Chapter 3 Japan's current situation and direction of progress after the economic crisis

In chapter 1, we confirmed the growing existence of emerging countries in global economy, especially in Asia, which have been leading the global recovery from the world economic crisis. In addition, it was mentioned that the global economy has been shifting from its overdependence on the consumption in the U.S. alone to the direction of multipolarized dependence supported by the expanding domestic consumptions in the emerging countries.

In chapter 2, we first confirmed that Asian economy, as a center of world economy growth, has been gaining more existence not only as a global factory but also as a global market. For Asia's continuous growth, in addition to establish good infrastructure, we need to overcome our common problems, such as population aging from low birth rate and environmental issues. We also confirmed that international cooperation in Asia and even Asia-Pacific range is effective in order to solve the problems.

This chapter depicts our new future image of Japan that corresponds to global changes.

Section 1 summarizes Japan's economic situation and understand the importance of international relationship, then confirms the current status of our globalization in various sections. In addition, with a keyword, 'globalization', other nations' growth models and strategies are analyzed to suggest Japan's direction of progress. Based on the above, section 2 describes the importance of the policies regarding the key issues for future growth, such as emerging countries, infrastructures and environment. At the same time, it explains the importance of smooth flow of people, material and money, and strong relationships with resource-supplying nations for Japan to become a center of knowledge economy. Global approaches on EPA/FTA, investment treaty, international standard system, WTO and APEC2010 etc. are also mentioned in this section.

Section 1 The future image of Japan that corresponds to global changes

Japan's economy has been slowly moving into the recovery process thanks to the economic stimulus measures etc.; however, it is necessary to further diversify the international relationship for its steady economic growth. It is essential to expand the range of globalization by building relationship with emerging countries as new exporting and investment partners, and developing some export industries, such as medical and infrastructure related industries, which are expected to grow from now on. In order to grow in the changing global economy, Japan needs to correspond to the new demand structure of the world with the following keywords, emerging country, attraction of Japan, safety, sense of security, infrastructure and environment, in mind, then strive for good circulation of domestic and foreign demand while contributing to the development of the foundation of global economy.

1. Summary of Japan's economic situation

After the impact of world economic crisis, because of the serious damage Japan suffered from the sudden decline of export, there were many opinions suggesting that Japan should stop relying on the export and expand out domestic consumption for its economic growth. However, the serious damage was not caused by the fact that Japanese economy was primarily depending on exports. The structure of Japanese export

was biased in terms of industries and regions. It seemed that the biases lead to this economic depression altogether.

Undoubtedly, it is important to increase domestic consumption. However, great expansion of the market is no longer expected since decline of the population has started in Japan. Thus, it is unavoidable to take in foreign vitality for expansion of domestic consumption.

(1) Long lasting economic slump in Japan

(A) Unpredictable Japanese economy

Affected by the global economic crisis after Fall 2008, our economy once fell into a huge negative growth, but has been slowly recovering since the second quarter of 2009 (see Figure 3-1-1-1). The leading factors of the recovery are the growth foreign demand by satisfactory export to Asia and increase of household consumption. However, the driving force of house consumption increase was limited in certain durable consumer goods, such as automobile and home electronics, that benefited from stimulus policies like a tax reduction (see Figure 3-1-1-2). Under the difficult circumstances in employment and incomes, the autonomous recovery is less likely.

Figure 3-1-1-1 Real GDP growth and contributions categorized by demand item

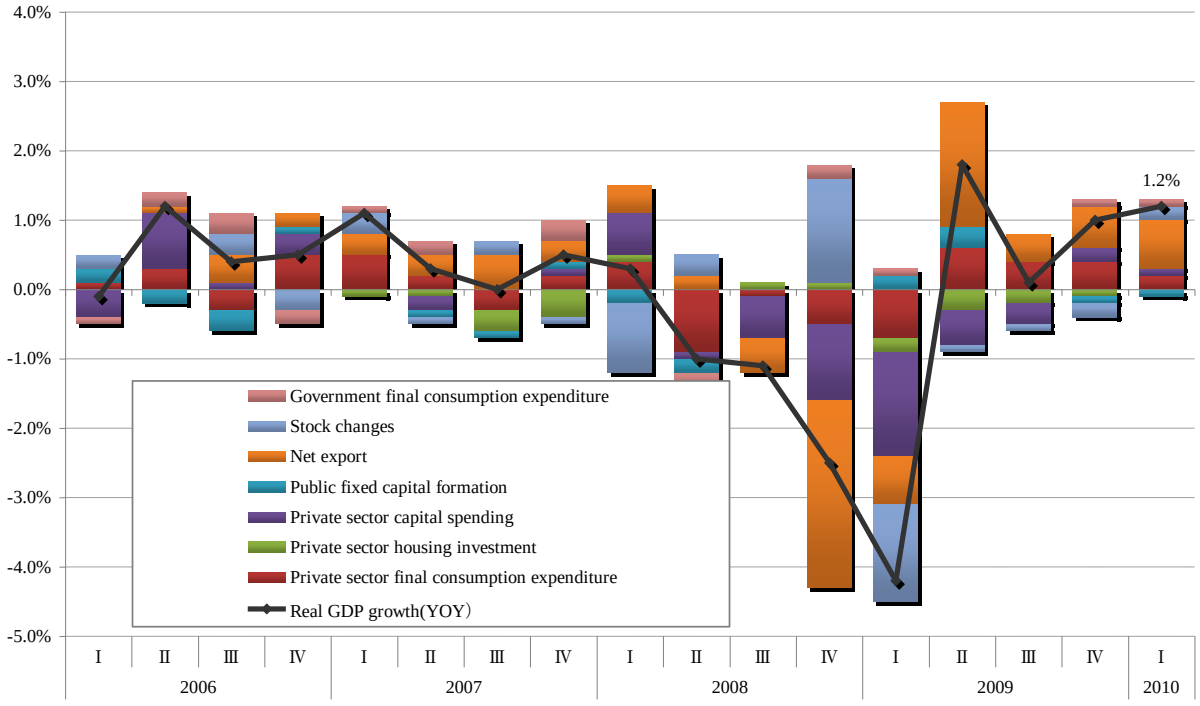
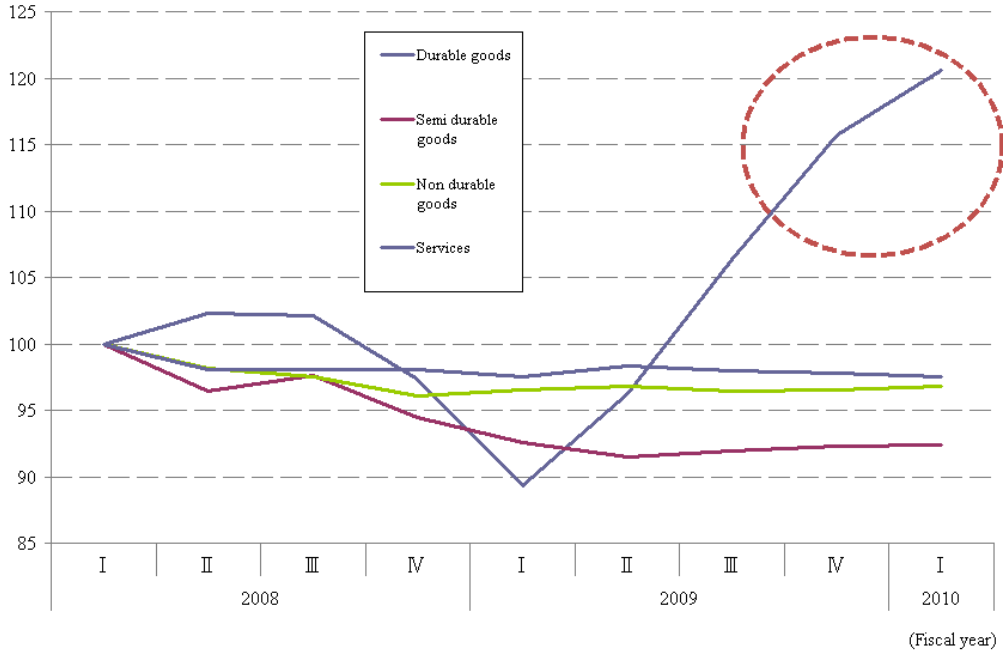


Figure 3-1-1-2 Changes in domestic household final consumption expenditure by commodity type

(2008Q1=100)



Source: *Nation economy calculation* (The Cabinet office)

(B) Medium- and long-term decline of Japan's presence

Reviewing the economic situation after 90's, Japanese economy has been stagnant, in contrast to the significant growth of emerging countries such as China, and even experienced a negative growth. Our nominal GDP, which had been at the second place in the world, is expected to be overtaken by Chine in 2010. Our world share of nominal GDP was 18% in 1994, when we had a big presence as a part of Japan-U.S- Europe trilateral structure; however, it shrunk to 9% by 2009, which is the same scale as China's (see Figure 3-1-1-3 and Figure 3-1-1-4).

In addition, as for the nominal GDP per person, it was the third place in the world in 2000 but it kept falling down to the 23rd place by 2008[1] (see Figure 3-1-1-5).

[1] It made the 17th place in 2009.

Figure 3-1-1-3 Changes in nominal GDP of major countries

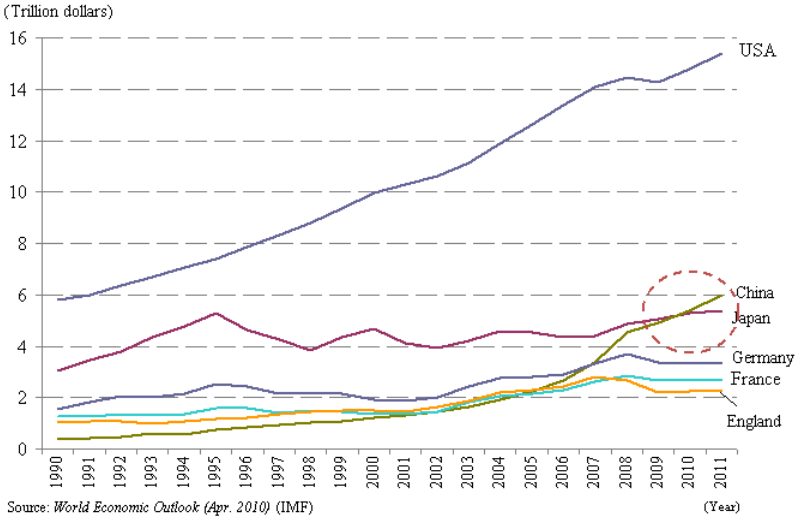
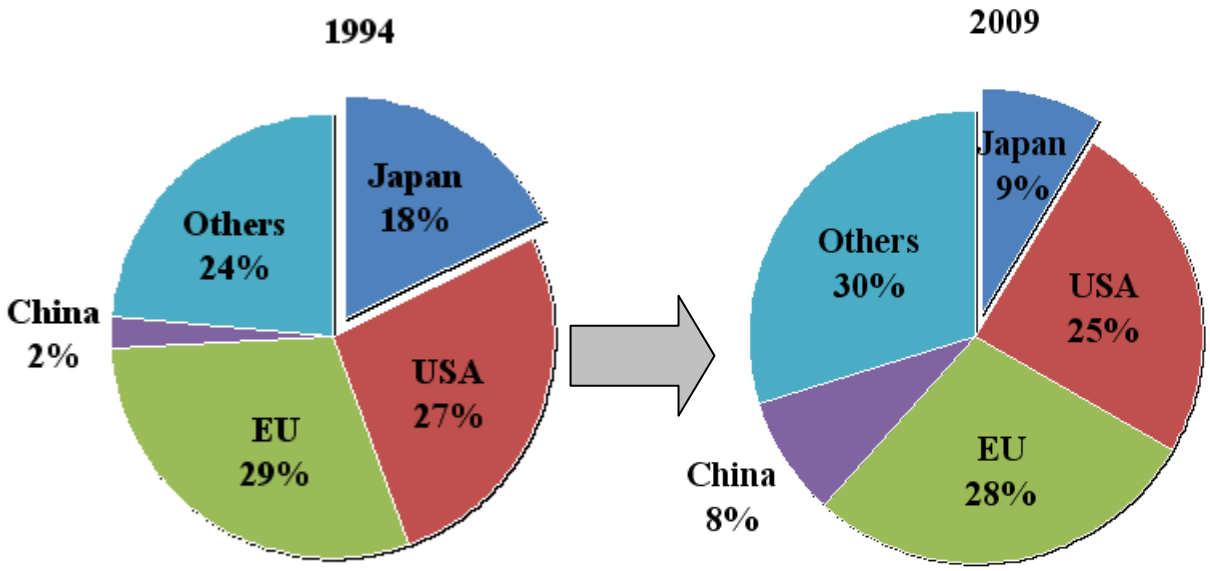


Figure 3-1-1-4 Japan's nominal GDP share



Source: *World Economic Outlook (Apr. 2010)* (IMF)

(2) Heading for break out of the long slump

(A) The importance of taking in foreign vitality

(a) Ceiling domestic market

The population of Japan is decreasing and predicted to transition from 120 million in 2005 to 95 million (below 100 million) by 2050 (see Figure 3-1-1-6). Moreover, the saving rate, which used to be high, has been going down gradually and declined from the level of about 18% in 1980 to 2.3% in 2008 (see Figure 3-1-1-7). The decline of saving rate was mainly caused by retired households that break into their savings as population aging proceed, and it has not resulted in the uplifting of consumption level (see Figure 3-1-1-8).

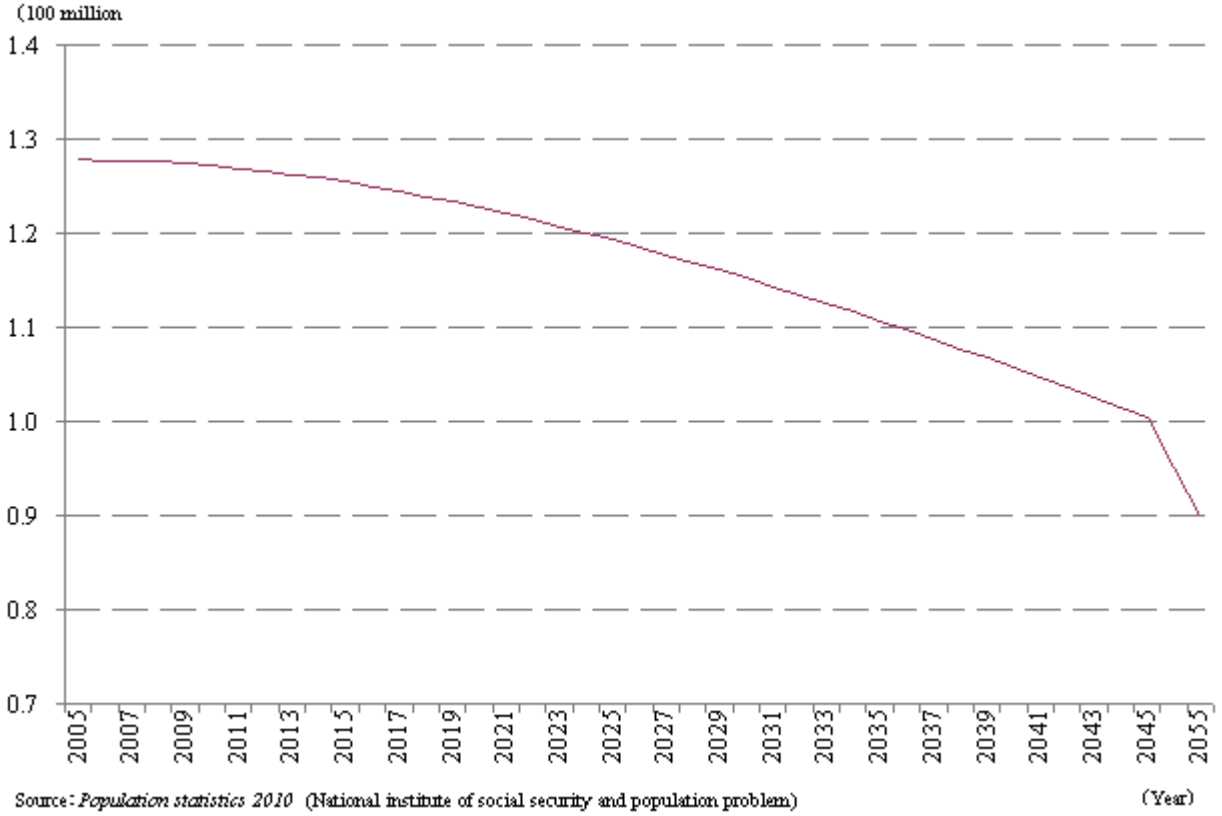
In consideration of the above situation, we cannot expect a major growth of domestic market in the future.

Since the problems like decreasing population and drop in saving rate cause labor and capital shortage, they not only limit the growth as a consumer ground but also as a production ground of goods and services.

