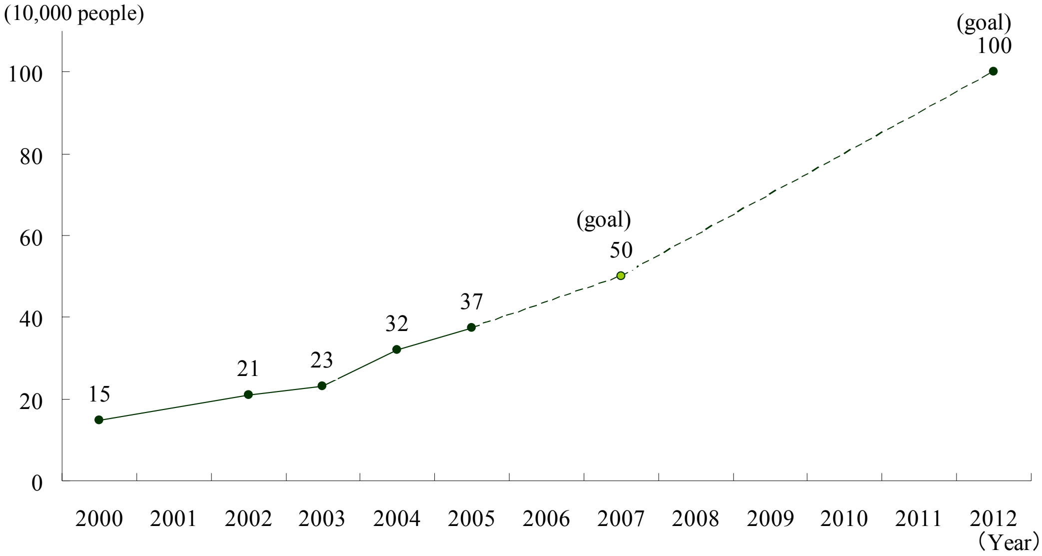
Notes: TEU is the unit expressing the carrying capacity of container vessels. (1TEU=one 20 feet container).
Source: "CONTAINERISATION INTERNATIONAL YEAR BOOK."

In addition to the aforementioned financial and logistics functions, the Singapore government is working to develop a variety of business infrastructure to become an international business hub. Favorable measures are being created such as reductions and exemptions from corporate taxes for foreign companies which locate their management functions in Singapore. Of the approximately 7,000 foreign companies which have located in Singapore, about 60% have a regional management function.

On the other hand, in addition to services for business, the Singapore government is also putting effort into expanding services for individuals.

It is developing various measures to make Singapore a medical hub in Asia, actively working to address the needs of people in U.S. and European countries who want to use good quality health care services at an inexpensive cost. The Singapore Medicine plan was launched in 2003 to unite the government and the medical care industry, announcing policies to obtain a position as a medical hub, by promoting new investment in the health care industry, developing transfer channels for foreign patients, etc. This plan includes the goal to increase foreign patients received from about 230,000 in 2003, to one million foreign patients in 2012, growing it into a market of 3 billion Singapore dollars (about ¥220 billion) (Figure 3-2-6).

Figure 3-2-6 Changes in the number of foreign patients accepted in Singapore



Source: Website of Singapore EDP.

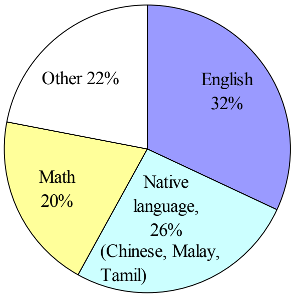
Further, Singapore is providing medical care service which aims at even better medical care results for specific symptoms such as algia. In addition to treatment by usual medicines, traditional Chinese medicines, such as acupuncture and moxibustion treatments, are used as a supplement and replacement. Instead of simply providing modern Western medical care at low cost, one can say that Singapore is aiming to differentiate itself from Western medical care services, by combining it with traditional Asian medical care.

As a result, 374,000 people visited Singapore in 2005 to receive health and medical care services and also to enjoy sightseeing, and these numbers are said to be growing rapidly in 2006.

The Singapore government is also making efforts in education services to make Singapore an education hub. It launched the Global Schoolhouse plan in 2002 to increase the number of foreign student enrollment. As part of this, Singapore is strengthening its education industry to attract more than 10 of the world's top class graduate schools and business schools within five years. (Figure 3-2-7). Singapore has also announced its goal to receive 150,000 foreign students by 2015 (Figure 3-2-8).

