Chapter 2 Japan growing with Asia's development - Asia -Pacific framework toward sustainable growth
Section 3 : Expansion of Asian consumer market. Targeting to be a quality market

4. For further expansion of Asian consumption

(1) Income disparity and the development of social security systems

Although the Asian consumer market is rapidly expanding, there are many undeveloped areas such as consumption volume per person and product and service quality compared the U.S. and EU. The Asian Market has some challenges to grow and exceed the market of the U.S. and Europe in terms of both volume and quality. One of them is income disparity in the region (see Figure 2-3-4-1).

The GDP per capita by country and region in Asia in 2008 shows that the highest was $46,824 of Australia and the lowest was $446 of Myanmar creating a 105-fold gap. On the other hand, as for the GDP per capita by country in EU in 2008, the highest was $62,097 of Luxembourg and the lowest was $6,561 of Bulgaria showing a 9.5 times difference.

Moreover, one of the characteristics of Asian countries and regions is high household saving rate (see Figure 2-3-4-2). Consumers have deep concern for future income and employment and presumably they curtail spending to save money when they have tendencies to avoid risks.

It is pointed out that one of the reasons for the high household saving rate in Asian countries and regions is their underdeveloped social security systems. For example, the coverage rate of public pension systems for major countries shows that the rate is 72.5% is in the U.S. and 71.4% in Japan, while Asian emerging countries present lower numbers such as 17.2% of China and 5.7% of India (see Figure 2-3-4-3) Moreover, according to a research of MasterCard[6], insufficient social welfare is pointed out as one of the reasons to curtail expenditure both in cities and rural areas in China. It represents the necessity for the development of social security systems (see Figure 2-3-4-4).

Once the developed social security system clears consumers' concern for future, consumers would spend more instead of saving and the Asian consumer market is expected to further expand.

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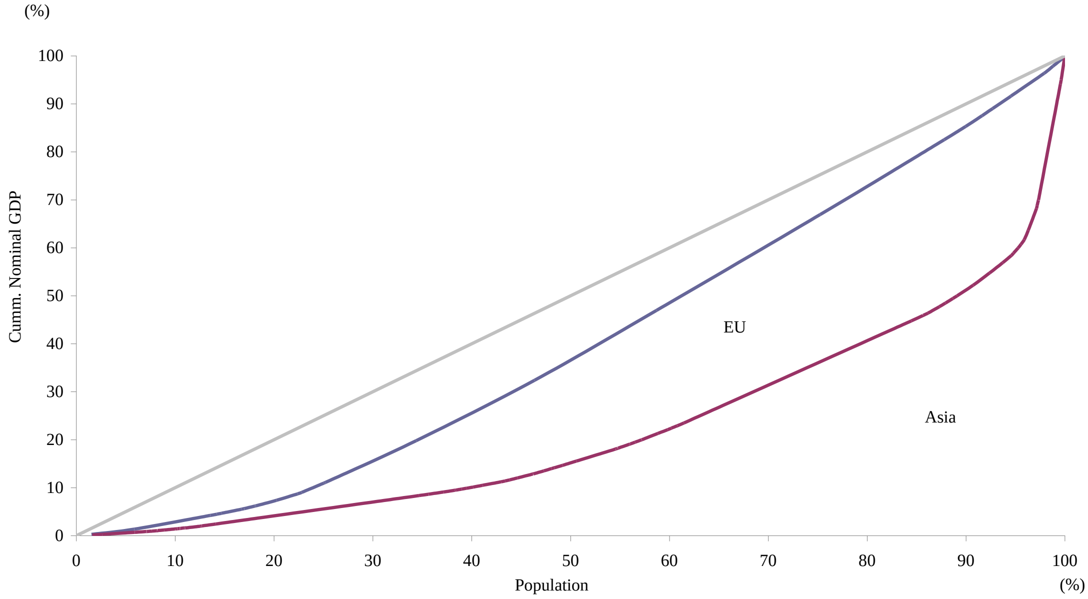
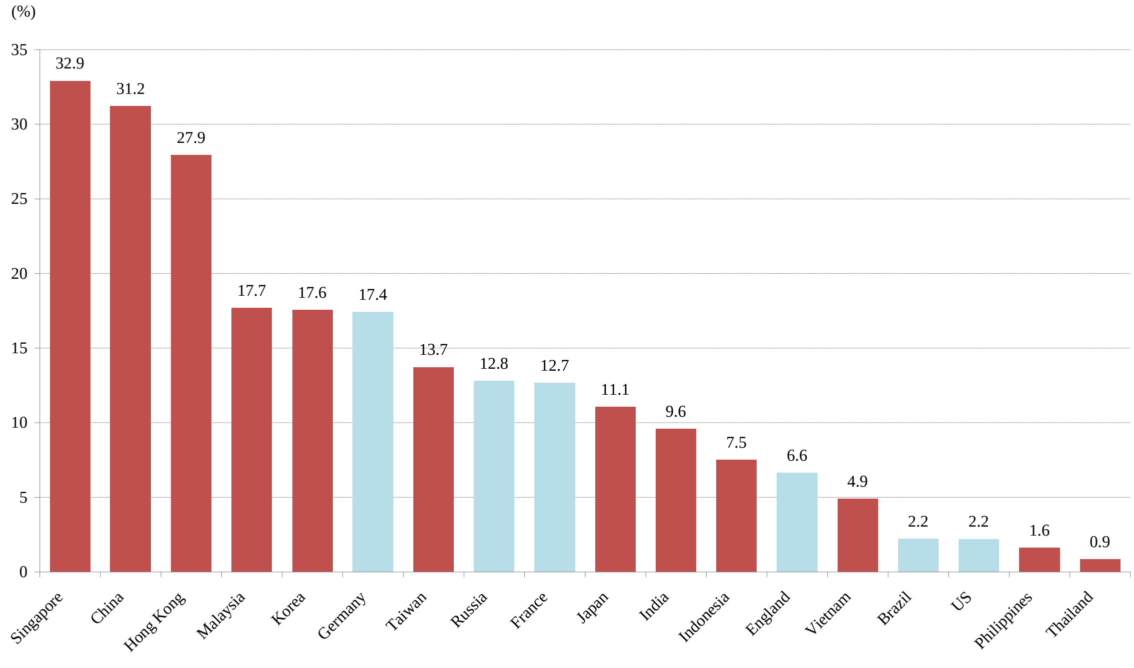
[6] MasterCard Worldwide Insights "CHUGOKUNIOKERU SEIFUNO KEIKISHIGEKISAKUTO SEIKATSUSHANO HANNOU (Economic stimulus measures by the Chinese government and the response of people)" Research period July to August 2009 (n = 4500 people in cities and 1800 people in rural areas)