Table 3-1-1-5 Japan's nominal GDP per capita ranking

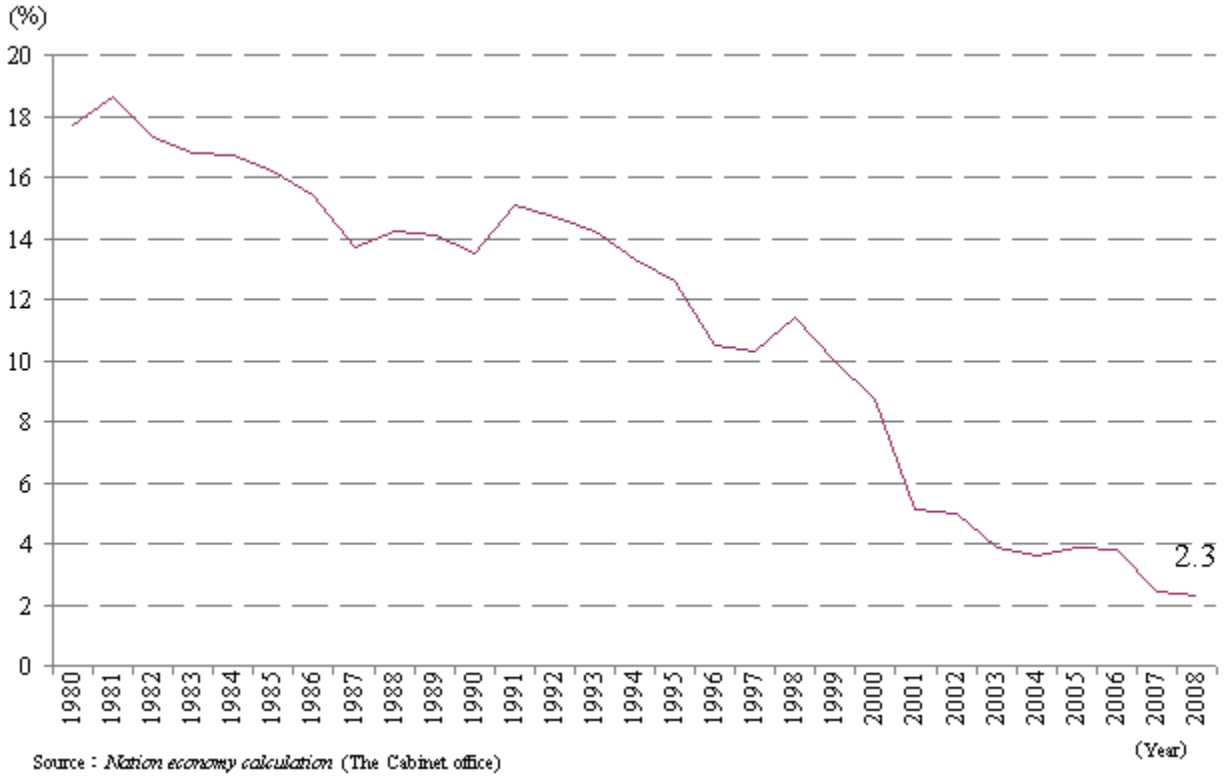
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
1st	Luxembourg	Luxembourg	Luxembourg	Luxembourg	Luxembourg	Luxembourg	Luxembourg	Luxembourg	Luxembourg	Luxembourg
2nd	Norway	Norway	Norway	Norway	Norway	Norway	Norway	Norway	Norway	Norway
3rd	**Japan**	USA	Switzerland	Switzerland	Switzerland	Iceland	Qatar	Qatar	Qatar	Qatar
4th	USA	Switzerland	USA	Ireland	Ireland	Qatar	Iceland	Iceland	Switzerland	Switzerland
5th	Switzerland	**Japan**	Denmark	Denmark	Denmark	Switzerland	Switzerland	Ireland	Denmark	Denmark
6th	Iceland	Denmark	Ireland	USA	Iceland	Ireland	Ireland	Switzerland	Ireland	Ireland
7th	Denmark	Iceland	Iceland	Iceland	Qatar	Denmark	Denmark	Denmark	United Arab Emira	Nederlands
8th	Qatar	Ireland	**Japan**	Sweden	USA	USA	USA	Sweden	Iceland	United Arab Emirate
9th	Sweden	Qatar	Qatar	Nederlands	Sweden	Sweden	Sweden	Nederlands	Nederlands	USA
10th	Ireland	Sweden	Sweden	**Japan**	Nederlands	Nederlands	Nederlands	USA	Sweden	Austria
11th	Hong Kong	Nederlands	England	Qatar	England	England	England	Finland	Finland	Australia
12th	England	England	Nederlands	Finland	Finland	Finland	Finland	United Arab Emira	Austria	Finland
13th	Nederlands	Hong Kong	Finland	England	**Japan**	Austria	Canada	England	Australia	Sweden
14th	Australia	Finland	Austria	Austria	Austria	Belgium	Austria	Austria	USA	Belgium
15th	Canada	Austria	Germany	Belgium	Belgium	Australia	United Arab Emira	Australia	Belgium	France
16th	Finland	Canada	Belgium	France	France	**Japan**	Belgium	Canada	France	Germany
17th	United Arab Emira	Germany	France	Germany	Germany	Canada	Australia	Belgium	Kuwait	**Japan**
18th	Germany	France	Hong Kong	Canada	Australia	France	France	France	Canada	Canada
19th	Singapore	Belgium	Canada	Australia	Canada	Germany	Germany	Germany	Germany	Iceland
20th	Belgium	United Arab Emira	United Arab Emira	Italy	Italy	United Arab Emira	**Japan**	Singapore	England	Singapore
21st	France	Singapore	Australia	United Arab Emira	United Arab Emira	Italy	Singapore	Italy	Singapore	Italy
22nd	Australia	Israel	Italy	Hong Kong	Singapore	Singapore	Italy	**Japan**	Italy	England
23rd	Israel	Italy	Singapore	Singapore	Spain	Kuwait	Kuwait	Kuwait	**Japan**	Spain
24th	Italy	Australia	Bahamas	Spain	Hong Kong	New Zealand	Brunei	Spain	Brunei	Kuwait
25th	Bahamas	Bahamas	Israel	New Zealand	New Zealand	Spain	Spain	Brunei	Spain	Hong Kong

Figure 3-1-1-6 Changes in population



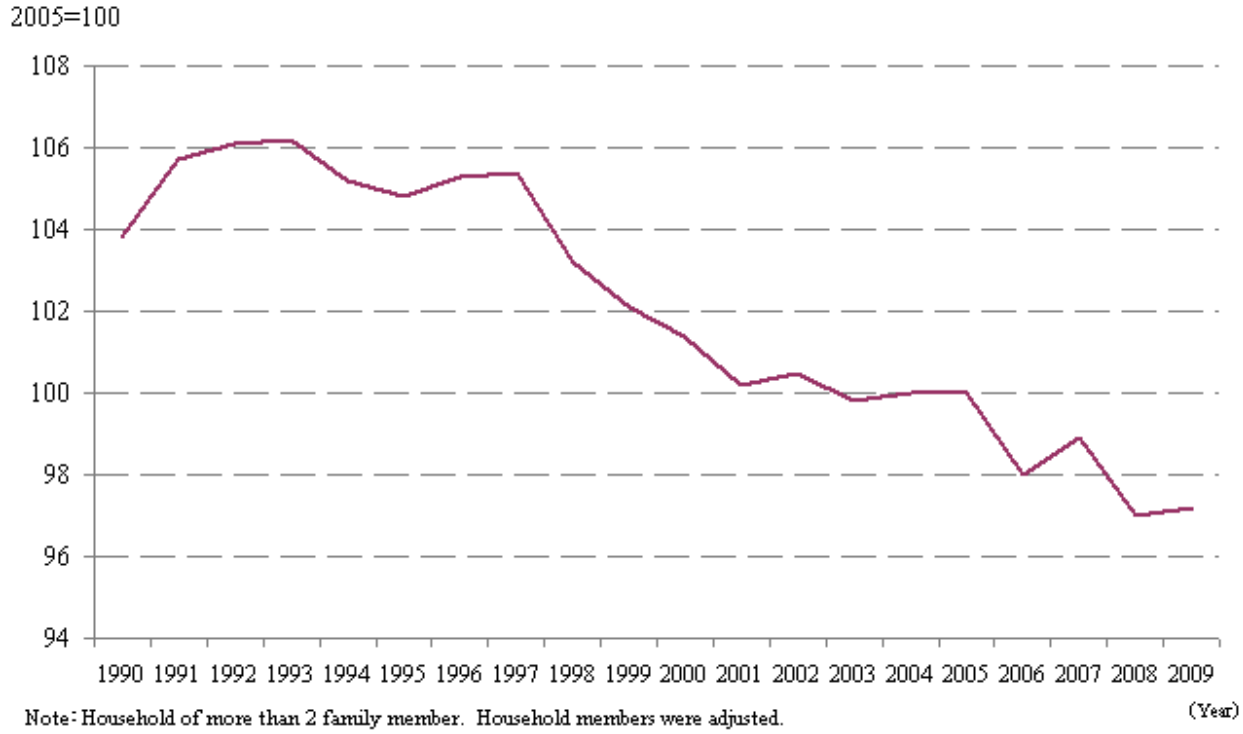
Source: *Population statistics 2010* (National institute of social security and population problem)

Figure 3-1-1-7 Changes in household savings



Source : *Nation economy calculation* (The Cabinet office)

Figure 3-1-1-8 Changes in consumption levels

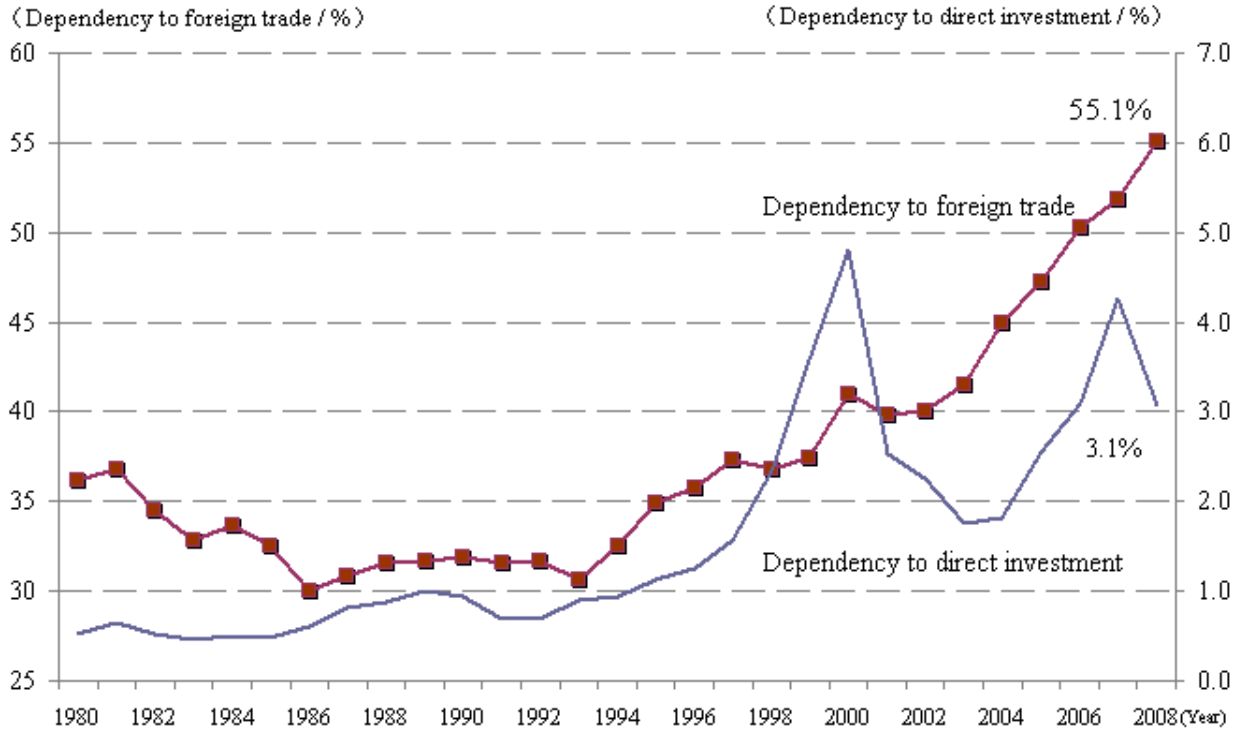


Note: Household of more than 2 family member. Household members were adjusted.

Source: *Household budget survey* (The Ministry of Internal Affairs and communications)

On the other hand, the scale of global market is expanding. According to IMF (2010)[2], nominal GDP of the whole world has expanded from 11.8 trillion dollars in 1980 to 57.9 trillion dollars, about fivefold. The ratio of trade and investment that account for entire world GDP has been increasing, which tells us that globalization, such as utilization of foreign capital is progressing rapidly (see Figure 3-1-1-9).

Figure 3-1-1-9 World's dependency to foreign trade and direct investment



Source: *World development indicators* (World bank) *BOP* (IMF)

(b) Economic effect of globalization

In recent years, many researches have been conducted on the economic effects of globalization progress. In January 2009, Jones and Romer[3] reported six standardized facts obtained from the researches on recent economic growths (see Figure 3-1-1-10).

Among the six facts, the first one, expansion of market scale, backs up the fact that globalization is essential for economic growth. It means that taking in people, goods, money, and intelligence (ideas) as much as possible through trades and investments, without limiting the source to be domestic, make the economy grow. As for the second one, accelerating growth, from the standpoint that human capital is important, it brings the idea, the more people the more intelligence. It seems effective to take in foreign vitality for human capital enrichment.

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2 IMF (2010)" World Economic Outlook. Apr. 2010"

3 Charles I. Jones and Paul M. Romer (2009) "THE NEW KALDORFACTS: IDEAS, INSTITUTES, POPULATION, AND HUMAN CAPITAL".

Table 3-1-1-10 Stylized 6 facts which brought about economic growth

1) Expansion of market scale Expansion of flows of goods, knowledge, finance and people by means of globalization and urbanization.
2) Acceleration of growth Growth rate of population and GDP per capita have been rapidly gone up in the 20 centuries.
3) Variance of growth rates The farther away from the technology frontier, the more obvious gap in economic growth rate are (developing countries).
4) Gap of income and gap of TFP Not more than half of the gap of GDP per capita can be explained by difference in volume of manufacturing factor inputs such as conventional capital or unskilled labor. (More than half of the gap is due to the
5) Upward trend of human capital "Human capital / Unskilled labor" are rapidly increasing worldwide.
6) Long-term stability of relative wages Despite of increasing human capitals in proportion to increasing unskilled labor wages, gap between 2 parties won't be solved.

In recent years, many researches that focus on relationship between oversea operation and productivity of Japanese companies have been conducted in Japan. Although we have not had a clear result, which shows that exporting and foreign direct investment lead to productivity improvement, the result of each individual research indicated that overall oversea operations contribute to productivity improvement of domestic companies. Matsuura and others (2008)[4] studied the influence from Foreign Direct Investment (FDI) by the Japanese electric machine industry to the domestic productivity of those companies, which executed the investment. In the study, investments were categorized in horizontal FDI and vertical FDI[5]. It indicated that horizontal FDI did not have much influence on domestic companies' productivity while vertical FDI had significant positive influence on domestic productivity level as well as its growth rate. According to the comprehensive analysis of relationship between direct investment and export of Japanese companies and their productivities by Wakasugi and others (2008)[6], the labor productivities between the companies that started exporting in 2001 and the ones that did not. The companies that started exporting had already had higher productivity average than the companies that did not in 2000, even before they started exporting. The gap has been getting greater yearly. The same trend can be recognized on direct investment, also (see Figure 3-1-1-11). These studies indicate that export and direct investment are effective for labor productivity improvement.

On the other hand, as companies increase their Foreign Direct Investments, possible loss of domestic employment, or de-industrialization, is concerned. However, many empirical studies deny the possibility.

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4 Matsuura, T., K. Motohashi and K. Hayakawa (2008) "HOW DOES FDI IN EAST ASIA AFFECT PERFORMANCE AT HOME? : EVIDENCE FROM ELECTRICAL MACHINERY MANUFACTURING FIRMS".

5 "Horizontal FDI" is a strategy that moves the business activity from home country to the country of target market in order to avoid trade obstacles, such as transportation cost. "Vertical FDI" is a strategy that moves the factory to overseas in order to seek for cheap labor.

6 Wakasugi, R. and others (2008) "THE INTERNATIONALIZATION OF JAPANESE FIRMS : NEW FINDINGS BASED ON FIRM-LEVEL DATA".

For example, in terms of employment, Ando and Kimura (2007)[7] and Hijzen, Inui, and Todo (2007)[8] studied the influence of Japan's Foreign Direct Investment on domestic employment. According to the results of the studies, companies that do Foreign Direct Investment tend to increase domestic employment compare to companies that do not.