Figure 3-2-7 Overview of education services in Singapore

①Proportion of school hours for first-fourth graders



Source: *CLAIR REPORT Education of Singapore 2005* (CLAIR).

②Graduate schools expanded to Singapore

Massachusetts Institute of Technology (MIT)
INSEAD（INSEAD, France）
Johns Hopkins University
The Wharton School of the University of Pennsylvania
University of Chicago Graduate School of Business
Stanford University
Waseda University, etc.

Note: The 2005 education related investment was 110 million Singapore dollars（approx. 7.3 billion yen）

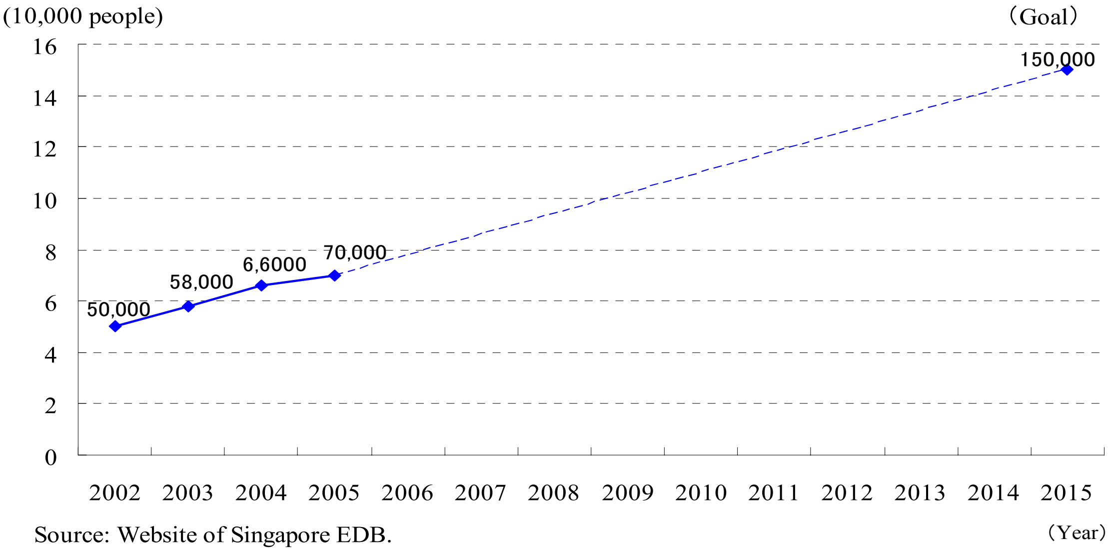
Source: Website of Singapore EDP.

③ Rating from 2005 international competitiveness ranking

	Singapore	(in reference) Japan
Quality of educational systems	1st	24th
Quality of public schools	3rd	11th
Quality of math, science education	1st	12th

Source: *The Global Competitiveness 2005-2006* (World Economic Forum).

Figure 3-2-8 Changes in the number of foreign students in Singapore



Source: Website of Singapore EDB.

The Singapore government's efforts to become an international business hub as described above can be said to have generated certain results. It can be said that in countries in the East Asian region, these kinds of policies are being developed for active introduction of foreign service companies to achieve economic growth. This movement is in synergy with the European and U.S. global service companies trying to obtain growth from the development of East Asian countries which are achieving higher economic growth than developed countries.

[Column 9]: Current situation of medical care services in Asian countries

In Asia, patients can receive advanced medical care services equal to those in Europe and the U.S. at far lower cost than in their own countries, so in recent years, the number of foreign travelers visiting Asian countries for health and medical care has grown rapidly. In 2006 the number of foreign travelers who visited the Asian region for the purpose of receiving medical care services reached 1.8 million, and this market is valued at about US$6.8 billion.

In the background of increasing numbers of patients visiting Asia is the situation of companies in developed countries such as Europe and the U.S. trying to reduce their large medical care expense burdens as much as possible. In particular, in the U.S. with its large medical care costs, about an 80% cost reduction is said to result from employees receiving medical treatment in foreign countries where medical care costs are low. This is why increasing numbers of companies are recommending that employees receive medical treatment in foreign countries such as Asia where medical care costs are low. Travel agencies are actively pioneering this market, cooperating with medical care institutions to plan medical tours which include local sightseeing.