Figure 2-3-4-1: Lorenz curves for Asia and the EU (2008)



Note: Equilibrium closer to the straight line.
Cummulative nominal GDP and cummulative population are cummulative values in order form low countries/regions (overall ratio). Uses data from China, Indian provinces and states.
Source: Created from IMF "World Economic Outlook", CEIC Database.

Figure 2-3-4-2:The household savings rates of major countries and territories (2008)

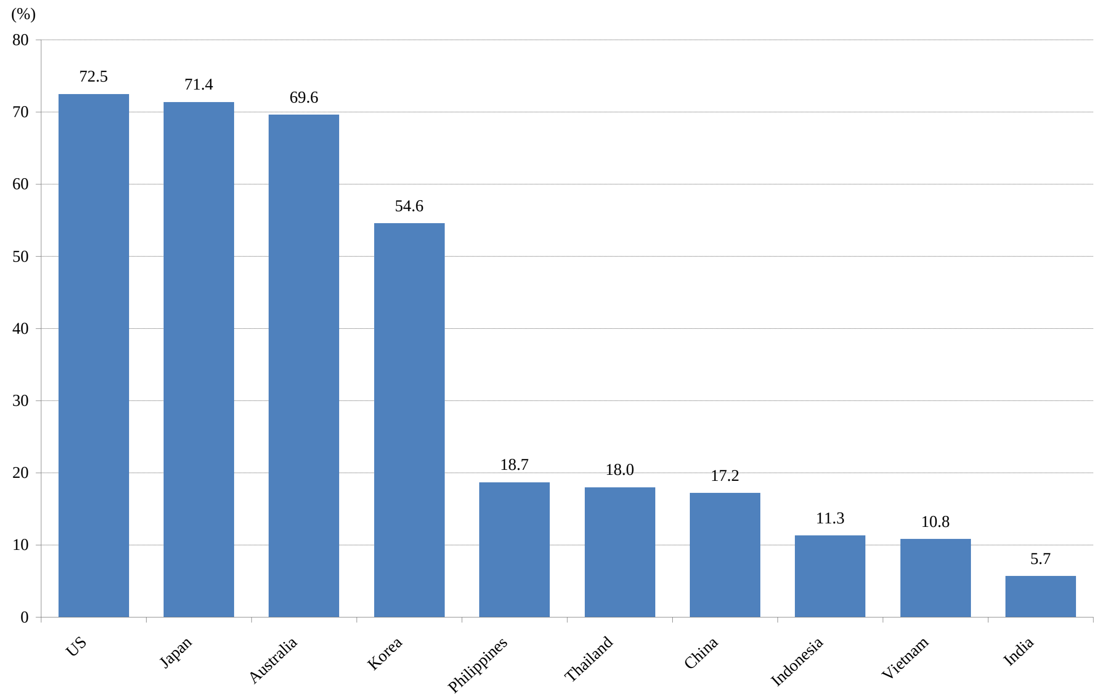


Note: Household Savings Ratio ＝（Disposable Income － Consumption Expenditure）÷ Disposable Income.
Source: Created from "Euromonitor Consumer International 2008/2009".