Figure 3-1-1-11 Changes in labor productivity of Exporting (Direct investment) companies and Non-exporting(Direct investment) companies

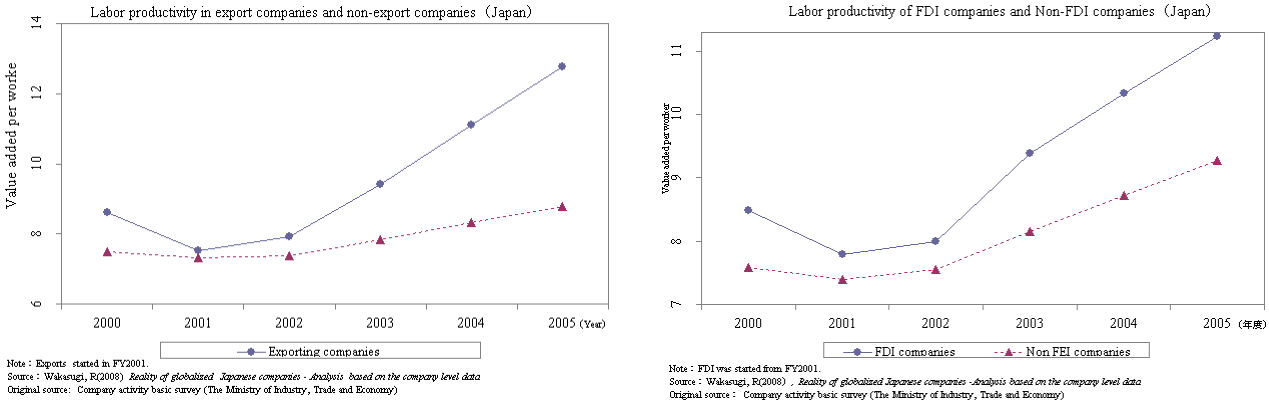
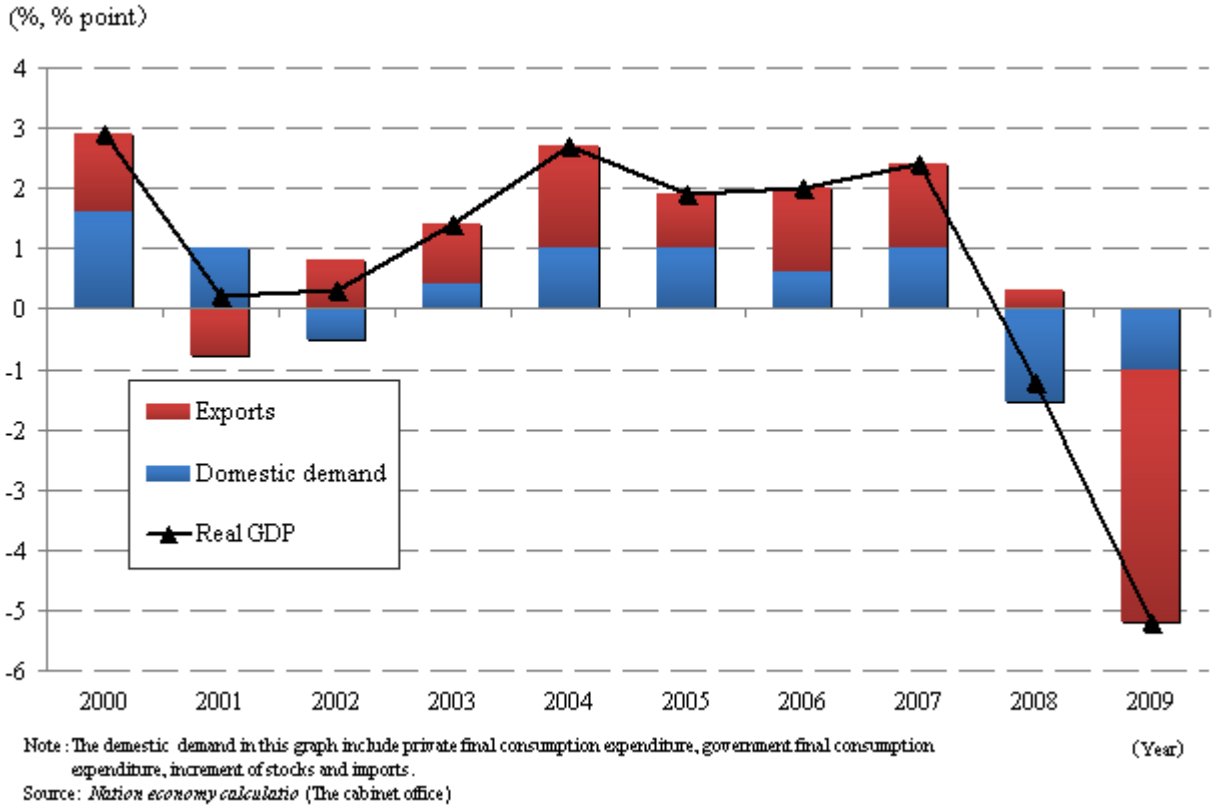


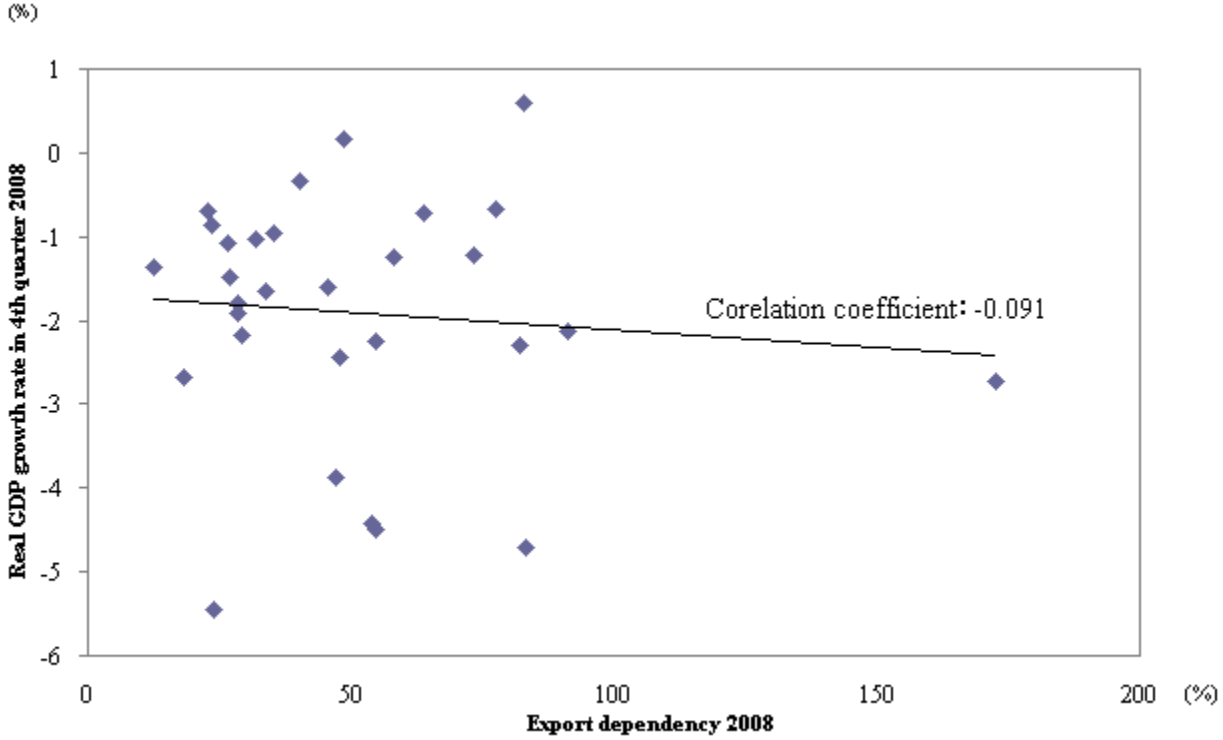
Figure 3-1-1-12 Contribution of exports to Japan's economic growth



[7] Ando, M. and F. Kimura (2007) "INTERNATIONAL PRODUCTION/ DISTRIBUTION NETWORKS AND DOMESTIC OPERATIONS IN TERMS OF EMPLOYMENT AND CORPORATE ORGANIZATION: MICRODATA ANALYSIS OF JAPANESE FIRMS".

[8] Hijzen, A., A. Inui and Y. Todo (2007) "THE EFFECTS OF MULTINATIONAL PRODUCTION ON DOMESTIC PERFORMANCE : EVIDENCE FROM JAPANESE FIRMS".

Figure 3-1-1-13 Relations between import dependency and economic growth ratio in OECD countries



Source: *BOP* (IMF) and OECD *Stat*.

(B) Expanding the range of globalization

Now, it is clearly important for Japan to take in foreign vitality. Even during the upturn period of economy after 2002, export was leading the economy and globalization had been progressing to no small extent (see Figure 3-1-1-12). However, in spite of the progress, Japan's entire economic growth had been transitioned in low level and significantly lowered its presence in global economy since a little less than 10 years ago. What was wrong with our globalization in Japan? In order to grow continuously, we need a process of recognizing our weak points that became clear during the last upturn period and the slump period after the world economic crisis and overcoming the weakness.

(a) Biased global industry

Japanese economy slumped more than Western countries in the world economic crisis. The main factor was the decline of exports. It is true that many countries suffered from export decrease as a result of world economic crisis, in which the total amount of world trade fell. However, it was not that the countries that rely on exports were more susceptible and suffered more. If we check the relationship between the reliance on exports and the economic growth by this world economic crisis, the correlation coefficient was -0.091; therefore, there was little correlation between them (see Figure 3-1-1-13).

We believe that the background of the fact that Japanese economy suffered more than other countries from the world economic crisis was the bias in export industries.

The main characteristics of globalizing Japanese industries are “large enterprises”, “manufacturing company of automobile, electric machinery etc.” and “destinations of consumption goods are western nations” (see Figures 3-1-1-14, 3-1-1-15 and 3-1-1-16).

Japan’s reliance on exports has become higher year after year, but the level is still low compared to other countries (see Figure 3-1-1-17). As you see in the figure above, which shows reliance on exports by business sectors, a part of sectors has been bringing up the average while many other sectors remain in the domestic market.

Figure 3-1-1-14 Percentage of direct exporters categorized by large company and small business

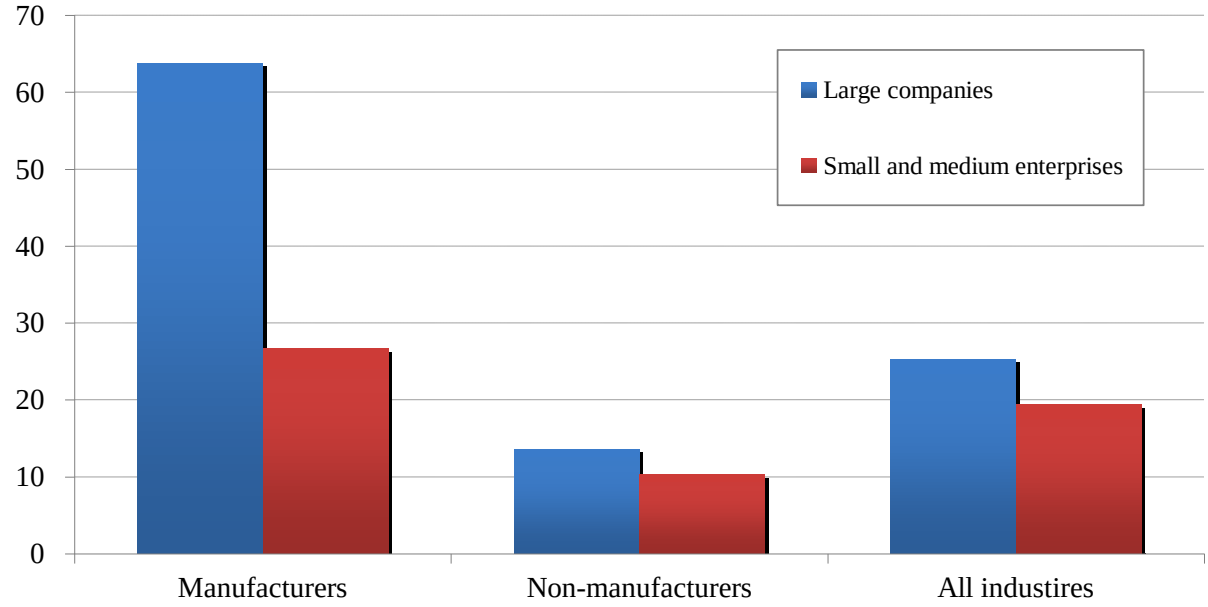
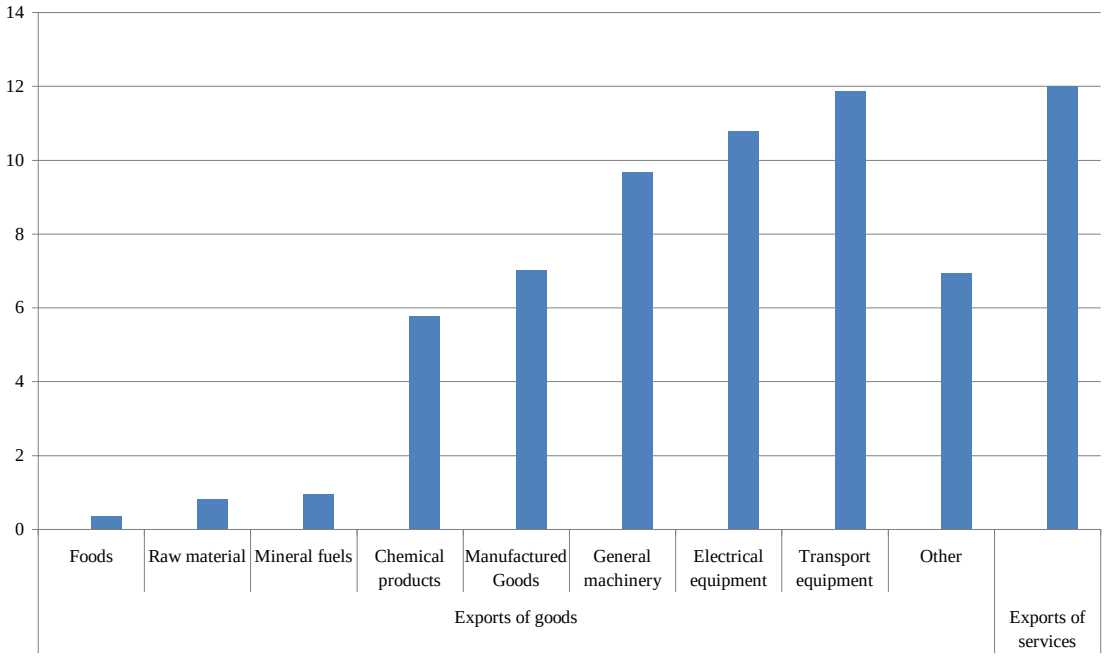
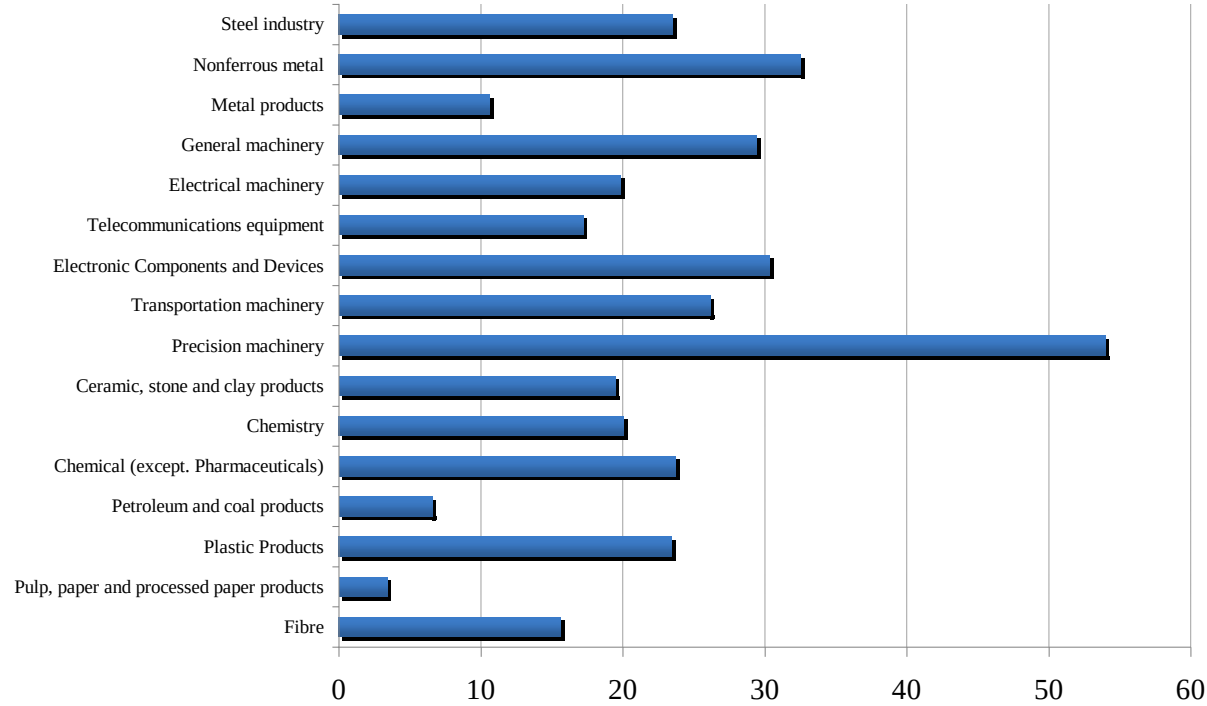


Figure 3-1-1-15 Japan's exports categorized by industry





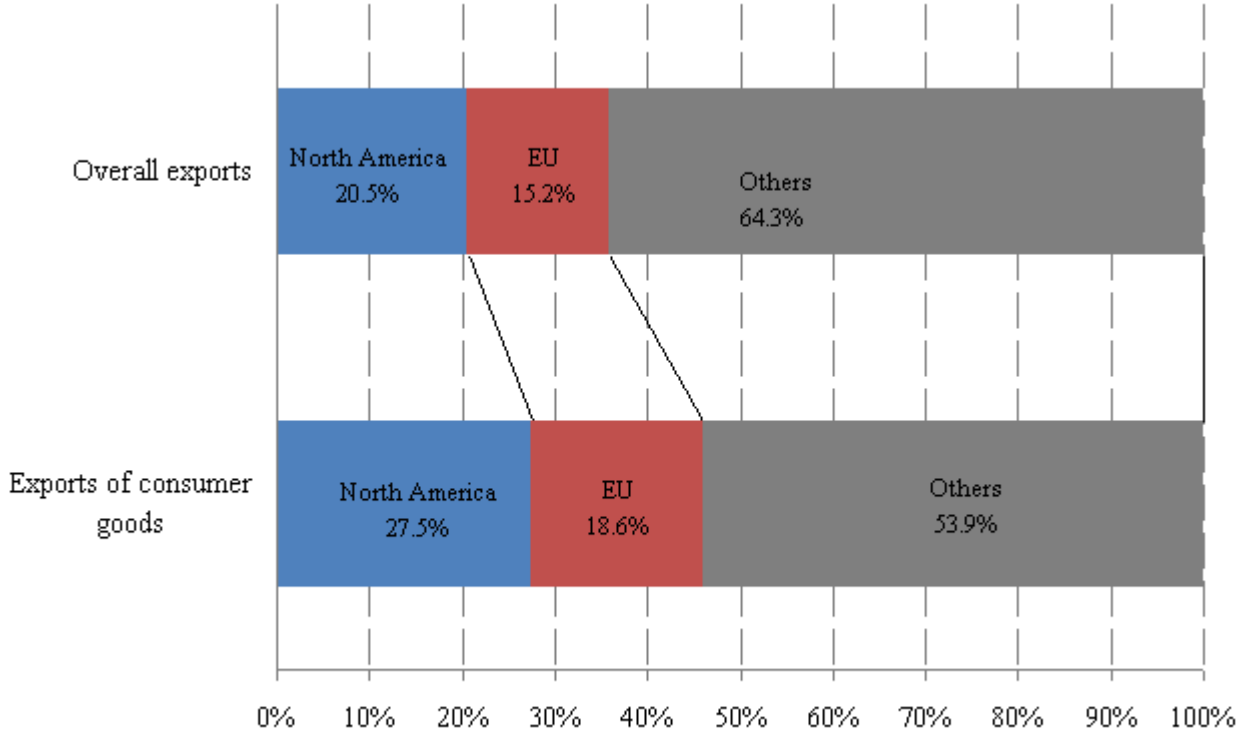
Source: The Break-down list of shipment of the mining industry (The Ministry of Industry, Trade and Economy)

In addition, according to Todo (2010)[9], among Japanese companies, take a look at all elements' productivity of some companies, which do not operate in overseas, there are many companies with value higher than median (see figure 3-1-1-18). Todo (2010) defines such companies as "Garyu Company" and recognized the same trend in the small and medium businesses. Moreover, according to Small and

[9] Todo, Y (2010) RIETI Symposium material "GARYOU KIGYOU NO KAIGAI SHINSHUTSU NI MUKETE"

Medium Enterprise Agency (2010)[10], many of small and medium businesses, which operate in overseas, said, “The representative has a close foreign friend.” or “The company has an employee, who learned a foreign language and understands the language to a certain degree.” On the other hand, many of small and medium businesses, which do not operate in overseas, said, “There is no special connection with oversea businesses.” Therefore, having some connection with overseas is an important factor for small and medium businesses to start oversea operations.