Similar to Singapore, India is also putting effort into serving demand for health and medical care services from foreign countries. In India, with a booming economy in the background, an increasing number of hospitals have developed comprehensive medical care facilities, and are actively fostering skilled and experienced doctors. Advanced medical care services are cheaper than in Europe and the U.S., and the waiting time is also short, which is attracting many patients from foreign countries to India. The Indian government is emphasizing this kind of medical tourism as a key to economic stimulation, and is also promoting it in a form linked to sightseeing in India’s domestic resorts. If people visiting India increase, many more people can recognize the attraction of India, which is achieving remarkable economic development. According to the Indian government, the medical tourism sector is achieving 30% annual growth.

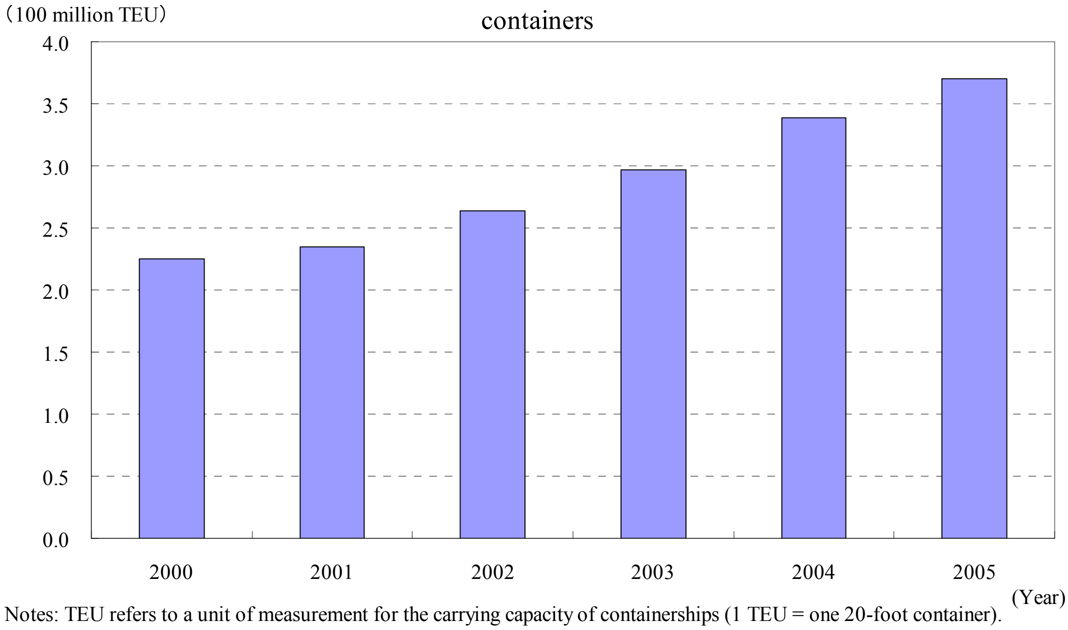
3. Globalization of customers and internationalization of service transactions

(1) Globalization of customers and internationalization of service transactions in various sectors

In recent years, in a background of globalization of company activities, there is increasingly active movement of goods, capital, information, and people across borders. These kinds of movements suggest the globalization of customers in the service sector, with demand pulling the industry towards globalization through increasingly active international service transactions.

First, looking at movement of goods, global port container transport volume is showing rapid annual growth of over 10% on average since the year 2000 (Figure 3-2-9). This is presumed to result from causes such as advancing global expansion of manufacturing industries and a growing system of international division of labor as seen in Chapter 2.