(2) Development of the service industry

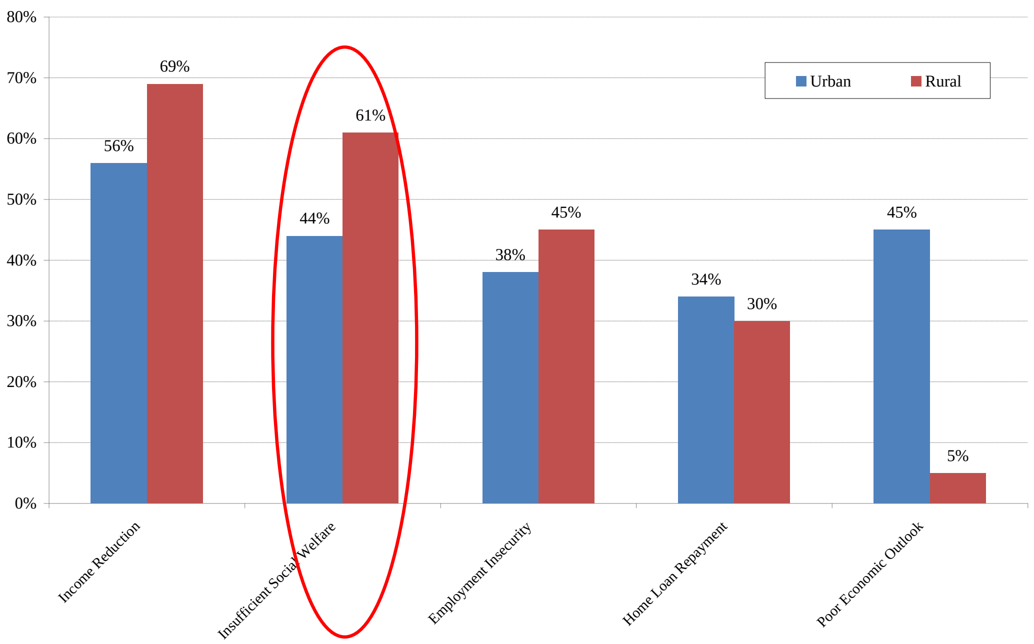
For the Asian consumer market to grow and mature, it is necessary to offer various services that meet the needs of diversified income groups in local markets. To do so, the relaxation of regulations that widely exist in the service industries of Asian countries and regions and the liberalization of trade and investment will contribute for the improvement of consumer confidence, the expansion of markets and the improvement of quality of market in local economies.

Figure 2-3-4-3: Public pension coverage in major countries



Source: Created from "OECD Pensions at a Glance SPECIAL EDITION:ASIA/PACIFIC 2009".

Figure 2-3-4-4: Reasons for declining household expenditures in China



Note: 1. Urban (Beijing, Shanghai, Guangzhou) n=4500, Rural (Kunshan Jiangsu, Laixi Shandong, Shenmu Shaanxi) n=1800
2. Survey period was from July to August 2009.
Source: Created from MasterCard "MasterCard Worldwide Insights Survey".

As the service industry expands, the improvement of productivity becomes more important.

Productivity is considered to substantially improve[7] with the introduction of privatization and competition. The entry of foreign companies will increase the competition and give influences such as new technologies[8]. The entry of foreign companies that were nurtured with different business customs in different economic environment will enhance consumers' benefit through the improvement of productivity with the introduction of new business models, the inflow of new management resources and the provision of new services that were not domestically available. In light of the above, it is important to increase inward direct investment through measures such as the deregulations for foreign companies to improve the service industry and to increase consumer benefit in each country and region[9].

Furthermore, the service industry is said to have higher employment capacity compared to the manufacturing industry. If the service industry grows and the number of its employees increases, it will contribute to the further expansion of consumer market.

Outstanding move was observed in countries such as Malaysia, Vietnam in Asia countries and regions. Malaysia has a plan to modify the guideline[10] that sets the regulations on the foreign capital entry in its distribution and service industry. Vietnam opened the area of distribution services to WTO member countries in 2007 and permitted the operations of fully foreign-owned agencies, wholesalers, retailers and franchisers in 2009

In this way, while the abolishment and relaxation of regulations progress in the service industry, there are still many regulations and business customs against foreign companies in each Asian country and region (see Table 2-3-4-5). Concerning these regulations, it is essential to encourage partner countries through trade negotiations and talks to implement business environment facilitation.