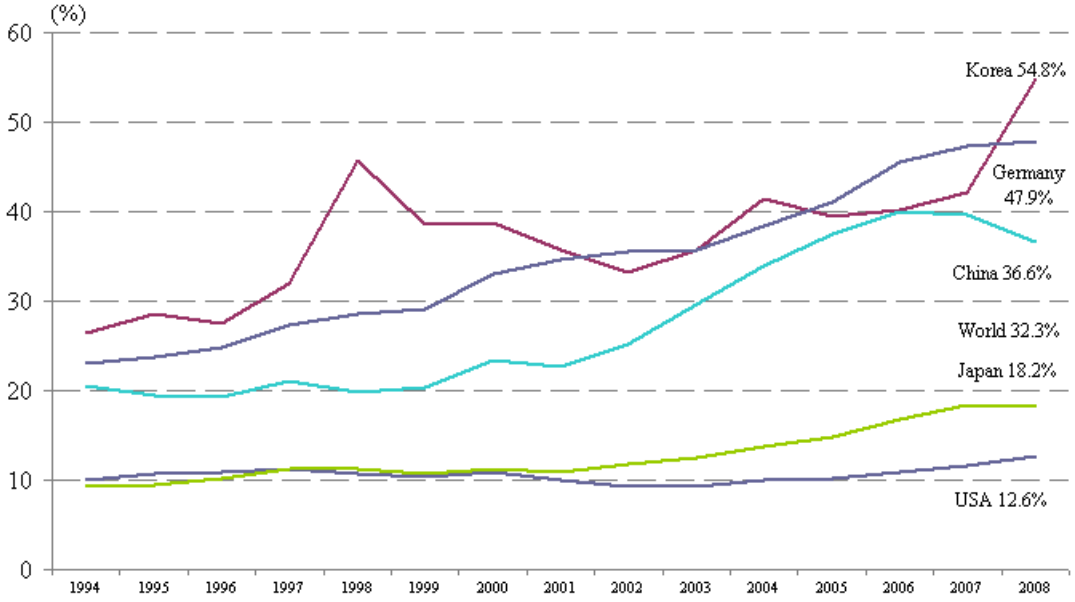
Figure 3-1-1-16 Proportion of exports of consumer goods to Europe



Source：*RITEI-TID2009*

[10] Small and Medium Enterprise Agency (2010) *WHITE PAPER ON SMALL AND MEDIUM ENTERPRISES IN JAPAN* (2010 Edition).

Figure 3-1-1-17 Changes in export dependency of each country

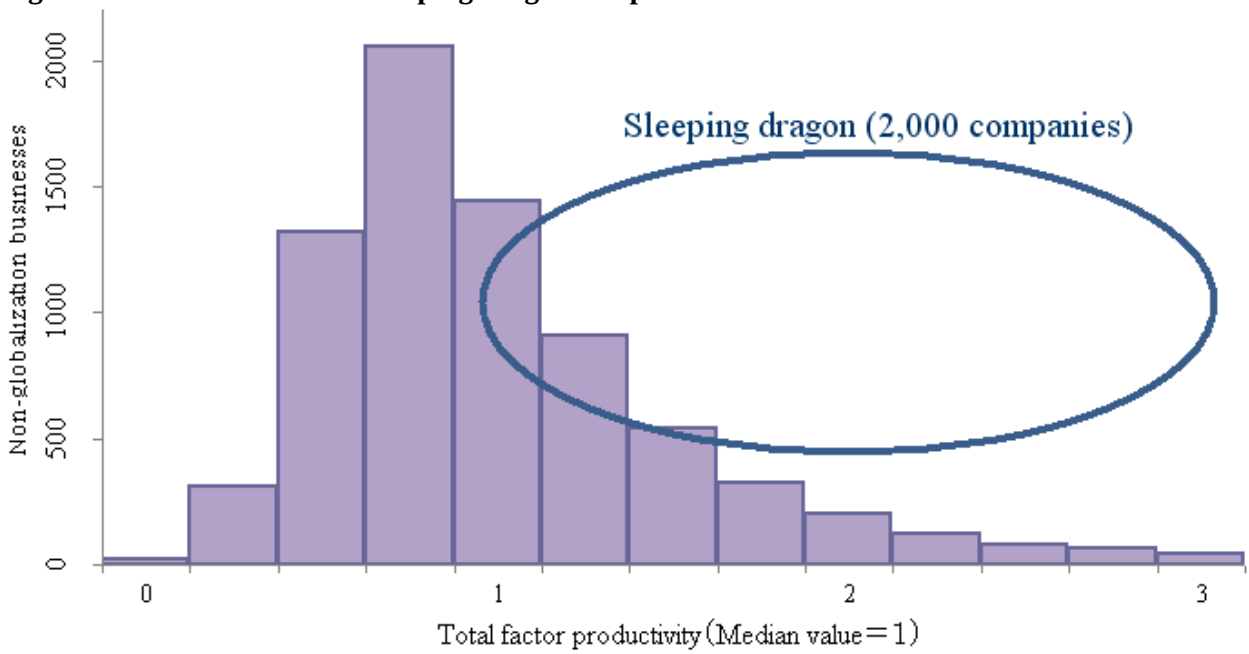


Note: Japan's export dependency in 2008 marked at 17.5% and in 2009 marked at 12.6% based on *Nation economy calculation* (Cabinet office)

Source: BOP (IMF), *World Economic Outlook, Apr.2010* (IMF)

In order to develop an economy that has a better tolerance against fluctuations in the global economy so that it may grow, we anticipate the expansion of globalization, such as progress of the overseas operation of the sector that has been operating domestically or small and medium businesses, and progress in the diversification of overseas operation.

Figure 3-1-1-18 Existence of sleeping dragon companies

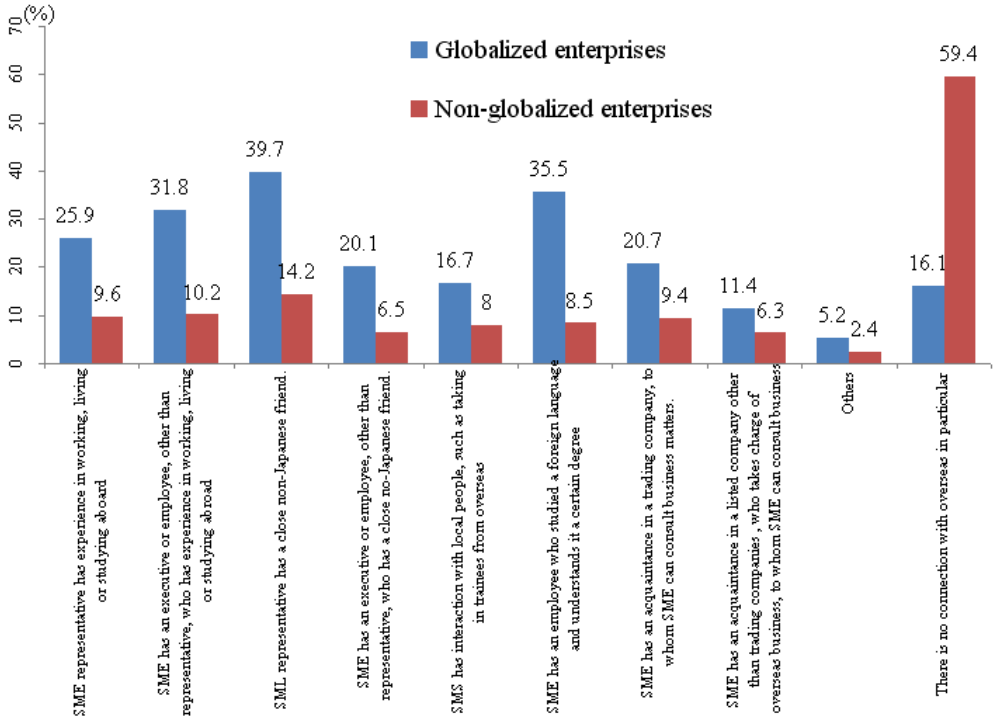


Note: Sleeping dragon businesses means businesses which remain in the country without a turning point to explore abroad, although their productivity is high.

Source: Todo, Y(2010), *Overseas development of sleeping dragons*

Original source: Wakasugi, R. and others (2008) *Reality of globalized Japanese companies - analysis based on the company level data*

Figures 3-1-1-19 Links of globalized small and medium enterprises and non-globalized small and medium businesses with overseas



Note: Due to multiple replies, the sum is not necessarily be a 100.
Source: *Small and medium sized enterprises whitepaper 2010* (Small and medium sized enterprises administration (2010)
Original source: *Questionnaires on globalization and company activities* (Nov. 2009) by Mitsubishi UFJ research and consulting institution (Outsourced by the Small and medium enterprises administration)

(b) Link from overseas demand improvement to domestic demand improvement

Japan's globalization has progressed mainly by large enterprises and manufacturers, such as automakers. In addition, about 30%[11] of domestic employment is for large enterprises and about 20%[12] is for manufacturers. Therefore, many employees are concentrated in small and medium businesses and non-manufacturing industry, which is relatively behind in terms of globalization. Consequently, there are many domestic companies that are not fully benefiting from globalization.

Expansion of globalization range, along with improvement of tolerance against a world economic crisis, contributes revitalization, productivity improvement and structure change of industries, which have not made progress in overseas operations. It is expected that spreading the benefit of globalization all over our country would contribute to income increase, which promotes increase of domestic demand.

During the last economic recovery, Japanese citizen's income did not improve as expected, thus the improvement of overseas demand did not link with domestic demand improvement. Expansion of globalization range is expected to solve such problem.

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[11] According to the Small and Medium Enterprise Agency (2010), *WHITE PAPER ON SMALL AND MEDIUM ENTERPRISES IN JAPAN* (2010 Edition), the number of employees working for large enterprises is 12.99 million (about 31%) and the number of employees working for small and medium enterprises is 27.84 million (about 69%) in October 2006.

[12] According to Ministry of Internal Affairs and Communication, "Labor Force Survey", 10.73 million people (17%) worked for manufacturers and 52.09 million people (83%) worked for other non-manufacturing businesses in 2009.

(3) Change of foreign economic relationship

Affected by the global economic slump, Japan's overall import and export and internal and external investment shrunk in 2009. However, recent years' trend of trade and investment changed not only in scale but also in its forms (contents). We can see, first, the transition from export to investment, second, increased relative importance of new emerging countries, where domestic demands increase, our export destinations increase, and third, the sign of diversification of export industries.

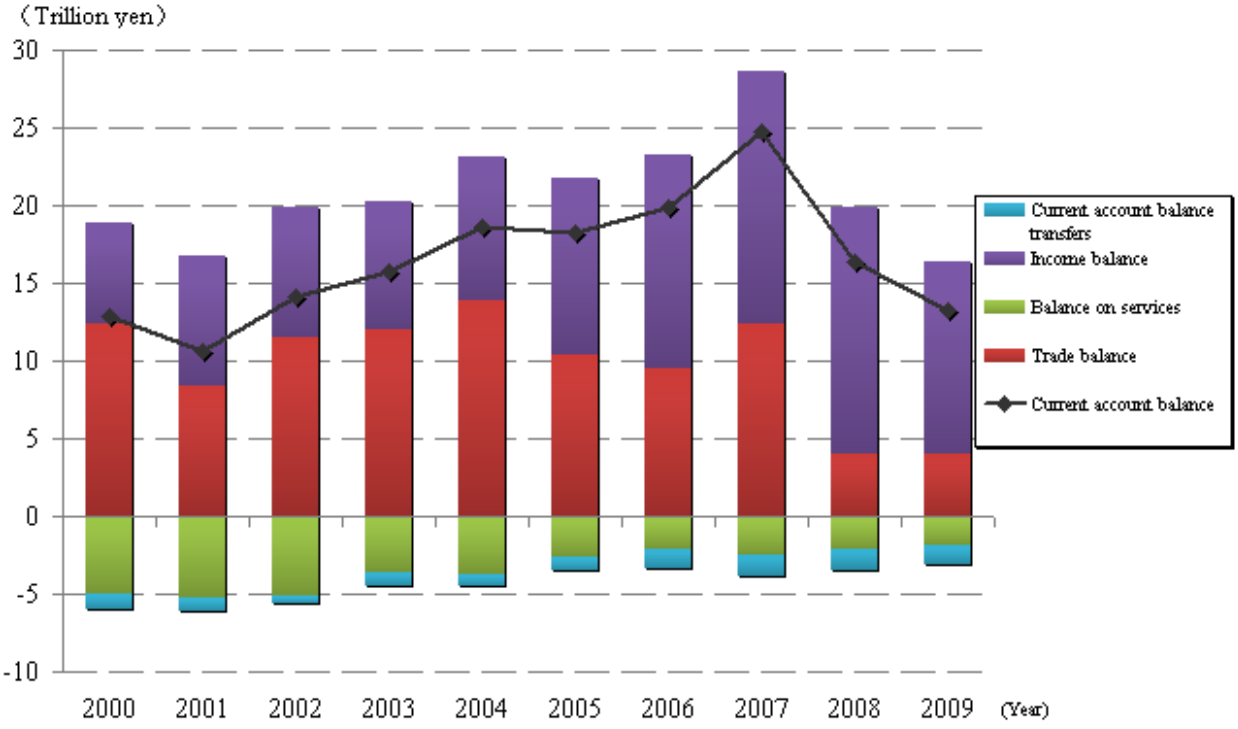
(A) Transition from export to investment

Affected by the global economic slump, Japan's current balance marked lower than the last year in two consecutive years. The current balance has been positive constantly, but the structure of weight is shifting from trade balance to income balance. Especially, in 2008 and 2009,the amount of positive income balance marked 3~4 times more than the amount of trade balance since export declined significantly (see Figure 3-1-1-21)[13].

Moreover, Japan's net international investment position (NIIP), which has been the first place since 1991, had stated increase more around 2006 and reached 2.5 trillion dollars by 2008 (see Figure 3-1-1-21).

Here, we take a look at the transition from export to investment with more concrete statistics.

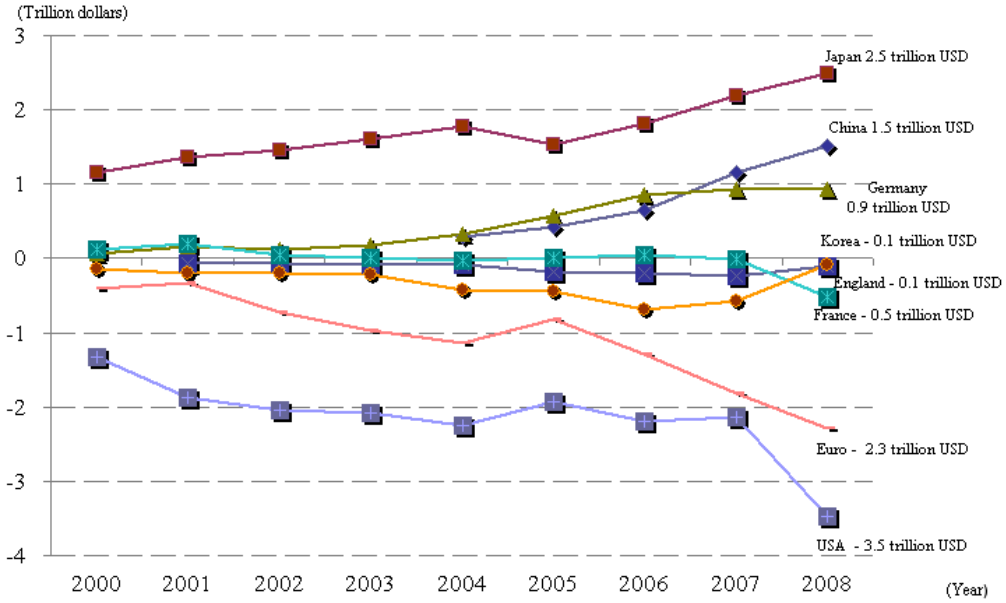
Figure 3-1-1-20 Changes in Japan's current account balance



Source: *International balance of payment statistics* (The Ministry of Finance)

[13] The situation of the income balance being higher than the trade balance indicates that we earn more profit form overseas through investments than trading.

Figure 3-1-1-21 Changes in net external assets of major countries



Source: *IFS* (IMF)

The advance of Japanese manufacturers' production in foreign countries started in 90s. The overseas production ratio was 11.8% in 2000 and became 17% in 2008[14]. In manufacturing industry, the overseas production ratios of transport machinery and communication equipments are especially high. On the other hand the ratio of our top three exporting items[15], transport machinery, electrical products and general machinery, in Japan's total export has been slowly declining from 71.5% in 1994 to 59.6% in 2009. One of the reasons of the decline is that some products, which used to be exported from Japan, have been manufactured in the market area as overseas production progresses (see Figure 3-1-1-22).

[14] Referred to Ministry of Economy, Trade and Industry "The 39th Basic Survey of Overseas Business Activities".
[15] The top 3 items categorized by the base of Ministry of Finance, Trade Statistics of Japan press release.