Figure 3-2-9 Changes in the world's transported materials using port containers

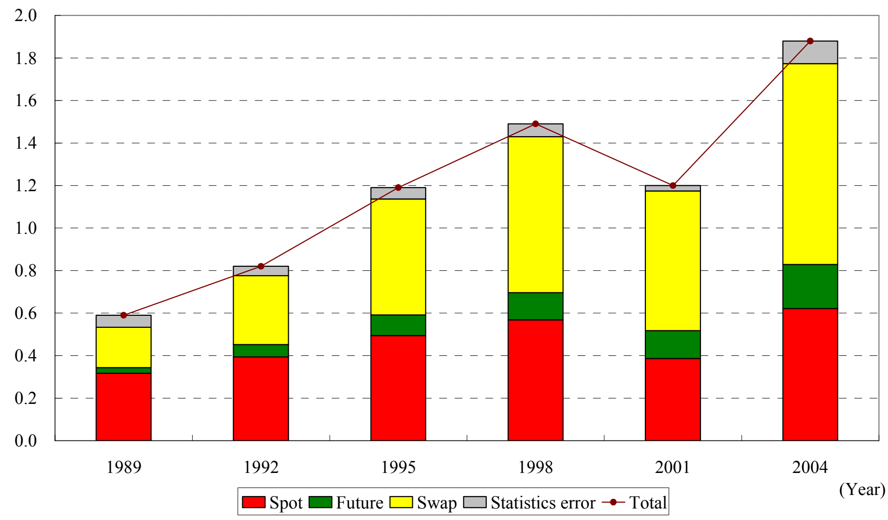


Notes: TEU refers to a unit of measurement for the carrying capacity of containerships (1 TEU = one 20-foot container).
Source: *WDI* (World Development Bank).

Next, looking at movements of capital, global daily currency trading volume is demonstrating a long term trend of expansion, except for in 2001, the year directly after the collapse of the U.S. IT bubble (Figure 3-2-10).

In a background of globalization of company activities, it appears that international capital movements are becoming increasingly active each year.

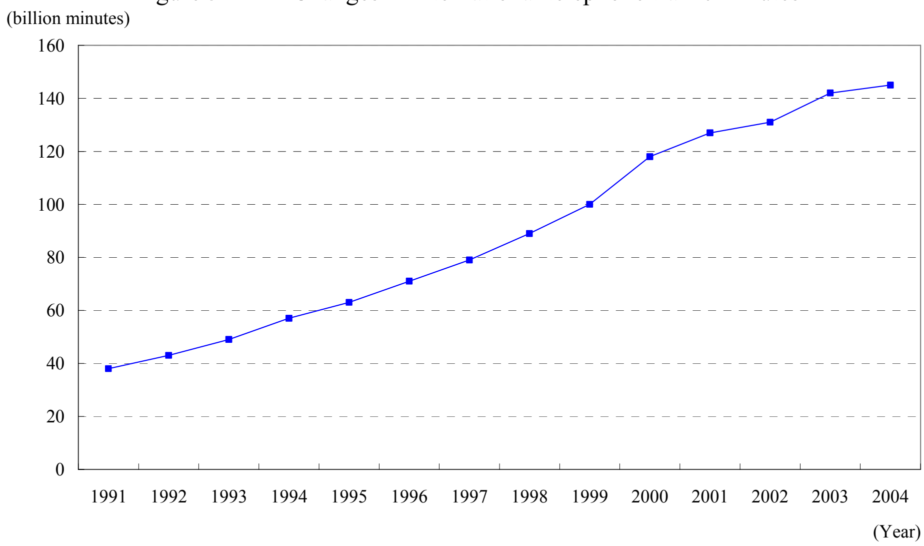
($ trillion) Figure 3-2-10 Changes in foreign exchange transaction volume per day in the world



Notes: The average of each April's foreign exchange transaction volume per day.
Source: *Triennial Central Bank Survey* (BIS).

Also, looking at the movement of information, while means of communicating information is diversifying by the spread of the Internet such as email, one can see that international telephone traffic minutes is dramatically increasing, hence the exchange of information across borders is rapidly expanding (Figure 3-2-11).

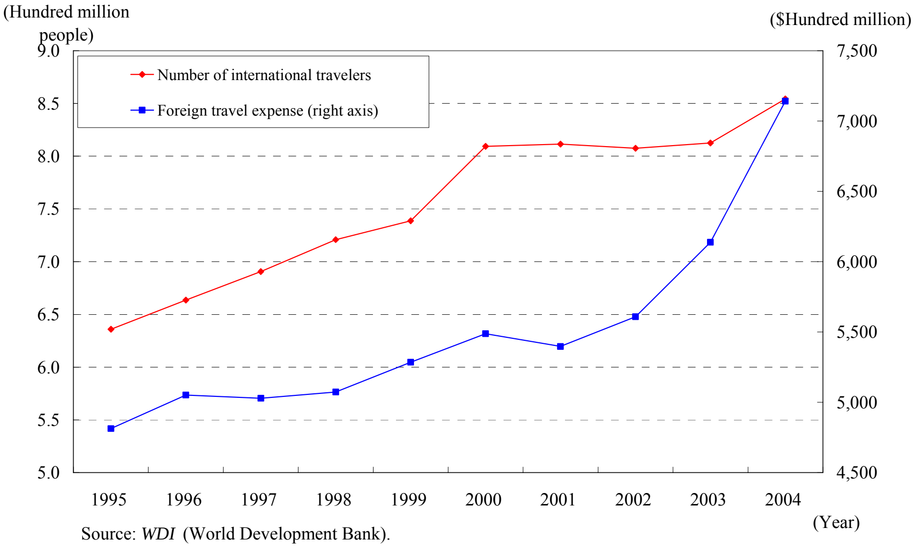
Figure 3-2-11 Changes in international telephone traffic minutes



Source: *Key Indicators of World Telecommunications,1991-2004* (International Telecommunication Union).