(3) Transport infrastructure development to increase the access to commercial facilities

In Asian emerging countries, the development of transport infrastructure is also considered inevitable to expand consumption. For example, in rural areas in China, the consumption is expected to grow as the infrastructure develops improving the access to commercial facilities in large cities. According to a questionnaire survey by MasterCard[11], many consumers in Chinese rural areas chose infrastructure development as a measure that would increase expenditure once it is implemented, as well as the enhancement of social welfare/development of social security systems (see Figure 2-3-4-6). Particularly about infrastructure development, it is distinctive that people who selected are mostly in rural areas rather than cities with many commercial facilities. The comparison of consumer propensity in cities and rural areas in China[12] displays that the rate is 71.4% in cities but low in rural areas registering 55.9% due to its restrained consumption. (see Figure 2-3-4-7)

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7 "A Handbook of International Trade in Services", Aaditya Mattoo, Robert M. Stern, and Gianni Zanini, Oxford University Press, 2008

8 "Service Trade and Growth", Bernard Hoekman, Aaditya Mattoo, The World Bank, January 2008

9 Ministry of Economy, Trade and Industry (2007), "White Paper on International Economy and Trade 2007"

10 Ministry of Domestic Trade, Co-operatives & Consumerism (MDTCC) "The Guideline on Foreign Participation in the Distributive Trade Services Malaysia by MDTCC"

11 MasterCard Worldwide Insights "CHUGOKUNIOKERU SEIFUNO KEIKISHIGEKISAKUTO SEIKATSUSHANO HANNOU (Economic stimulus measures by the Chinese government and the response of people)" Research period July to August 2009 (n = 4500 people in cities and 1800 people in rural areas)

12 The ratio of consumer spending (cash spending in rural areas) to disposal income (cash income in rural areas) The higher number shows more active consumer spending

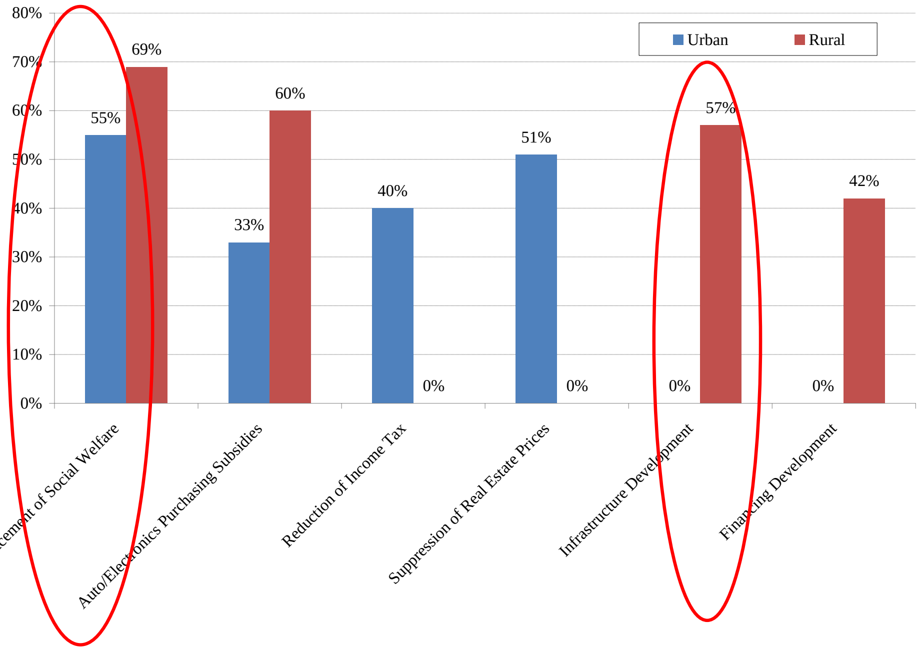
Figure 2-3-4-5 Major Restrictions to Foreign Companies in Asian Countries/Regions