Figure 3-1-1-22 Proportion of exports of top three items

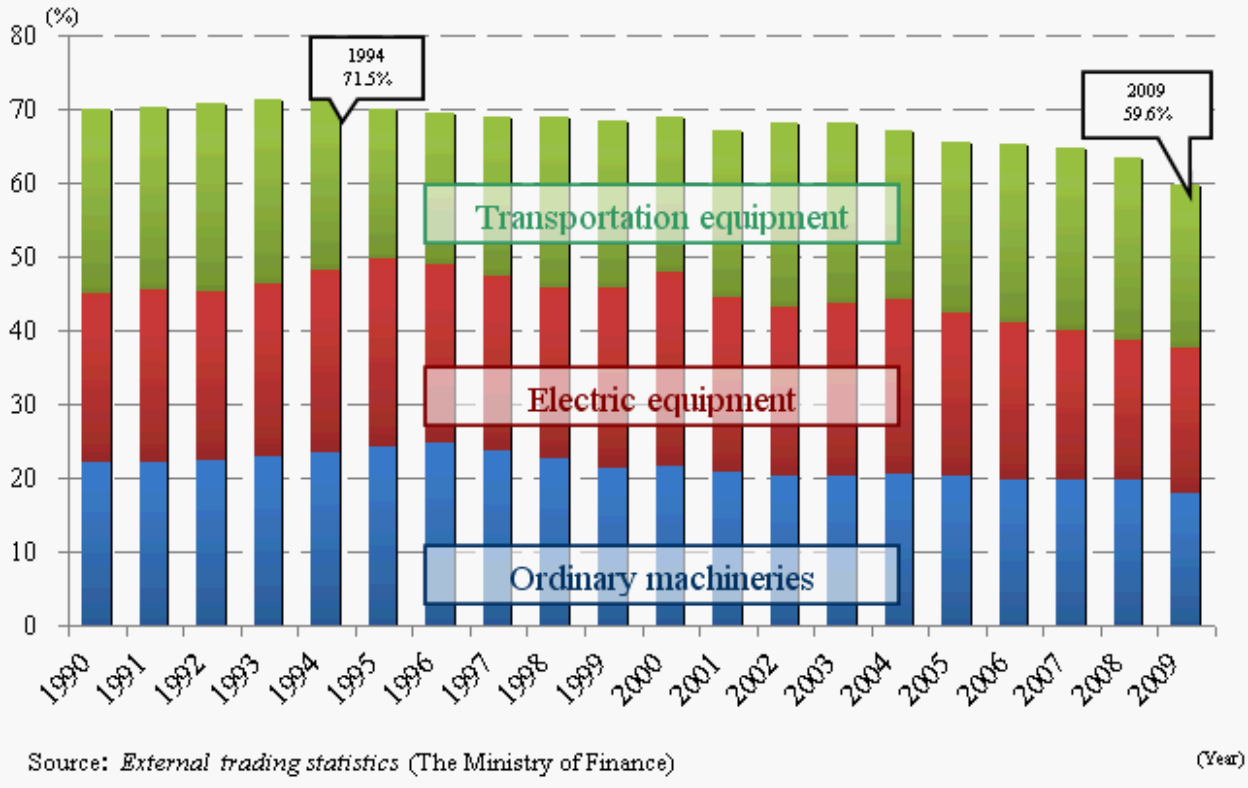
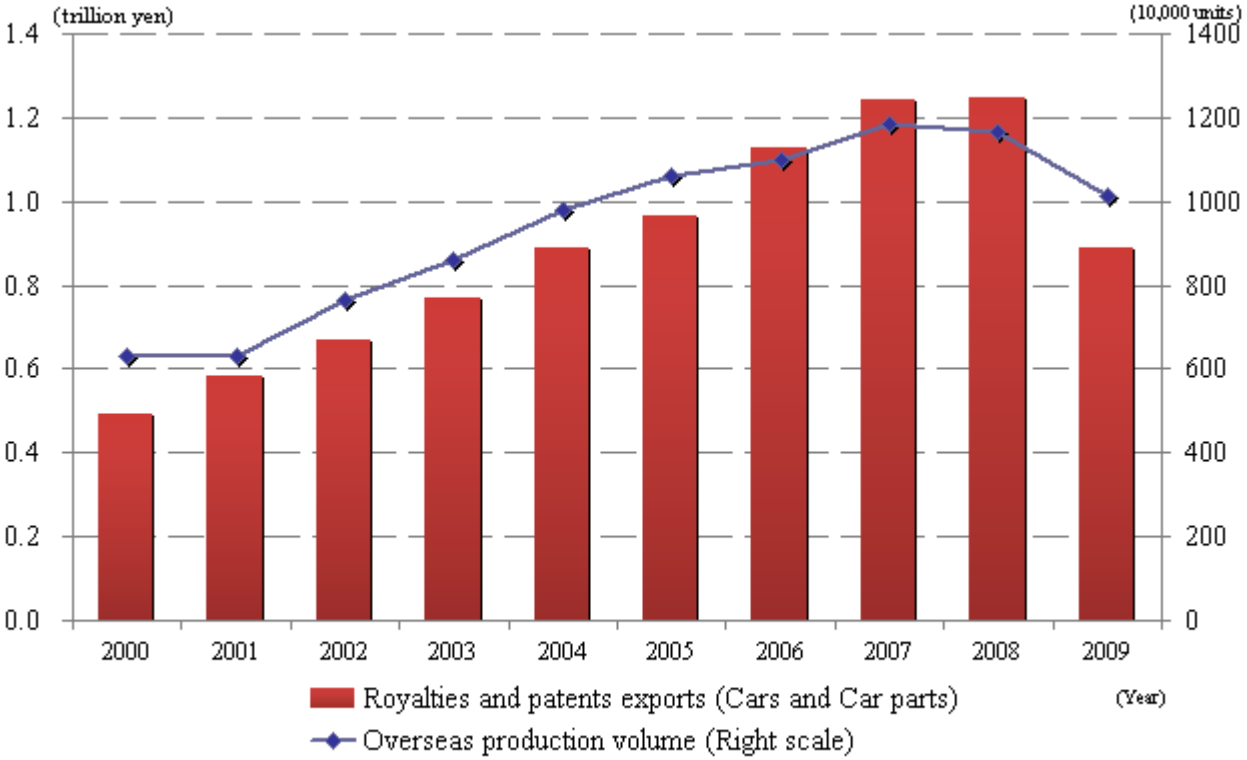


Figure 3-1-1-23 No. of Japanese Vehicles Produced Overseas, and Patent Royalties etc.



Source: Japan automobile manufacturers association and *Science technology research* (The Ministry of internal affairs and communication)

Although export declines as overseas production progresses, the earnings from loyalties and licensing fees, of the service balance item, has been increasing. It reflects the greater flow of licensing fee from overseas production of automobiles etc. We expect an increase of the earnings from royalties and licensing fees as our overseas production progresses in Asia and other area (see Figure 3-1-1-23).

Column 17 Transition from export to investment

<Case1>

Yamahachi Chemical Co. Ltd. has the main office in Gamagori-City, Aichi-Prefecture. It has a patent of production technology for self-inking rubber stamp using open-cell material[16], which the company spent 10 years and more to develop. The company successfully established a new business project that they can take initiative in negotiations.

The company has aggressively participated in famous exhibitions, such as Frankfurt Messe and Paper World China, to introduce their product and received orders from Germany, Poland, Russia, India, Hong Kong, and so on. Self-inking stamp using their open-cell material received great attention from foreign stationary makers and toy manufacturers. The strength of the product opened up overseas market for itself, and drove forward the company's export business development.

As importance of overseas operation increases, the company built a factory in China in 2001 to cut down the cost of the production process, which has high personnel expense ratio, and to build an optimal production and supply system. At the factory in China, the company spent more than 5 years to nurture talented local people by providing education of the company's 'monozukuri' (industrial inventiveness) culture, etc. In the beginning, they had about 10 employees, who were in charge of the final production process using the open-cell materials as a basic material. However, their goal is to establish a system, where other processes can be carried out, in China.

[16] A unique ventilating material. The entire material consists of serial microscopic pores.

"Continuous pore material" which consists of continuous pores of 5-30μ are widely used such as its main product, self-inking rubber stamps and brush-pen chips.

Chairman and president by themselves periodically stay at China factory for the training of local staff and the guidance on production technology.

Participation to the dealer conference hosted by the exclusive agent in Calicut, India in 2006.

Product presentation as an exhibitor at Paperworld China in Shanghai.

<Case 2>

Okinawa Chosei Yakusou Honsha Company has the main office in Nanjo-City, Okinawa-Prefecture. The company produces medicinal herb blend teas and a pioneer of the nationwide natural blend tea boom in the market, which major beverage companies join now.

In 2001, the company started exporting to Japanese restaurant group in the U.S. They distributes not only to the restaurants but also sell canned blend teas for general consumers. In addition, they are engaging in exports to China and Hong Kong and had welcomed group of inspectors from Chinese government to their facility.

They established joint company in Fujian-Province and all their operation in China is done through the company. In 2008, as a result of continuous entries in FHC CHINA[17] to extend the market, they entered a sole agency agreement with a company in Shanghai. They are actively pushing forward their export operation. Having a sole agency agreement made them able to control the market, bacause a price competition can be avoided among multiple distributors, which could sell the same product with different prices.

Their development and success of medicinal herb blend teas invited new businesses entries. The sales of health-food industry rose rapidly and increased employment in Okinawa. There is a great expectation in their successful global development from now on.

[17] Food and Hospitality Exhibition in China. The largest exhibition and trade fair for food and drink specialty in China. Businesses of agricultural, forestry and fisheries products, processed foods and drinks etc., which seek out new markets in China, come together.

<Case3>

On the other hand, there is a case that a company cannot easily start investing even though it is positively working on overseas business development.

Konan Tokushu Sangyo Co., Ltd. is a manufacturer that produces metal molds for plastics, which are used for auto-upholsteries. Including a porous electroforming, which utilizes micron-size pores, they have multiple world's top class technologies. The high level technologies are adopted by not only by domestic automakers but also by foreign automakers, such as GM and Renault. The company has been moving forward to establishing local subsidiaries or joint ventures in Canada, the U.S., Mongolia, Thai, and Korea since 1989.

Recently, they have been receiving many joint offers from Chinese companies, which noticed the company's advanced technology. Now they are facing a dilemma because of the fear for technology drain.

In a process of discussion over joint venture establishment, the company asked Chinese side what to expect if they decided to withdraw. It turns out that the process of withdrawal would take for about 5 years, and they felt that Chinese side would take away all their technologies.

It may be possible that the China obtains advanced technology as good as theirs from somewhere in Europe etc. even though they did not enter a joint venture with a Chinese company. However, once their technologies are drained by entering a joint venture, there is no way to take them back.

Fast growing Chinese market is very attractive, but there is a great risk. The company is pressed to make a difficult decision now.

Column 18 License business

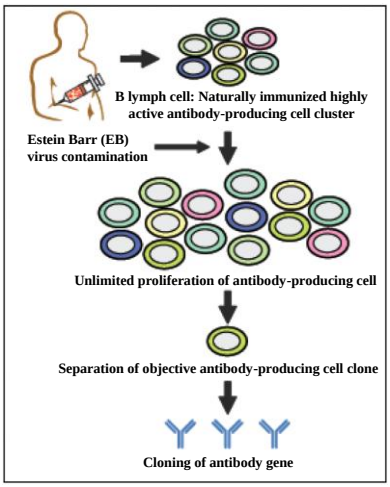
<Case1>

Evec Inc. is a biotechnology venture company emerged (derived) from a university. Based on the research accumulated by Professor Kenzo Takada in the Institute for Genetic Medicine in Hokkaido University the company developed a "fully human antibody" using solely domestic technology without relying on any patent developed in western world.

In September 2008, German major pharmaceutical manufacturer, Boehlinger Ingelheim GmbH, accepted the antibody and the Evec made a contract with them to receive 5.5 million Euros (about 880million yen with the exchange rate of that time) as a lump-sum payment, milestone payments and royalty that is in proportion with sales once it becomes a drug.

Japan's patent income has been increasing yearly. A large part of it is from Japanese companies going into foreign markets. In the future, however, we expect an increase of biotechnology venture companies that make license businesses with western major pharmaceutical companies like this company.

Production of perfect human antibody



<Case2>

Ubukata Industries Co., Ltd. is a medium-sized company that manufactures bi-metallic switches and seismic sensors in Nagoya-city. Many of their products are for industrial use, therefore, consumers rarely see their products directly but this company's product has over 80% domestic market share. Majority of air-conditioner compressors and gas meters uses their products. Moreover, the company has strong competitiveness and has equivalent share with the largest U.S. manufacturer in overseas. About 80% of the total sales are from sales in overseas.

The background of the overwhelming competitive power of this company is the perfect management strategy for their intellectual properties as well as their advanced technologies.

They consider their intellectual properties as a vital point of business strategy and have applied for more than 1000 patents since their foundation in 1957. They started business in overseas in 1979 and 10~20% of their patents are applied in overseas, such as the U.S. or China. With an intensity of a motto, "We'll never let any product step out from this company if it does not have our brand name on it," they make sure to put their brand name on their product even it is small.

They have established a joint business and a wholly foreign owned enterprise in Ningbo, China. However, they prevent a new competition to enter the market by thoroughly protecting the technologies used on the mains parts in the main office. On the other hand, they provide the factory in China, too, with technologies that would not become threats to their status even if they drain, so that they will be their source of income.

As you can see, the company manages its each technology to suit its nature and use and keep the overwhelming share in domestic and foreign markets.

Figure 3-1-1-24 Changes in Japan's top five export countries and regions

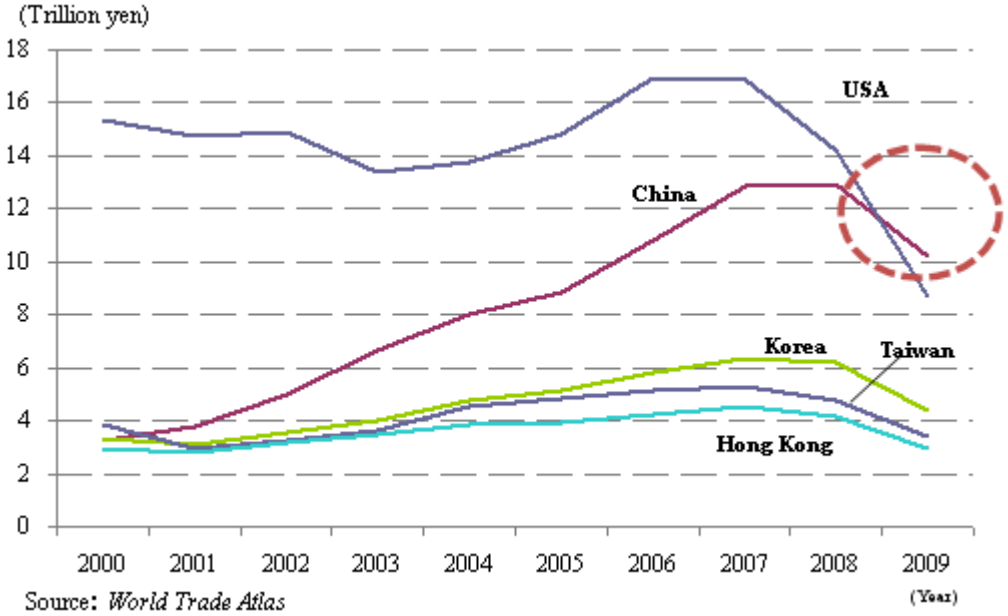
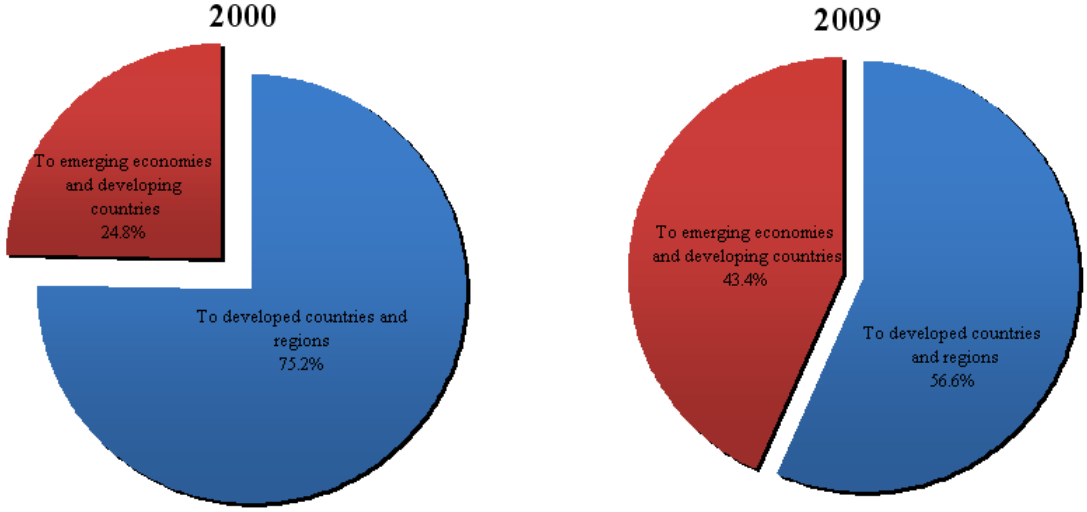


Figure 3-1-1-25 Comparison of exports to developed countries and to emerging economies/developing countries



Note: The developed countries in this graph refer to 33 countries and regions defined by IMF(Australia, Austria, Belgium, Canada, Cyprus, Czech, Denmark, Finland, France, Germany, Greek, Hong Kong, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxemburg, Marta, Nederland, New Zealand, Norway, Portugal, Singapore, Slovakia, Slovenia, Spain, Sweden, Switzerland, Taiwan, England and USA), while emerging economies and developing countries refer to 149 countries and regions other than the developed countries.