Finally, looking at movements of people, the number of international travelers and the amount of foreign travel expenses are in a long term growth trend. Especially, foreign travel expenses are growing remarkably since 2002. Demand for foreign travel is also forecast to grow in the future along with growing incomes, and growth in traveler numbers and travel expenses is forecast to continue (Figure 3-2-12).

Figure 3-2-12 Changes in number of international traveler and foreign travel expense



Source: *WDI* (World Development Bank).

In this way, movements of goods, capital, information, and people crossing borders are all becoming active in recent years. These active movements also lead globalization of customers for various service sector such as distribution, finance, communications, and services to individuals, as service sector are being pulled into global expansion by demand.

(2) Growth in international transactions through offshoring from companies in developed countries to developing countries

There is active offshoring to Asia, such as establishment of call centers one after another in Asia by developed countries in recent years, even in service sector. This is led by utilization of IT in labor intensive industries which are relatively weak in developed countries.

Foreign companies primarily focus on India as a country for offshoring of software development and call centers, etc. Reasons given for the focus attracted by India are (a) Abundant human resources with strong English ability at low wages, (b) Solid human resource development institutions, such as universities and research centers, (c) With a low average age, future labor force supply is also expected. In addition, full scale offshoring of services to India from European and U.S. companies is said to have begun about the year 2000. Since then, India has gained experience in organizational response, quality control, deadline management, etc. India has met the expectations of European and U.S. companies, and it is thought that this will now lead to even more demand for offshoring to India.

There are also causes for concern for the future. For example, demand has increased suddenly in recent years, causing a mismatch between skills which companies seek in India's workers, and skills held by India's workers. Companies are said to be having difficulty in securing capable human resources, and from an employment aspect, it is pointed out that companies providing offshoring services have an extremely small share of India's overall labor force, so they have a limited impact on the overall Indian economy.

However, over 80 software development companies in India have acquired the highest level 5 in the software Capability Maturity Model (CMM),[10] a global standard for rating software development companies. This comprises 68% of the 117 companies which have completed certification globally, and their software development capabilities are highly evaluated. Thus in addition to software development and call center business, there are an increasing number of cases in recent years where they are entrusted with higher value added work, such as market analysis and survey research business.[11]

Demand for offshoring in India is also forecast to increase in the future.

The same efforts are also seen in China to handle global demand for offshoring. In 2004, the Chinese government established six "National Software Export Bases" in Beijing, Shanghai, Dalian, Shenzhen, Xi'an, and Tianjin to carry forward industry accumulation and grow large bases for software exports. Compared to India, this is characterized by attracting software development bases of global companies to China as part of export promotion. For example, several dozen major Japanese companies have created software development sites in Dalian, in addition to European and U.S. companies.

Japan is said to be the destination for about 60% of China's software exports. Thus China's export related software companies are providing training in the COBOL language, which is one of the programming languages in demand by Japanese customers. Many of China's software development companies have a strong focus on the Japan market, with some companies able to work in the Japanese language, including development staff, etc.[12]

Also, among ASEAN countries, there is active offshoring to the Philippines. Call centers continue to be established in the Philippines by U.S. companies, with revenues of the Philippine call center industry reaching US$1.6 billion in 2005, even achieving rapid growth of 70% over the previous year. Reasons given for many U.S. companies establishing call centers in the Philippines are: English speaking human resources can be employed at lower cost than in surrounding countries, and the Philippines and the U.S. have relatively close English accents, etc. There are currently 100 call centers, with over 100,000 employees.[13] Full scale entry by U.S. companies began in 2000, with some of the companies expanding the scope of offshoring into sales of real estate and financial

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[10] The Capability Maturity Model was developed by Carnegie Mellon University (USA). CMM establishes elements for criteria of the software process, and classifies a project organization into five stages, by degree of capability maturity. Each level is described as follows. Level 1: (Initial stage) There is no quality assurance department, and absolutely no established process exists to cope with changes in requirements or design. Level 2: (Repeatable stage) Planned reviews of the management and progress of projects, and an established procedure is specified which is able to cope with changes. Level 3: (Defined stage) A technical team is formed which specializes in taking charge of customization and improvement of the development process, with a prepared architecture which defines the technical and management development roles, and clear development techniques and tools prepared. Level 4: (Managed stage) Each product's cost and quality is analyzed based on a specified database, and quantitative data is collected. Level 5: (Optimizing stage) A feedback way of thinking is introduced based on measured results, data collection is automated, and there is continual improvement of the actual development process while utilizing statistical data.