China	・Foreign ownership restrictions (49% or less stake in wholesalers or retailers with more than 30 stores handling a particular product. For joint ventures between foreign and Chinese companies, foreign investment must be 25% or more) ・Territorial restrictions in distribution, communication ・Entry restrictions to computer related services ・Entry restrictions to legal insurance field ・Restrictions on the production and distribution of AV ・Minimum capital requirements (generally more than USD$150,000) ・Foreign currency remittance restrictions (permission required for purchase, sale and distribution)
India	・Foreign investment prohibited (general retail) ・Foreign ownership restrictions (Retail 51% (limited to brand holders), Insurance 26%, Banking 74%) ・Foreign currency remittance restrictions ・Limits on establishing computer related service businesses ・Freight restrictions imposed on international maritime hubs
Thailand	・Foreign ownership restrictions (Retailers with up to 100 million baht in capital, Wholesalers with up to 100 million baht in minimum capital per store, up to 50% of advertising etc. In the manufacturing industry, 75% of sales and 60% of after sales service) ・Minimum capital requirements (in principle, 2 million baht or more. 3 million baht or more for regulated industries) ・Limitations and restrictions on foreign investment in telecommunications service sector
Indonesia	・Foreign investment prohibited (retail except for supermarkets and department stores, mail order, land transportation equipment rental etc.) ・Foreign ownership restrictions (up to 35% in telecommunications, up to 49% in shipping, transportation of goods, airline related businesses, up to 55% in construction, and up to 95% in energy/power, etc.) ・Limited foreign fields (Supermarkets, department stores etc.)
Malaysia	・Minimum capital requirements (Higher for 100% foreign capital ventures than for local capital or local-foreign joint ventures) ・Restrictions on foreign investment in the telecommunications sector ・Limits on locations in the distribution sector
Philippines	・Foreign ownership restrictions (Public works construction and repair: up to 25%; Advertising: up to 30%; Telecommunications and international maritime transportation: up to 40%; and Construction and Investment companies: up to 60%, etc.) ・Minimum capital requirements (In the case of foreign capital in the retail sector, USD$2.5 million, etc.) ・Limits on locations in the distribution sector
Vietnam	・Foreign ownership restrictions (From January 2009, 100% foreign capital became acceptable in the wholesale and retail sectors, but restrictions of up to 49% for businesses with facilities essential to telecommunications infrastructure, or up to 51% for WTO member businesses that don’t hold essential facilities, and from January 2010 began opening up the service sector to up to 65% foreign ownership.)

Sources: Created by METI from Foundation for International Economics “Survey of Future Multilateral Trade Rules” (March, 2010), METI Trade Policy Bureau “Unfair Trade Report, 2009 Edition”, JETRO “Business Information by Country/Region (J-FILE)”, Japan Business Council for Trade and Investment Facilitation “Demand and Issues in Trade and Investment for Countries and Regions (2009 Edition)”, and Global Service Institute “The Challenge of Innovation through Value Creation with Asian Consumers” (March, 2009).

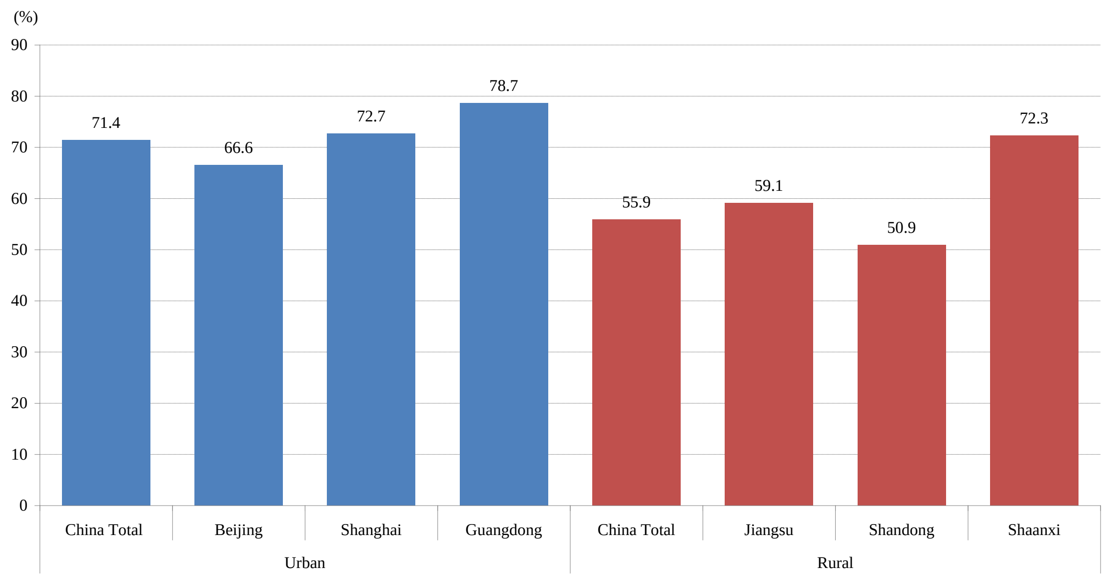
The reason for the curtailed consumption is assumed to be the difference of the conditions of social security systems in cities and rural areas in China. Another factor would be the lack of abundant consumption choices in Chinese rural areas. Once the quality and volume of goods and services available in rural areas improve through the development of infrastructure, it will create new investment targets such as distribution and commercial facilities and generate new consumer markets in Chinese rural areas and Asian emerging countries.