Source: DOTS (IMF)

Figure 3-1-1-26 Exports from China dominate the world

	Import country and region ↓	Largest counterparty country	
		2005	2009
Developed countries and regions	USA	Canada	China
	Canada	USA	USA
	EU(27)	USA	China
	Australia	USA	China
East Asian countries	Japan	USA	China
	China	Japan	Japan
	Korea	Japan	China
	Singapore	Malaysia	USA
	Thailand	Japan	Japan
	Phillipines	USA	Japan
	Indonesia	Singapore	Singapore
	Malaysia	Japan	China
Other emerging economies	Brazil	USA	USA
	Russia	Germany	China
	India	China	China*
	Middle East	USA	China
	Africa	France	China
	Mexico	USA	USA

Note: China=Red、USA=Blue, Japan=Green

Regend: * Data for 2008

Source: *World Trade Atlas*

(B) Increasing exports to new emerging countries

Japan's trade had been heavily relying on the U.S. for both exports and Imports in the past, but our trade with China rapidly increased in 2000's. It seems that the great increase of import and export with China was a result of the East Asia production network, in which we make products in China and export the final product to western countries or reverse import to Japan.

In 2009, China overtook the U.S. and became the biggest export destination of Japan (see Figure 3-1-1-24).

It is not only China that is growing as our export destination but emerging countries are growing, too. It shows the Japanese businesses' movement to capture the markets of emerging countries (see Figure 3-1-1-25).

On the other hand, when we look at the import situation of emerging countries, we can see China's overwhelming power as an exporting country. In the other countries and areas, such as Russia, Middle East and Africa, the largest importing partner had been the U.S. or Europe, but China has been taking the place for the last several years. In terms of trading, China also shows its power in advanced countries, such as the U.S., EU, Australia and Japan (see Figure 3-1-1-26).

Column 19 The impact of Chinese yuan revaluation on Japanese economy

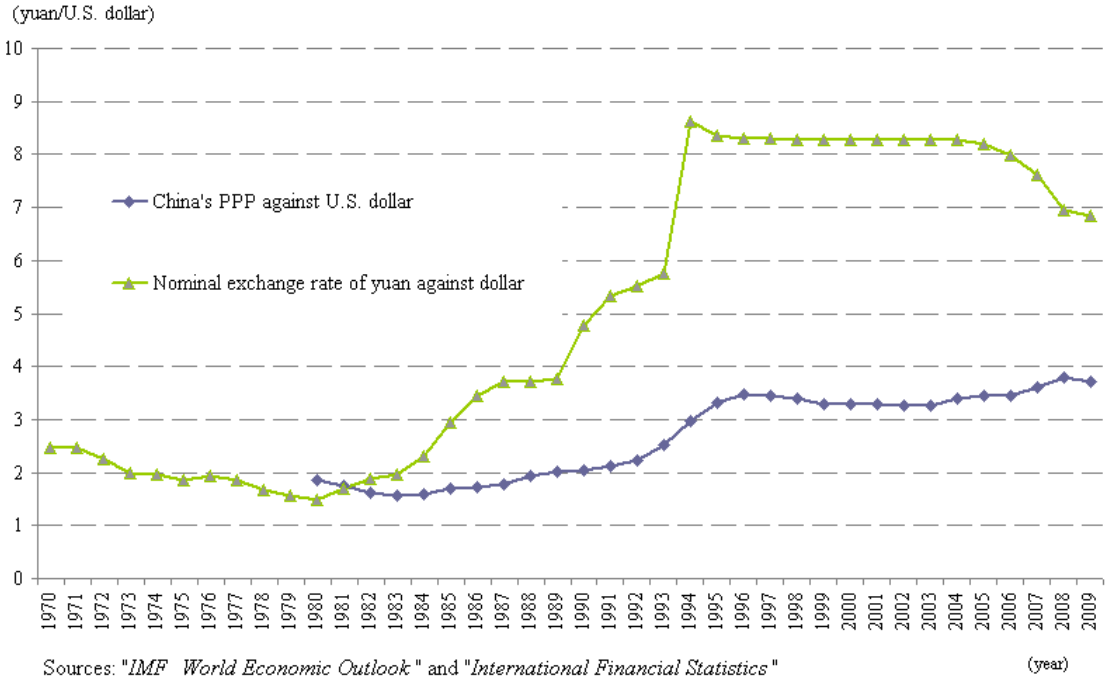
The rate of Chinese yuan against U.S. dollar had been pegged around 8.27~8.28 yuan per dollar since the devaluation in 1994. Yuan had been revaluated slowly since 2005, and has been fixed at 6.8 yuan per dollar. It was to somewhat support exporting companies that was suffering from the curved performance since the global financial crisis in 2008. This rate is detached greatly from the purchasing power parity. We believe that yuan is cheaper than the price that the actual economic status indicates.

Summary of the good and bad impact on Japanese economy when China revaluates yuan is as follows.

Additionally, the trial calculation of the influence on Japanese-owned local subsidiaries in China if yuan is revaluated is as follows. Negative impacts would be on manufacturers, positive impacts would be on non-manufacturers and slightly positive impacts for overall. We can see the tendency that when the import ratio is higher, and the export ratio is lower or the local supply rate is lower, the company makes more profit. Generally speaking, many raw material type business or non-manufacturing companies went to China to sell their product in Chinese market. Thus, their exporting competitiveness would not decline much. However, industries of electric equipments and general machinery assembly etc. and textile industry has higher exporting ratio in total sales; therefore, we suspect decline of their exporting competitiveness.

Revaluation of yuan may lower the competitiveness of local subsidiaries of export-oriented business in China and the business may need to move to a country or area that has lower labor cost. On the other hand, since expensive yuan will increase purchasing power in China, companies that made inroads into China may switch from export-oriented to home consumption-oriented in China. Comprehensively, expensive Chinese yuan will promote an increase of domestic demand and expansion of economy scale in China, and Japanese businesses will be required to develop corresponding to the progress of Chinese economy.

Column 19-1 China's PPP Rate and Exchange Rate



Sources: "*IMF World Economic Outlook*" and "*International Financial Statistics*"

Column 19-2 Examples of Effects on Japanese Economy of Chinese Yuan Revaluation

Example of favorable influence	○ The increase of purchasing power in China increases China-bound exports and Chinese tourists to Japan.
	○ Due to the increased export prices of Chinese products, Japanese products gains more favorable position in the competition against Chinese products in overseas markets.
Example of unfavorable influence	● The increase of purchasing power in China resultes in the hike of resource prices in the world.
	● The costs to import Chinese products increases.
	● In the short term, the Chinese economy slows down due to the declined Chinese exports. Japanese exports to China for its processing trade shrinks and causes a negative effect mainly on Japanese machinery industry of which dependency to China

Source: Ministry of Economy, Trade and Industry

Column 19-3 Examples of Effects on Japanese Companies in China from Chinese Yuan Revaluation

Example of favorable influence	○ When parts are obtained importing from outside of China, the acquisition costs will decrease.
	○ Chinese companies that handle domestic sales will grow through comparative purchasing power increase.
Example of unfavorable influence	● The companies that position China as its the production/export =base for the markets of developed countries, increased China's export prices will increase the costs and decrease the amount of sales.

Source: Ministry of Economy, Trade and Industry

	Profit structure							Influence of appreciation of yuan				
FY2007	Purchase cost (vs. Sales) (%)	Local acquisition ratio (vs. Sales) (%)	Import ratio (vs. Sales) (%)	Sales (vs. Sales) (%)	Local sales ratio (vs. Sales) (%)	Export ratio (vs. Sales) (%)	"Local sales ratio" - "Local acquisition ratio"	Ordinary profit (a) (100 million yen)	Ordinary profit 10% of yuan appreciation (b) (100 million yen)	Changes in Ordinary profit (c)=(b)-(a) (100 million yen)	Profit increase ratio (c)/(a) (%)	Increase in consolidated ordinary profit* (%)
Total	79%	47.2%	31.7%	100%	66.1%	33.9%	**18.9%**	11,246	11,890	644	**5.7%**	**0.2%**
Manufacturing	76%	44.4%	31.4%	100%	60.6%	39.4%	**16.2%**	9,577	9,239	-338	**-3.5%**	**-0.2%**
Food products	67%	65.4%	2.0%	100%	87.5%	12.5%	**22.1%**	331	305	-26	**-7.9%**	**-0.6%**
Textile	76%	40.2%	35.6%	100%	41.8%	58.2%	**1.7%**	61	-16	-77	**-126.7%**	**-2.7%**
Chemical	68%	44.6%	23.8%	100%	75.3%	24.7%	**30.7%**	293	315	23	**7.7%**	**0.1%**
Oil, Coal	84%	57.2%	26.5%	100%	93.7%	6.3%	**36.5%**	27	37	9	**33.3%**	**0.3%**
Steel	87%	50.8%	35.9%	100%	86.3%	13.7%	**35.5%**	170	321	152	**89.4%**	**1.0%**
Nonferrous	77%	50.5%	27.0%	100%	62.0%	38.0%	**11.6%**	43	26	-17	**-38.8%**	**-0.4%**
Metal products	63%	39.6%	23.5%	100%	45.9%	54.1%	**6.3%**	77	32	-45	**-58.8%**	**-2.6%**
General machinery*	73%	62.2%	10.4%	100%	28.9%	71.1%	**-33.3%**	405	101	-303	**-75.0%**	**-6.5%**
Business machinery*	77%	33.0%	43.7%	100%	16.5%	83.5%	**-16.5%**	254	12	-242	**-95.2%**	**-3.5%**
Electric machine	77%	45.4%	31.5%	100%	48.5%	51.5%	**3.1%**	1,059	679	-379	**-35.8%**	**-3.2%**
Telecommunications equipment	78%	24.7%	53.1%	100%	31.7%	68.3%	**7.0%**	1,006	562	-444	**-44.2%**	**-1.9%**
Transport machinery	77%	54.6%	22.2%	100%	87.1%	12.9%	**32.5%**	5,205	6,220	1015	**19.5%**	**1.6%**
Non-manufacturing	88%	55.2%	32.7%	100%	81.9%	18.1%	**26.7%**	1,669	2,651	983	**58.9%**	**0.8%**
Construction	82%	82.3%	-	100%	98.6%	1.4%	**16.3%**	36	38	2	**5.3%**	**0.0%**
Telecommunications	52%	46.2%	5.6%	100%	61.9%	38.1%	**15.7%**	25	8	-18	**-70.2%**	**-0.1%**
Transportation	77%	76.6%	0.5%	100%	88.1%	11.9%	**11.4%**	126	108	-18	**-14.2%**	**-0.2%**
Wholesale	90%	51.6%	38.4%	100%	80.4%	19.6%	**28.7%**	1,206	2,203	997	**82.6%**	**2.4%**
Retail	79%	74.6%	4.3%	100%	98.9%	1.1%	**24.2%**	90	105	15	**17.1%**	**0.2%**
Service	87%	73.9%	12.8%	100%	84.3%	15.7%	**10.4%**	20	17	-3	**-13.6%**	**-0.1%**

Notes: Estimate is based on the actual results in 2007. *Consolidated ordinary profit is the sum of the results in Japan and the world.

*"General machinery" includes elevator, conveyer, freezer, boiler, motor, and pump. "Business machinery" includes copy machine, optics, lens, measurement equipment and analysis equipment.

Original sources: Ministry of Economy, Trade and Industry *" KIGYOKATSUDO KIHONCHOUSA (Survey on corporate activity)"* and *"KAIGAIJIGYOUKATSUDOU KIHONCHOUSA (Survey on overseas bossiness activity)"*

Source: Daiwa Institute of Research *"CHUGOKU BABURUNO KOZO/HIKISHIMESAKUNO KINYUUSHIJOU ENO EIKYOU (The structure of bubble in China: The influence of tightening policy on financial market)"*

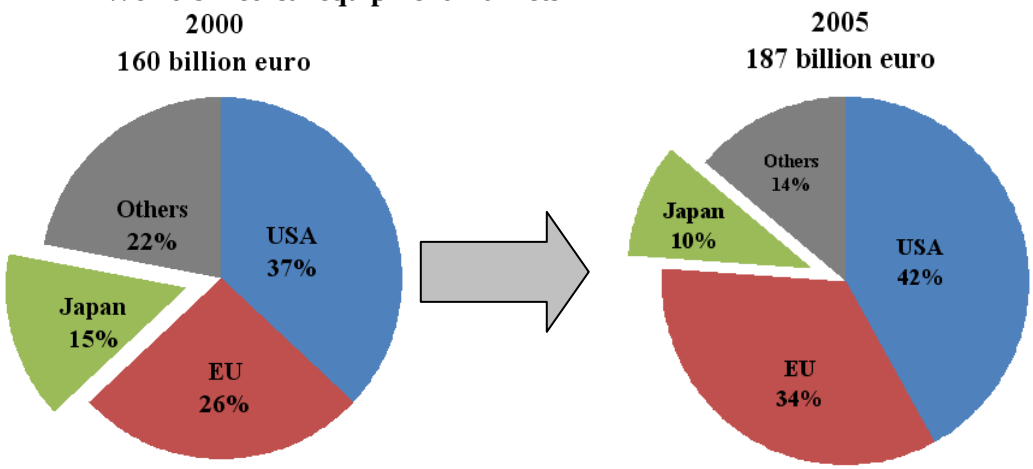
(C) Hope for the growth of new export industries

Japan's export suffered from a great impact after the global economic crisis, but has started recovering again being supported from the demand from emerging countries like China. However, as described above, our past major export products of automobiles and electric equipments has been manufactured in overseas more, while production of these products in new emerging countries, such as China and India, is increasing. In addition, during the global economic crisis, export of automobiles, which have great price flexibility, slumped especially. It clearly showed the high risk of export industries being inclined to the products that has high price flexibility.

In order to expand export from Japan, we need new export industry in addition to the old ones.

For example, global medical equipment market is one of the categories that are expanding. It grew from 160 billion euros in 2000 to 187 billion euros in 2005, but Japan's share of the market relatively shrunk from 15% to 10% (see figure 3-1-1-27). Additionally, Japan's medicinal equipments and supplies have been in excess of import for a while, which means that our market is being taken away by foreign makers (see Figure 3-1-1-28 and 3-1-1-29).

Figure 3-1-1-27 World's medical equipment markets



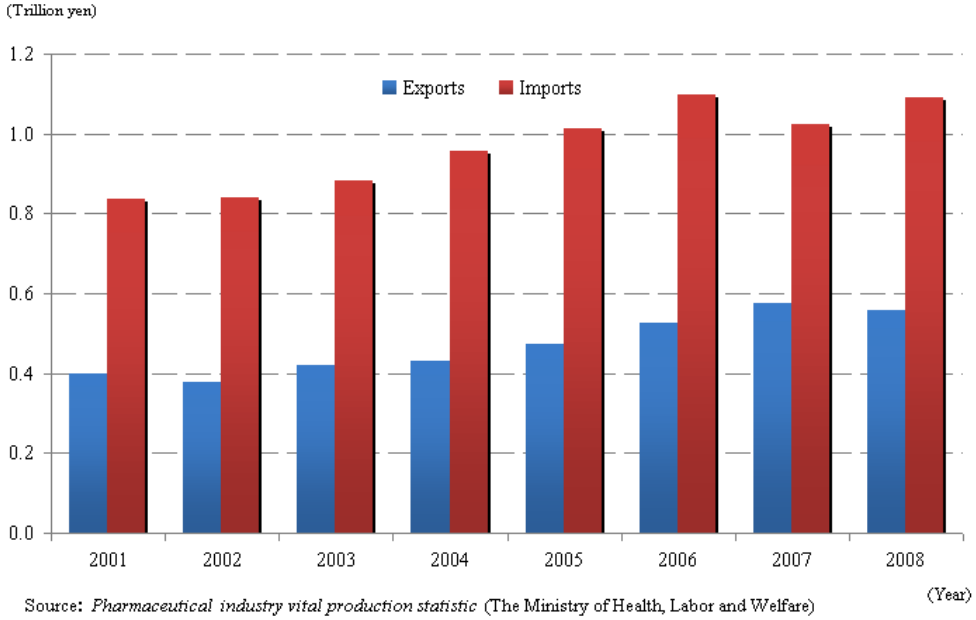
Source: New medical equipment and medical technology industry vision (The Ministry of Health, Labor and Welfare)

Original source: EUCOMED

However, not only in advanced countries but also in emerging countries, medicine is a category that is expected to expand from now on. As for medicinal equipments and supplies, the growth of our export to the U.S, which has been the biggest export destination since 2000, has been insignificant, while the growth of export to China has been quite significant (see figure 3-1-1-30). Moreover, while Japan's overall export decreased rapidly because of the global economic crisis, the export of medicinal[18] supplies did not drop at all (see figure 3-1-1-31). Since it is hardly affected by economic ups and downs, it would hopefully grow to become our export industry.

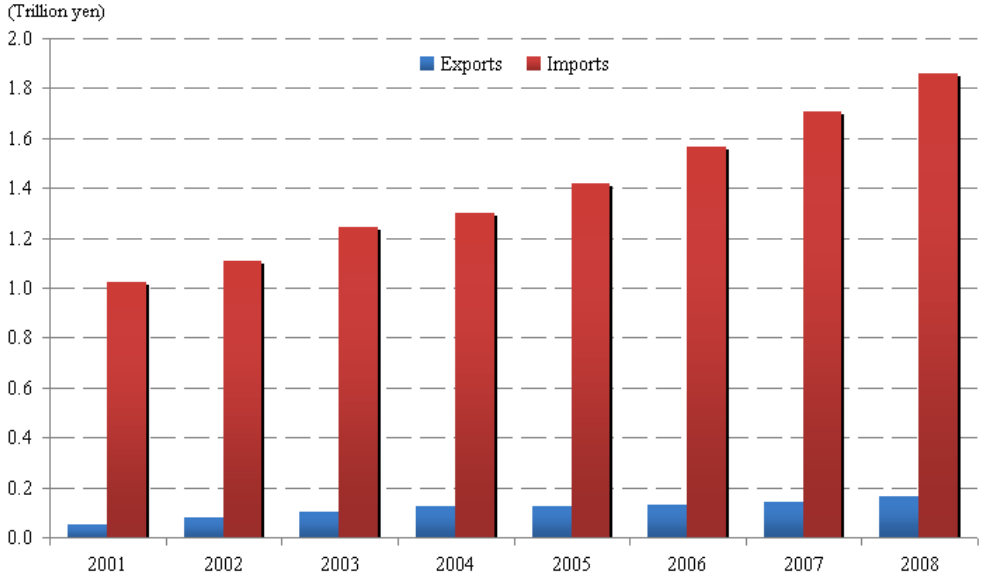
[18] Here, "Medical Products" indicates items that come under the HS code 30, including medicinal supplies.