[11] Schaaf, J. (2005) "Outsourcing to India : Crouching Tiger Set to Pounce", Deutsche Bank Research.

[12] Jianmin, J. (2005)"Nikkei kigyo niyoru taityugoku offsore kaihatsu no jittai to jyoken".

[13] ADB (2007), *ASEAN DEVELOPMENT OUTLOOK 2007.*

products.

4. Strengthening company competitiveness through globalization

(1) Achievement of economies of scale in service sector

As described above, IT investment is one of the major factors that determine a company's competitive strength in service sector. Many European and U.S. service companies moving forward with global expansion place IT investment as a pillar for strengthening competitiveness, and are actively making investments. On the other hand, IT investment costs are becoming larger each year along with systems becoming increasingly advanced and complex, and there is an increasing trend towards shorter renewal periods. Thus finding a way to recover huge IT investments in a short time is becoming a large issue for many companies. In this situation, it is thought that many global service companies are trying to expand the scale of their business by broadening their business from domestic to foreign markets, thereby aiming at efficient recovery of investment costs by obtaining economies of scale.

For example, IT investments by financial institutions are transitioning from accounting systems of the past into information systems in recent years, and the scale of investments is also increasing each year. As financial services become more advanced and complex, and international transactions are growing along with rapid globalization of economies, investment in information systems is becoming an important key for the competitive strength of financial institutions. Thus it is thought that major global financial institutions are actively expanding globally, strengthening competitiveness even more by reinvesting the profits obtained through expanding business scale, and thereby solidifying the growth as an enterprise.

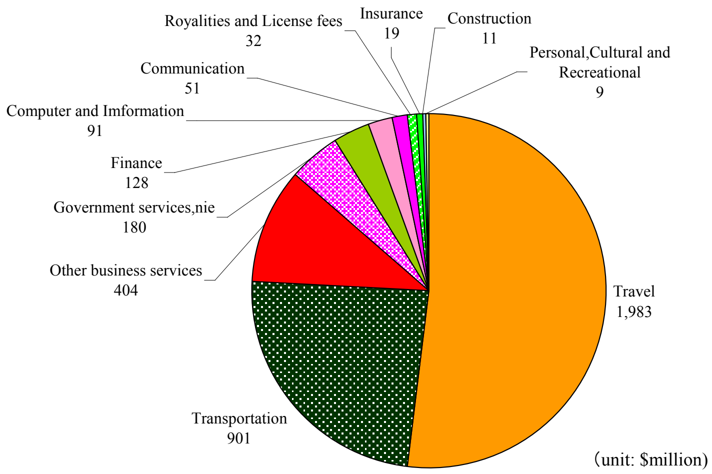
In addition to expanding their business size to recover IT investments, it appears that some industries including wholesale and retail industries are also expanding the scope of their business into foreign countries to increase buying power, thereby obtaining economies of scale, and to provide a wide variety of products at low cost to consumers.

In the past, regional bonding was the main source of competitive strength for companies in service sector, business scale became limited, and as a result there were limits to obtaining economies of scale. But as mentioned above, achieving economies of scale by simultaneously pushing forward with active expansion of IT investments, large volume purchasing and global expansion can bring a favorable cycle of benefits from all these factors.

(2) Importance of direct investment

Looking at the breakdown of exports of service from developed countries, over half are mainly dominated by travel, which is consumption abroad (Mode 2). Even when totaling the share of all services that are mainly provided through cross-border supply (Mode 1) such as transport, other business services (mainly trade intermediation commissions), and finance, they comprise less than half of the total (Figure 3-2-13).