Figure 2-3-4-6: Policies that will will increase expenditures in China if implemented



Note: 1. Urban（Beijing, Shanghai, Guangzhou）n=4500, Rural（Kunshan Jiangsu, Laixi Shandong, Shenmu Shaanxi）n=1800
2. Survey period was from July to August 2009.
Source: Created from MasterCard "MasterCard Worldwide Insights Survey".

Figure 2-3-4-7: Propensity to consume in Chinese urban and agricultural areas (2008)



Note: Propensity to Consume = Consumption Expenditure (Cash Expenditure) ÷ Disposable Income (Cash Income)
Source: Created from CEIC Database.

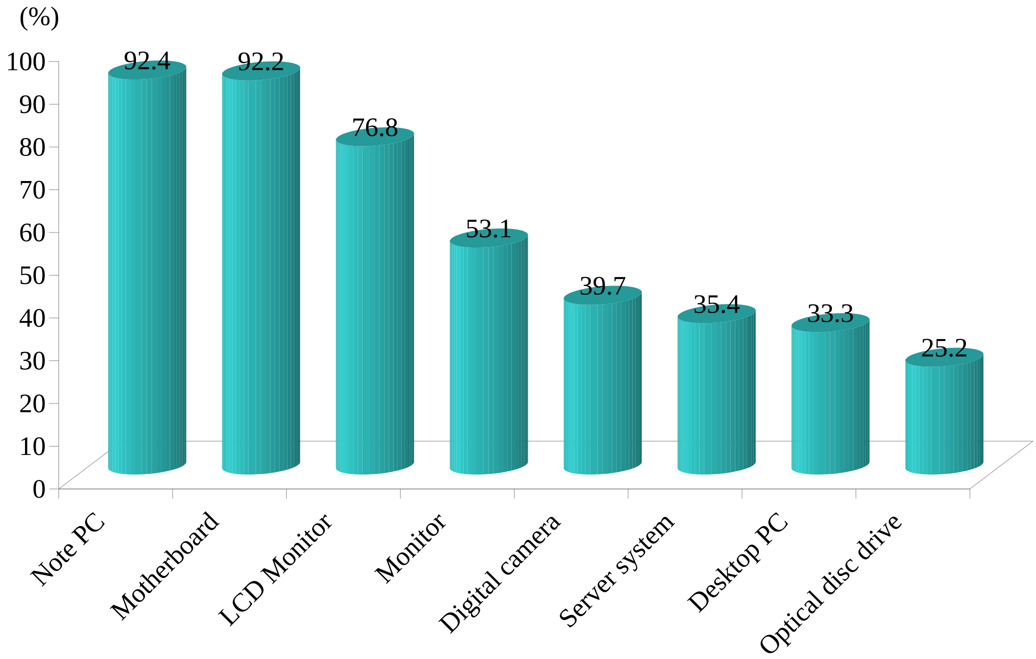
Column 16 Expansion to China through Japan-Taiwan alliance

While China gains the spotlight for its transformation from “factory” to “market” after the global financial crisis, the alliance between Japanese companies and Taiwanese companies are receiving attention due to the changes of Japanese companies’ management strategies to focus on China business to explore the domestic market in China and the improvement of the relations between China and Taiwan. This column will present an overview of the expansion of Taiwanese companies' presence in the world and Chinese market and introduce the merits of alliance with Taiwanese companies to penetrate the Chinese domestic market.

1. Taiwanese companies' presence in the world and China

Taiwanese companies gained large market shares in the area of semiconductor and liquid crystal displays in the word as the utilization of OEM (Original Equipment Manufacturer) and ODM (original design manufactures) systems for IT products progresses. Their world market shares on OEM production base in 2008 include 92% for notebook computer and 92% of motherboard and demonstrate its overwhelming presence (see Column Figure 16-1).