Figure 3-1-1-28 Japan's medical equipment trading



Source: *Pharmaceutical industry vital production statistic* (The Ministry of Health, Labor and Welfare)

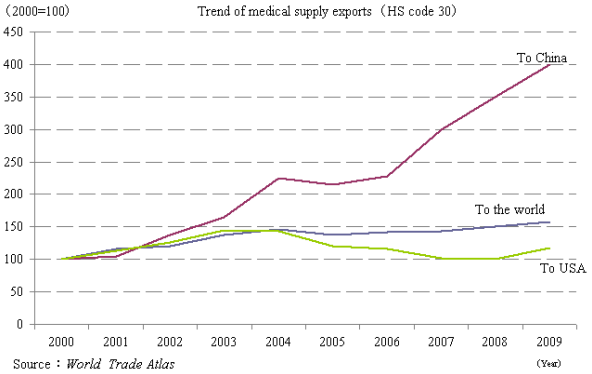
Figure 3-1-1-29 Japan's pharmaceutical products trading



Source: *Pharmaceutical industry vital production statistic* (The Ministry of Health, Labor and Welfare)

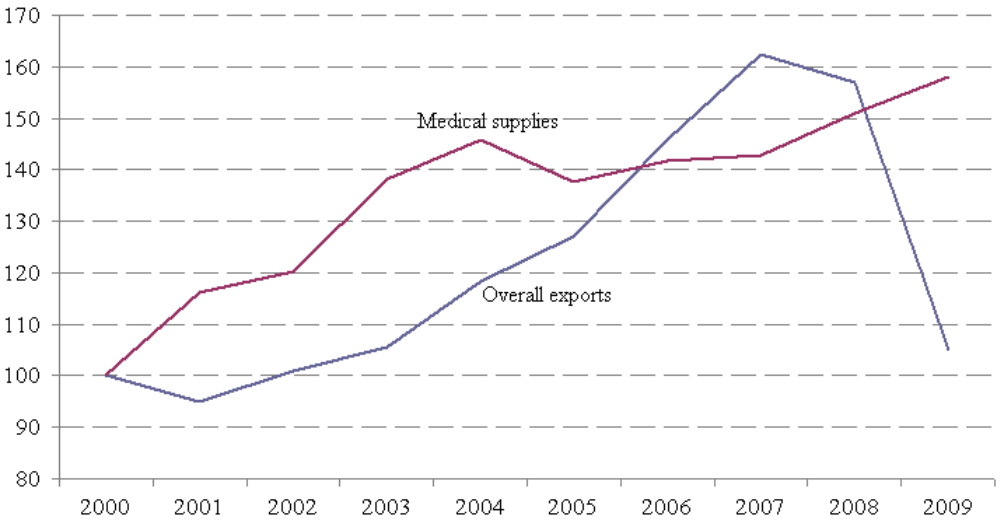
Figure 3-1-1-30 Trend of exports of medical equipment and medical supplies categorized by region

Source : *World Trade Atlas*



Source : *World Trade Atlas*

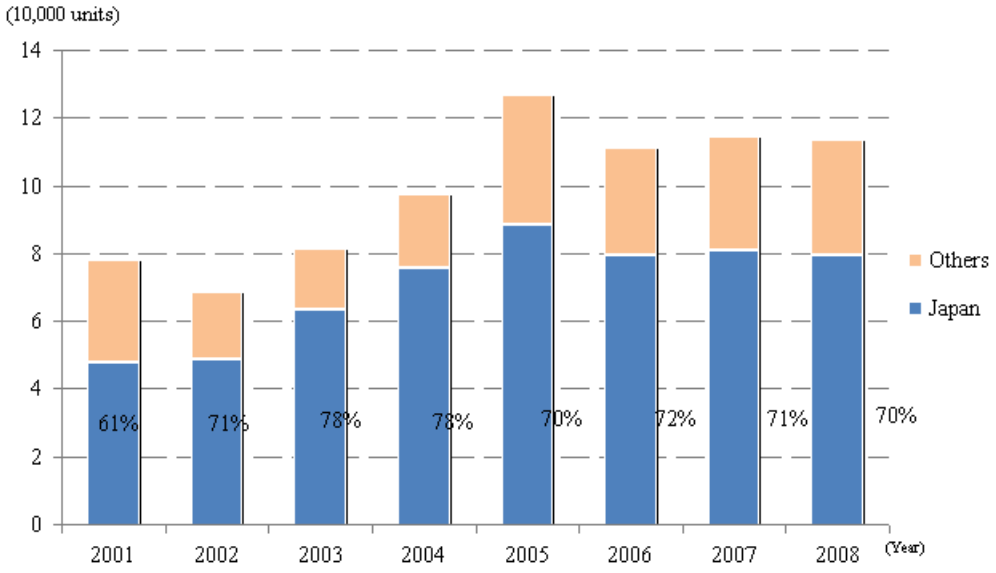
Figure 3-1-1-31 Exports of medical supplies



Note: The medical supplies in this graph refers to those applicable to the HS code 30, inclusive of pharmaceutical products.

Source: *World Trade Atlas*

Figure 3-1-1-32 World's industrial robot shipment volume



Source: *Corporate survey on manipulator robots (2008)* (Japann robot association) and *World Robotics 2009* (IFR SD)

Besides medicinal industry, robot industry is a category that is expected to expand the demand in the future. Currently, almost all robots that are manufacture in Japan are for industrial use. Majority of them are used in automobile or electric-electronic industries. Japan has maintained the global share of 70% for industrial robot (based on numbers of robot shipped) (see Figure 3-1-1-32).

In addition to industrial robots, needs for robots in other fields, such as life support robots (nursing care robot), have been growing. Domestic robot industry is predicted to grow current scale of 700 billon yen to 2.9 trillion in 2020 and 9.7 trillion yen in 2035[19].

Being in the forefront nation of population aging, demand for life supporting robot is especially increasing. Entering early into new fields, like life support robots, which have a good potential to grow, Japanese companies will hopefully obtain some advantage, such as acquisition of the international standard, to open up the overseas market for international competition in the future.

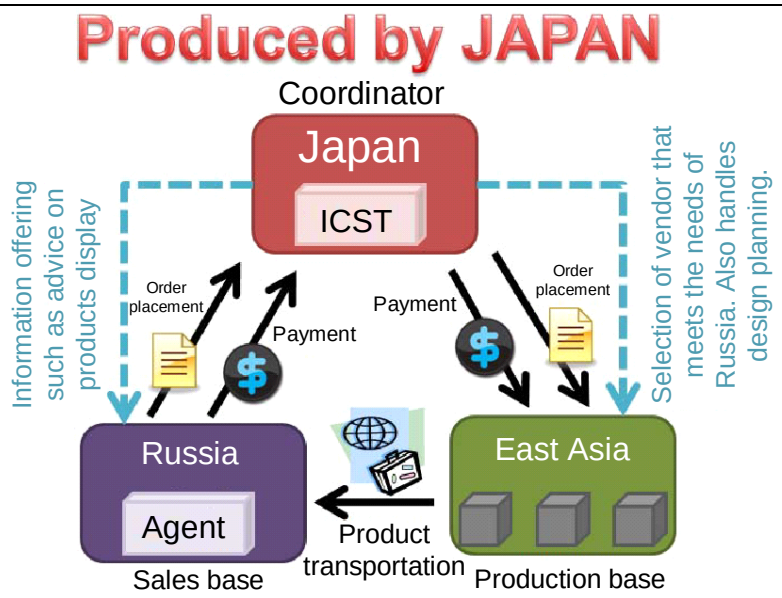
Column 20 Overseas development in medicinal field

<Case1>

ICTS Corporation is a company of 7 employee founded in 2004. It exports medicinal equipments and health equipment to mainly Russia. The business takes advantage of the fact that there is not enough supply of medicinal and health equipments in emerging countries while the people are becoming more conscious of their health. People's life expectancy in Russia is especially short compare to other emerging countries and people are highly conscious about their health. Additionally, since the president had good connections in the area before he founded this company, the company chooses Russia as their main market.

Column 20-1 ICST Trade Between Three Countries

[19] Press release by Ministry of Economy, Trade and Industry, on April 23, 2010. Estimated by Ministry of Economy, Trade and Industry and New Energy and Industrial Technology Development Organization (NEDO).



A problem that often pointed out about Japanese companies, which enter markets of emerging countries, is that Japanese products' excessive performance makes it hard to win price competitions. However, with an innovative idea of buying products made in China and sell them to Russia, this company's sales is increasing in the middle class market of emerging Russia. There are many makers that have their production center in China or Eastern Asian nations. However, ICST sells products already made in China and does not have its own manufacturing function. The president used to work as a research worker at a medicinal equipment manufacturer before he founded ICST. Therefore, he does not have to have a subsidiary to make products but select products with certain quality with his excellent judgment skill. However, the company does not sell products of China to Russia as they are. They improve a part of design to fit Russia's needs, add value by putting their bland logotype on the product or conduct new product development in their office to realize "Produced by Japan".

In Russia, Japan's technology is appreciated very highly. They use such image of Japan effectively by selling the product with Japanese brand name.

Triangular trade like this can be applied to not only Russia but also any countries as long as you find good business partners. Since no subsidiary is involved, the risk of the company does not rise too much even if the business scale expands.

We anticipate the application of this tactic in fields other than medical equipments as a new method to enter markets of emerging countries.

<Case2>

In recent years, researches of tissue engineering are ongoing in many countries as it is a highly anticipated field of medical treatment. Tissue engineering uses your own or others' cells to regenerate your damaged tissue or organ. Cell Seed Inc. is close to begin marketing of the world's first "Epithelial Cell Sheet for Corneal Regeneration," which has a base of Japan's first "Cell Sheet Engineering" in the

regenerative medicine field. A part of human eye, called epithelium, has stem cells[20] that control metabolism. Once the stem cells are destroyed by disease or trauma, an optical impediment will occur soon or later. Many treatments have been applied, but no effective treatment has been found so far.

Epithelial Cell Sheet for Corneal Regeneration developed by Cell Seed Inc. is a product to treat these corneal diseases. They use oral mucosal epithelial cells (It has similar characteristics with corneal epithelium) collected from the patient as a base material. The cell sheet (Epithelial Cell Sheet for Corneal Regeneration) made with a temperature responsive cell culture device is transplanted on the patient's affected area. The characteristics of the product are a low possibility of having immunity rejection, since the main ingredient is the patient's own oral mucosal epithelial cells, and possible use on patient's both eyes.

This company chose Europe for the first marketing region of Epithelial Cell Sheet for Corneal Regeneration and established a subsidiary in Lyons, France in October 2008. Certification of the product through clinical testing is in its final stage and scheduled to be completed by the end of 2010. The company has entered into a consignment manufacturing agreement and a joint sales agreement, already.

The company is planning on to expand the business of Epithelial Cell Sheet for Corneal Regeneration in the U.S. and Japan as well as in Europe.

Column 21 Medium- and small-businesses that challenge new fields

<Case1>

In Tokai region, where many medium- and small businesses are concentrated, the local economy slumped significantly after the global economic crisis of Fall 2008, due to the rapid fall of the key industry, automobile export. There are some medium-and small businesses that stepped into new fields for survival.

TEAM Ecollabo was organized with 8 medium- and small-businesses of different type of businesses in Tokai region, such as an auto parts maker, a building material maker and a water service system company. It engages in product development in environment field, which seems to have a great business potential in the future. They are not interested in old subcontracting business and willing to send out environmental products or systems that they design.

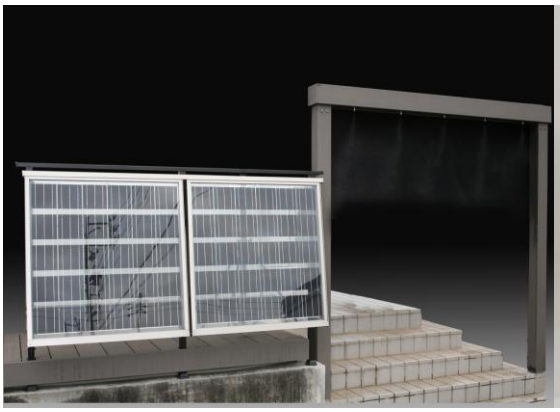
They have developed Cool series, such as "Solar Fence", a fence with solar panels on and "Cool Gate" which sprays mist with solar energy", and "Eco Light Beam", which uses LED. Overseas promotion of these products is in their view while they promote domestic sales.

The building of Center for Japanese Studies in Fudan University is under reconstruction now and a product of Ecollabo is planned to set at a corner of this Center for Japanese Studies. Many of the alumni of this Chinese prestige school, Fudan University, have held important posts of big companies and the government. Therefore, we believe that advertisement effect by making the student become familiar with Ecollabo products is great. In addition, since many Japanese companies visit this center, it can be an advertisement toward domestic market of Japan.

[20] A cell that can be a base (source) of cells. It has abilities to differentiate into various kinds of cells and to differentiate even after cell divisions.

They have a plan of setting their “Cool Series” products at the Shanghai International Exposition, for hot summer season.

Other than China, TEAM Ecollabo aims to sell a solar panel power device, called ”Solar Station” to developing countries, where power source supply is poor.



Solar fence&Cool gate

Solar station

<Case2>

Amino Ace Ltd. in the Kochi Food Industrial Park was established in July 2006 for sales of roasted chicken bone soup and other related goods produced by a member company of industrial park union. Majority of the company’s products are human food. However, the expansion of anxiety over foreign made pet food increased the demand for domestically produced pet food. In order to meet the demand, they began to enter the pet food development, production and sales operations. Kochi prefecture is blessed with warm weather and is a national leading farmland that produces sweet potatoes (Satsuma Potatoes) and small citrons (Yuzu). Fishery is also a major industry. It is famous for fish cake production using fresh fish off the coast of Tosa. Amino Ace produces pet foods made of their local resources in Kochi-prefecture. They also make pet food using sweet potato skin and pulp from soybean milk (okara), which they used to abolish as wastes.

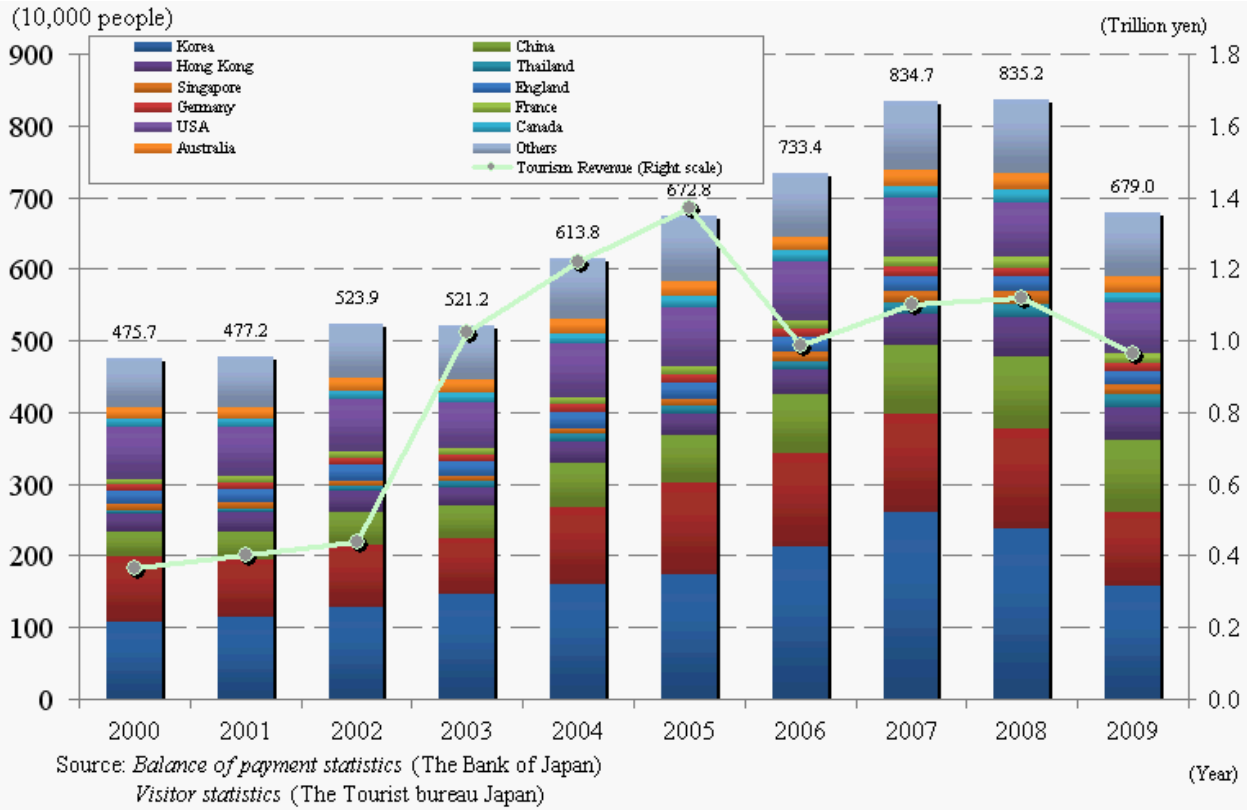
When their products were displayed in various exhibitions, they caught attentions for being made by a food maker for people. Then not only the order the company receive increased, but also they began receiving request of OEM productions and a new product development. We believe that the company’s product is highly trusted in terms of safety because their pet food is not only made domestically, but also by a food maker.

Currently, they export their products to Asian countries, starting with Singapore, in addition to the sales in Japan, and the sales are soaring.