Figure 3-2-13 Breakdown of trade in services in developed countries（2005）



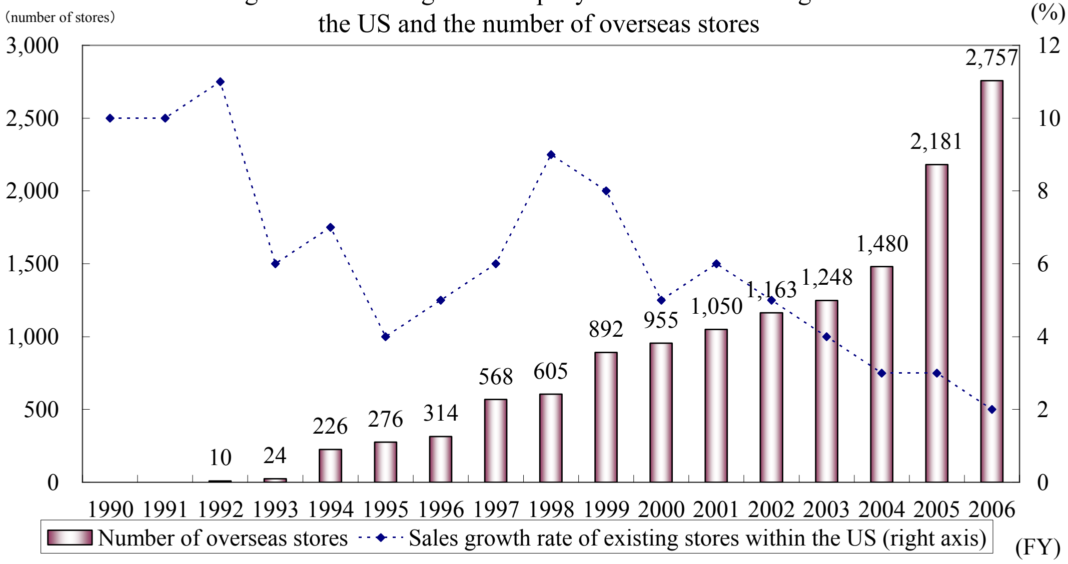
Notes: The developed countries refer to Japan, US, UK, France, and Germany.
Source: *BOP* (IMF).

Thus for service sector to capture demand in foreign markets, without relying only on exports, there is a need to construct a local business base through direct investment. Further, for service sector to achieve global expansion through direct investment, they must accurately meet the needs of consumers and companies in the market locations, and build a clear distinction with European and U.S. companies and leading local service companies which have already moved forward with foreign expansion. To compete successfully, it is important to ascertain the company's original strengths and make them even stronger, while moving forward with strategic business expansion which maximizes their utilization. It is important to also strengthen domestic competitiveness while moving forward with global expansion.

[Column 10]: Foreign business expansion of global distribution companies – Example 1

U.S. retailer "A" achieved over 10% annual growth in U.S. domestic sales in FY1991 and FY1992, but growth slowed since FY1993 (Column Figure 10-1). On the other hand, it began expansion through overseas stores in FY1992, expanding to 2,757 stores by FY2006 year end, with the ratio of foreign sales also exceeding 20% in FY2006. Through this very rapid global expansion, it succeeded in building its strong position as a top global retailer.

Column Figure 10-1 Changes in company A's domestic sales growth rate in the US and the number of overseas stores



Notes: The number of stores refers to the number of stores at the end of each fiscal year.
Source: *Company A manual report.*

As described above, even while the company's domestic growth slowed due to intense competition, the company maintained its growth by moving forward with overseas business expansion, acquiring foreign customers, and expanding its share in overseas growth markets.

This overseas business strategy is thought to be the reason for active global expansion of European and U.S. companies. In general, it seems that European and U.S. service companies which are actively expanding globally have overseas business strategies with the following features: Ascertain the company's competitive strengths which can be internationally effective, such as efficiency from IT utilization; Expand into overseas markets in which these strengths can be maximized; The entire company obtains the benefits associated with expanded scale by maintaining the proper degree of integration and consistency of domestic and foreign operations, achieving even more competitive strength and growth. Of course, a certain amount of effort towards local adaptation can be seen, but the characteristics of global coordinated strength and strategy are thought to be distinctive when compared to Japan's service companies in general.

An active business stance which tries to incorporate the vitality of high growth markets such as East Asia into the company's business strategy is also seen in this kind of foreign business strategy of European and U.S. service companies.

On the other hand, Japan's service sector carry out business expansion which flexibly responds to the business environment of the market locations, and this ability to adapt to markets is highly regarded. But as international competition is forecast to further intensify in the future, to achieve even faster growth, a strategy similar to European and U.S. global service companies is demanded to foster and deliver competitive strengths which can be delivered regardless of the country, execute successful global expansion, and use that success to strengthen the entire company.