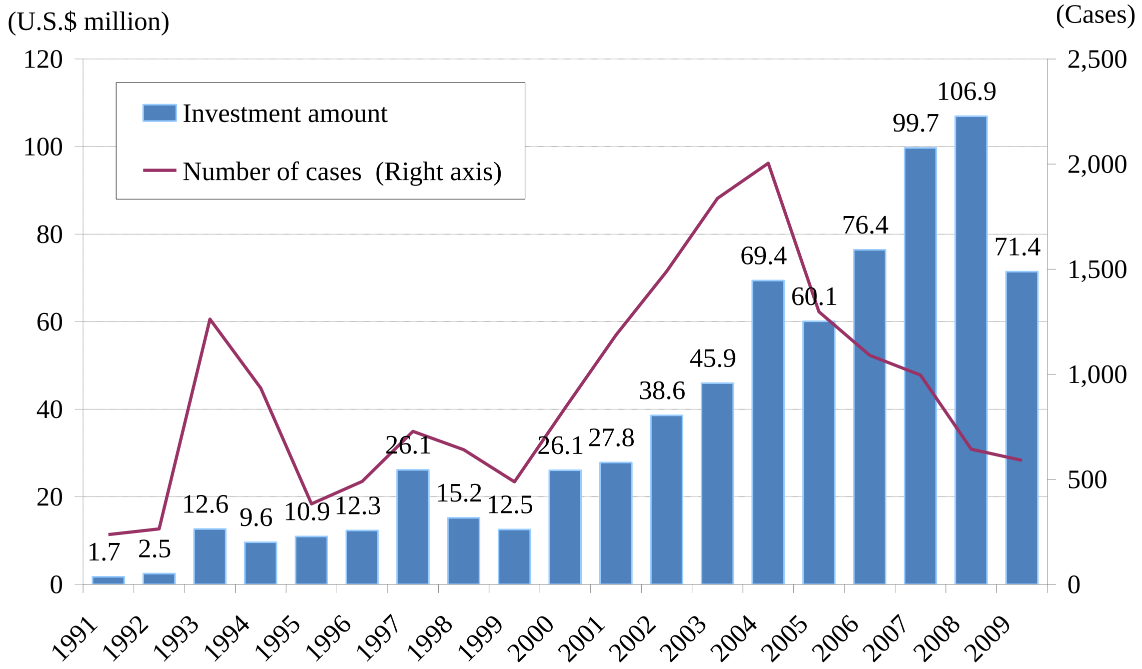
Column16－1 Figure: Taiwan's global share of IT products (2008)



One of the background factors for this world share expansion is Taiwanese companies' production base shift to China. The investments by Taiwanese companies in China are rapidly increasing especially affected by the upsizing of investments due to the China's industry structure change, the rapid increase of IT assembly factory transfer and the relaxation of regulations on Taiwanese investment in China (see Column Figure 16-2)

As a result, Taiwanese companies increased their presence in the economic activities in China and created many successful cases. As for the companies with largest export value in China, 6 out of 10 companies are Taiwanese companies (see Column Table 16-3).

Column16－2 Figure: Trends in Taiwan's direct investment in China



Source: Investment Comission, Ministry of Economic Affairs, R.O.C

16-3 Top 10 exporting companies in China in 2008

	Company	Parent company/Country	Business description
1	Hongfujin Precision Industry Co	**Hon Hai Precision Industry (Taiwan)**	Computer prepheral
2	Dafeng (Shanghai) Computer Co.,Ltd.	**Quanta Group (Taiwan)**	Computer
3	Nokia communication Co.,Ltd	Nokia (Finland)	Fixed line telecommunications service
4	Suzhou Mingshuo Computer Co. Ltd.	**ASUS (Taiwan)**	Computer related parts
5	Huawei Technologies Co. Ltd	Chinese private company	Communication equipment
6	Inventec Electronics	**Inventec (Taiwan)**	Computer and accessories
7	Compal Information Industrial (Kunshan) Co., Ltd.	**Compal (Taiwan)**	Computer and accessories
8	China National Petroleum Corporation	Chinese government-owned company	Energy
9	Wistron (Kunshan) Co., Ltd.	**Wistron (Taiwan)**	Computer and accessories
10	Sinochem Corp	Chinese government-owned company	Energy

Source: Investment Promotion Agency of Ministry of Commerce, P.R.C.

2. Merits of Japan-Taiwan alliance at the Chinese market penetration

While Taiwanese companies improve their presence in the China market, more Japanese companies are considering their expansion to China through Japan-Taiwan alliance[13]. Taiwanese companies have high risk management capability on China business accumulated through their expansion that started from the beginning of the 1990s. Conceivably, the merits of alliance would be high for the companies that don't have sufficient know-how[14]. As the benefit of alliance between Japanese companies and Taiwanese companies to create synergy, Taiwanese companies offer the commonality with China in terms of language and culture, the labor management capability over Chinese workers, the facilitation skills to obtain authorization from central and local governments, the ability to establish networks

[13] According to Japanese financial institutions in Taiwan, the number of the consultation requests from Japanese companies for Japan-Taiwan alliance is increasing.

[14] The success ratio of Taiwanese companies in China (the ratio of companies with profits) is high and 77.2% of top 1,000 Taiwanese companies in China ended in the black. ("Top 1000 Taiwanese companies in Mainland China", 2008) Meanwhile the profit ratio of Japanese companies in Taiwan is 51.9%. (JETRO "ZAIASIA/OSEANIA NIKKEIKIGYOU KATSUDOUCHOUSAJITTAI – CHUGOKU/TAIWAN/KANKOKU HEN" Surveyed in 2009)

(especially sales networks) in China[15], the management skills with fast decision-making capability[15] and its business sense while Japanese companies provide technologies including research, development and quality control skills, its brand that is widely recognized in the world, and its project management skills. “Taiwan Business Association” that is equivalent to Chamber of Commerce for Taiwanese companies in China holds over 20,000 member companies establishing over 85 groups in China as of 2005[16]. With the support of Taiwan Business Association, Taiwanese companies are successfully establishing extensive networks handling complicated business customs and regulations in the Chinese market.