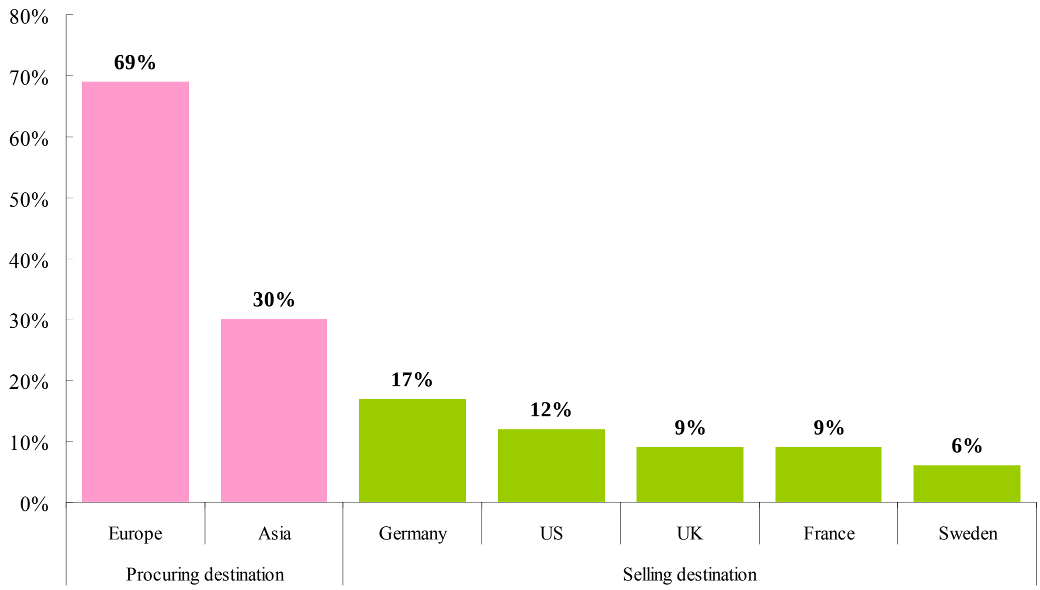
[Column 11]: Foreign business expansion of global distribution companies – Example 2

Corporate Group B – a well known major Swedish furniture retailer – began with entry into Norway in 1963, then moved forward with foreign expansion into each European region, the U.S., Asian countries, etc. As of March 2007, it had expanded into a global distribution company with a total 253 stores in 35 countries and regions, reaching sales of 17.3 billion euro (2006). This company opened a store in China in 1998, and is also moving forward with opening stores in other parts of the Asian region, including in Japan in 2006 (Funabashi City in Chiba prefecture, and Yokohama City in Kanagawa prefecture).

One of this company's characteristics is global purchasing and global sales in the furniture sector.

Corporate Group B currently purchases from 1,300 manufacturers in 54 countries, and sells in 35 countries and regions. Approximately 69% of its suppliers are in Europe, with 30% in Asia. On the other hand, Germany comprises the largest share of its sales at 17%, followed by the U.S. (12%), UK (9%), France (9%), and Sweden (6%) (Column Figure 11-1).

Column figure 11-1 Top five countries in company B's supplying regions and sales locations



Notes: The proportion of the total procuring amount and sales amount of company B shared in the respective countries and regions.
Source: Website of company B.

Furniture is the main product handled by this company. Furniture is essentially a heavy and large volume product, resulting in high storage and transport costs, so even if low cost products are purchased from foreign countries, they cannot compete on price with domestically produced goods which have low storage and transport costs. This is one reason that there are limitations on international distribution accompanying expansion.

For Corporate Group B, the biggest issue is how to store and transport to the consuming regions at low cost while maintaining high quality of furniture purchased from throughout the world, and it is taking the following measures.

(a)To achieve low weight and volume without losses in design and functionality, it carries out thorough product development which requires attention to the logistic cost reduction starting in the designing process.

(b) Achieved dramatic reductions in transport and storage costs by adopting an assembly type of construction which also reduced volume.

(c) Moved forward with development and centralization of international distribution centers for each region in Europe, Asia, etc., and built efficient regional distribution systems.

Corporate Group B put forth the innovation which achieves this kind of thorough reduction of distribution cost while maintaining design and functionality as its greatest source of competitive strength. It strategically selects foreign business locations and expansion techniques from the viewpoint of utilizing this competitive strength, and is actively globalizing.