Recently more Japanese companies are considering the expansion to China in the service industries including retail, food service and distribution, however, the regulations in the tertiary sector in China are seemed to be complicated. To cope with these regulations, it is effective to build cooperation with Taiwanese companies.

Moreover, another reason for Japan-Taiwanese alliance to gain attention is the progress of the relaxation of China-Taiwan relations and their tighter economic ties. Due to political reasons, there have been various restrictions on the investments by Taiwanese companies in China. After the change of Taiwanese administration with the inauguration of Ma Ying-jeou of Kuomintang in May 2008, the tension between China and Taiwan is swiftly easing such as through the abolishment of the ban on direct flights between China and Taiwan and the substantial deregulations for investments (see Table Column 16-4). In addition, the ties between two countries are expected to become closer due to Economic Cooperation Framework Agreement (ECFA) which will likely be concluded within 2010 (see Column Table 16-5). Depending on the contents of ECFA which will be materialized later, the alliance with Taiwanese companies will make the expansion into the China market more easily feasible.

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[15] Furthermore, there are regulations to protect Taiwanese investors and it is said that Taiwanese will receive preferential treatment under the Chinese laws and regulations. (The People’s Republic of China Investment Protection Law for Taiwanese)

Source: Taiwan Affairs Office of the State Council Website

[16] Source: Taiwan Affairs Office of the State Council Website

Column16－4 Figure: The situation regarding deregulation for cross-strait economics and trade

	Item	Period	Description
Implemented	Normalization and more relaxation with Mini Three Links	June, Sept 2008	Full liberalization of direct trade links between Kinmen, and Matsu and Xiamen
	Authorization of Renminbi exchange in Taiwan	2008/6/1	Trade less than 20,000 yuan by authorized financial institutions
	"Three Direct Links"	July and Dec 2008, Aug 2009	Phase-in implementation of direct access by sea and air. Regular air flight service started and the number of flights was increased.
	Relaxation of the regulations for the stock market listing for foreign companies. Partial allowance of the investment by companies of mainland China to Taiwan stock market.	2008/7/1	Relaxation of the requirements for foreign companies to be listed on Taiwan stock market etc.
	Lifting a ban on Chinese people's group trip to Taiwan	2008/7/1	Allowed travel groups from mainland China to Taiwan up to average 3,000 people a day.
	Relaxation of regulation for mainland investment amount limits and improvement of assessment	2008/8/1	• Upper limited of mainland investment was increased to 60% of net asset. • Simplification of investment assessment procedure
	Approval of investment and the establishment of office with China fund	2009/7/1	Phase-in expansion of authorized investment items with positive list method (effective on June 30, 2009) Authorized items: 64 items for manufacturing industry, 25 items for service industry and 11 items for infrastructure construction
	MOU on financial matters	2009/10/1	Relaxation of regulations on financial institutions both in mainland China and Taiwan
Under discussion	The Economic Cooperation Framework Agreement (ECFA)	Within 2010 (Plan)	Abolishment of tariffs by mainland China and Taiwan
	Free travel to Taiwan of Chinese people	Pending	Lifting a ban on free travel for individuals

Source: Mainland Affairs Council, ROC and Straits Exchange Foundation

To obtain shares in the China's domestic demand market, it is inevitable for Japanese companies to acquire business know-how and networks that are different from what they used to have including how to cope with local regulations. Under these circumstances, Japanese companies will likely increase their interest in the alliance with Taiwanese companies that are developing more extensive networks in the market of mainland China taking advantage of relaxed China-Taiwan relations.

Column16－5 Figure: Overview of Economic Cooperation Framework Agreement (ECFA)

Overview of ECFA (Economic Cooperation Framework Agreement)

Positioning of ECFA	• Only matters related to economic cooperation between mainland China and Taiwan shall be stipulated. It should not mention any political issues such as unification and independence. • It should meet the rules defined by WTO. • Framework and targets
Proposed items	○ Commodity trade (Low tariff, abolishment of cargo import restriction) ○ Service trade ○ Guarantee of the right to receive profits from Investment ○ Economic cooperation ○ Early harvest list (for early market opening) → Starting with urgent items with higher consensus and expand the application ○ Mechanism to solve dispute ○ Termination clause

Source: Mainland Affairs Council, R.O.C.