In service field, Japan is trying to have 10million foreign travelers to Japan in 2010 in order to become a tourism nation. The number of tourists, who visit Japan, has been increasing rapidly since around 2004. It reached 8.35 million people in 2008 (see figure 3-1-1-33). According to the World Tourism Organization (UNWTO), the number of foreign tourists in 2008 is 1.8 times of the number in 1990; however, it was less than the growth rate of the whole world, 2.1 times (see figure 3-1-1-34).

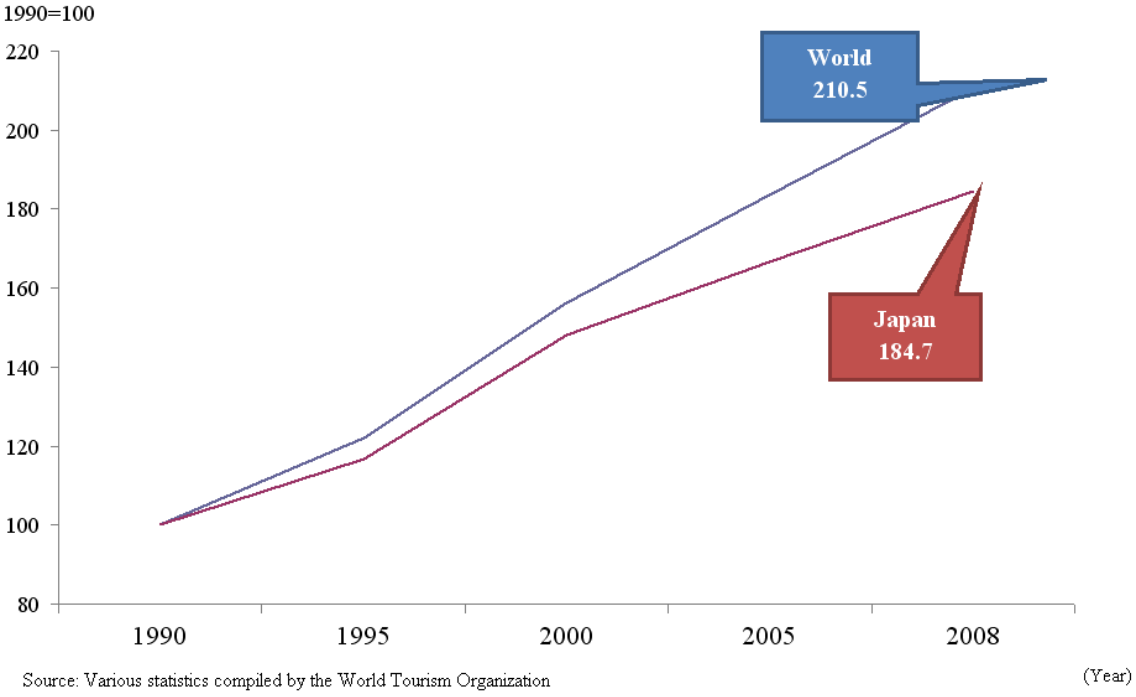
Economic effect of tourist increase has a ripple effect, which expand to wide range of industries from travel agents to transportations, accommodations, and restaurants. Therefore, it is important to positively send out attractions of Japan to further increase tourists from overseas.

Figure 3-1-1-33 Changes in the number of tourists visiting Japan



Source: *Balance of payment statistics* (The Bank of Japan)
Visitor statistics (The Tourist bureau Japan)

Figure 3-1-1-34 Number of tourists visiting Japan and other countries



Source: Various statistics compiled by the World Tourism Organization

Column 22 Global development of a service business

KUMON is an educational service franchise company originated form Japan. It uses original methods and materials, called Kumon Method, in math, English and language arts classes offered. They started overseas operation in 1974. It opened classes to meet the demand form Japanese people living overseas at first, but started opening classes for native children operated by natives little by little. As of March 2010, it has classes in 46 countries and regions including Japan. The world total number of learners at their facilities is 4.33 million and 2.88 million, more than 60% of total, are in overseas.

One of the difficulties of overseas operation is the difference in culture, custom and mindset. For example, it is customary to do homework assigned from school in Japan, but there are some countries, where people do not have a concept of homework. KUMON advocates the importance of education at home and integrates homework in the learning cycle to make children develop study habits. Therefore it is very hard to make guardians understand the importance of homework. In addition, working attitudes differ by countries and some talented people the company educated and nurtured in terms of the business philosophy and Kumon Method may quit after a short period of time.

Regulations and educational systems are also different by country and they become obstacles to develop overseas business. For example, in a case of India, the Prime Court made a decision all of a sudden that all commercial activities are prohibited in residential area, where they rented a building for classes, forcing them to withdraw from the area. Therefore, a possibility of radical change in business environment, which is caused by regulation changes, needs to be taken in consideration.

Based on the experience above, KUMON tries to run their business rooted in the region to stabilize its overseas operation. Education is a base of a nation; therefore, in order to root their business and win the trust from the locals, KUMON proceeds with their business as it tries to hire locals, who are very familiar with the local situation, for class instructors and respects the culture and religious practices in the area to fit in the region.

It also believes in the importance of staying with the principle of Kumon Method. While it respects the local cultures etc., it does not change the principle of Kumon Method, which it believes essential to nurture children's learning ability, depending on country or region. For example, with KUMON, the student measures his/her own study time to use it as an indicator of the child's ability. They explained the meaning of time measuring and its effect to the children and the guardians many times in a country where people do not have custom of time measuring. As a result, the children's self-management skill, studying attitude and learning ability were all improved.

KUMON has a dream of "Contribute to the world peace through education" and a vision of " Provide opportunities to learn with Kumon Method in every country and region in the world and aim to create situation, where students initiate to study for their own dreams and goals." Kumon holds World human Capital Development Forum, where the personnel in charge of nurturing talented people gather, and opportunities for information exchange, such as a World Promotion Forum, for employees to share their values on each subject. Additionally, it holds an annual Global Instructors' Study Forum, and KOMON Global Forum, where instructors in different languages exchange information.

KUMON's math materials are written in different languages but the problems are the same worldwide, and not set for each nation's standard. Thus, instructors can communicate using KUMON material as a common language. For example, an instructor in Singapore adapts the new means developed in the U.S. or a Japanese instructor makes an improvement to the case happened in Indonesia and adopts it. The common language, Kumon Method, realized the invention across the borders and new means of services developed in overseas has started to come back in to Japan, where KUMON has its origin.

We anticipate the company's active operation to promote Japan's attraction overseas as it satisfies the universal needs of receiving good education.

(D) Japan's problem shown in the import status

Japan's import status in recent years shows that amount of mineral fuel import has been gaining the share in the total import as resource prices rises (see Figure 3-1-1-35). Resource price jumped in 2008 and went down afterwards. However, since demand of resources tend to increase as emerging countries grow, in medium- and long-term, resource price is very likely to go up. Japan's trade balance in 2009 was a surplus of 5, 234 billion yen. However, if we calculate as the number of import and yen/dollar exchange rate to be the same, the crude oil price would be 111dollar/ barrel [21]and the trade balance would be a loss of about 2 billion yen. For us, the trade loss caused by high resource price is significant. Improvement of trade condition is a theme for the future (see Figure 3-1-1-36). One of the means is to promote industries that use fewer or less natural resources.

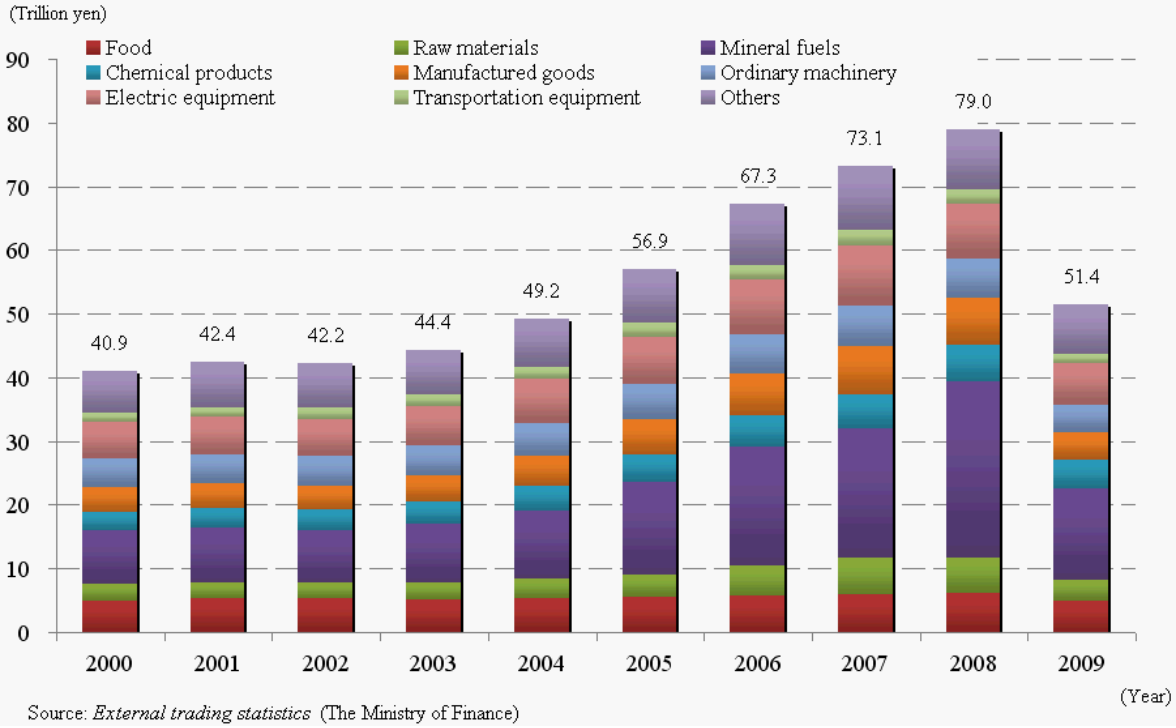
On the other hand, as for importing countries, we have been trying to diversify the importing countries to reduce our dependency to the Middle East. However, in 2009, 59.6% of mineral fuel was from Middle East countries.

Even though it is less than mineral fuel, Japan relies on the U.S. for a quarter of all food import (see Figure 3-1-1-37).

We believe it is essential to diversify importing countries on items that directly affect citizen's security so that we can secure them stably.

[21] 68.90 dollars/barrel in 2009. (Ministry of Finance "Trade Statistics of Japan")

Figure 3-1-1-35 Changes in Japan's import commodities

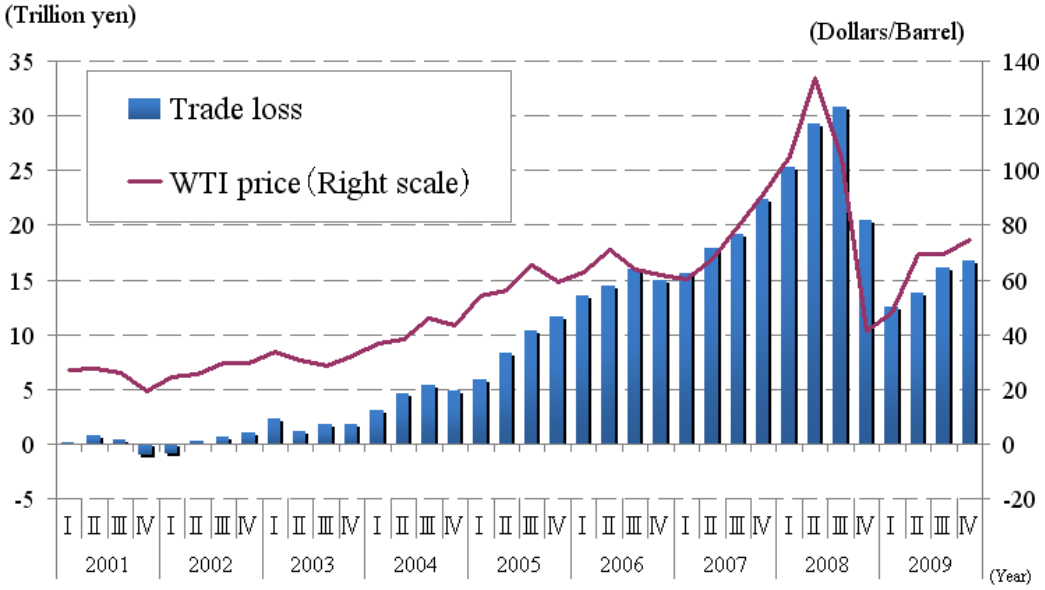


Source: *External trading statistics* (The Ministry of Finance)

(E) For better Investment Performance

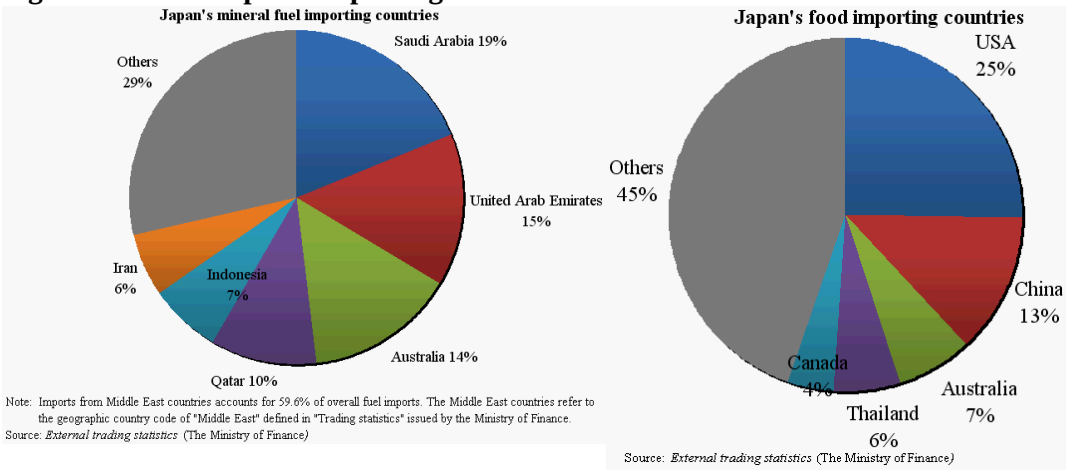
As described above, Japan has the best net international investment position and the scale is still growing. Therefore, importance of the return on investment is increasing.

Figure 3-1-1-36 Changes in Japan's trade loss amount and crude oil price



Source: *Nation economy calculation* (The cabinet office) and the energy information bereau of USA

Figure 3-1-1-37 Japan's importing countries of mineral fuel and foods



Note: Imports from Middle East countries accounts for 59.6% of overall fuel imports. The Middle East countries refer to the geographic country code of "Middle East" defined in "Trading statistics" issued by the Ministry of Finance.
Source: *External trading statistics* (The Ministry of Finance)

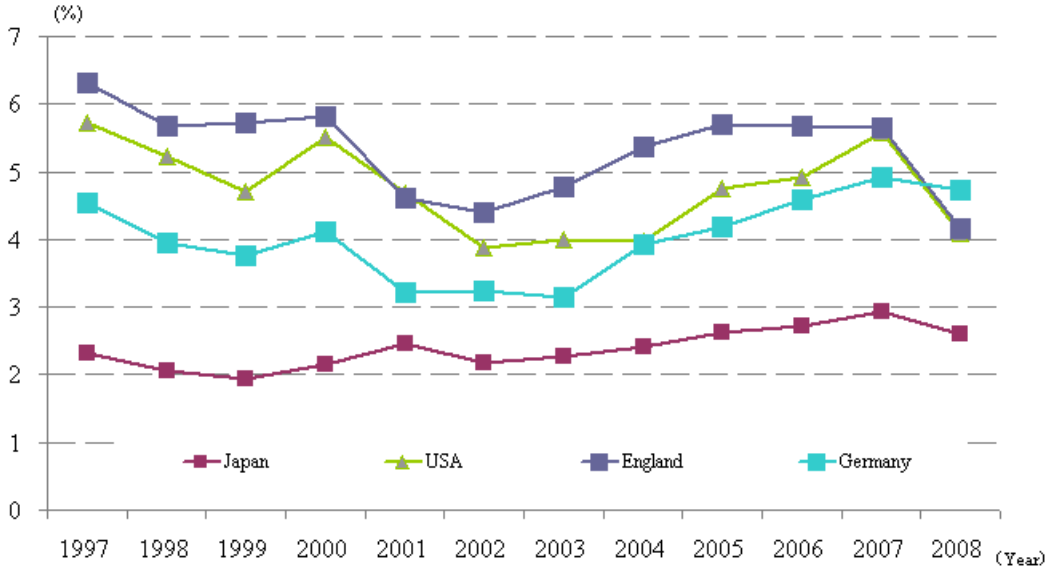
Source: *External trading statistics* (The Ministry of Finance)

Japan's return on cross border investment is lower than the ones of the U.S. and Great Britain, but a little improvement of the return rate would make a great difference in the balance on income because of the large scale of international investment position (see Figure 3-1-1-38).

(a) Japan's international investment position concentrated on the U.S. securities investment

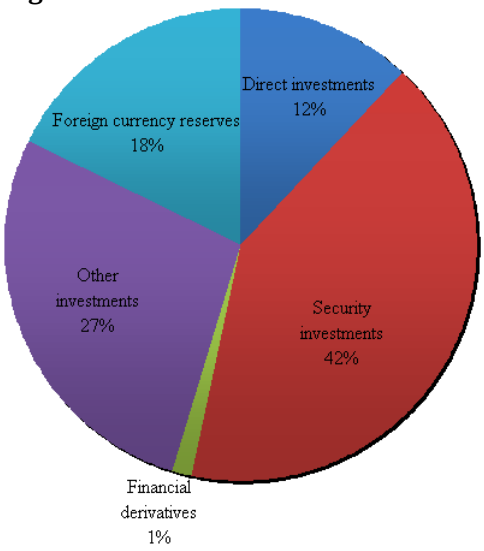
In terms of the types of Japan's international investment, it is concentrated on securities and was 42% of the entire investments in 2008 (see figure 3-1-1-39). Furthermore, if we see Japan's securities investment by countries, the ratios of investment in North America and EU have decreased in 2008 from 2003, but about 70 % of the total securities investment is still in western countries (see Figure 3-1-1-40).

Figure 3-1-1-38 Changes in ratio of return on foreign asset in each country



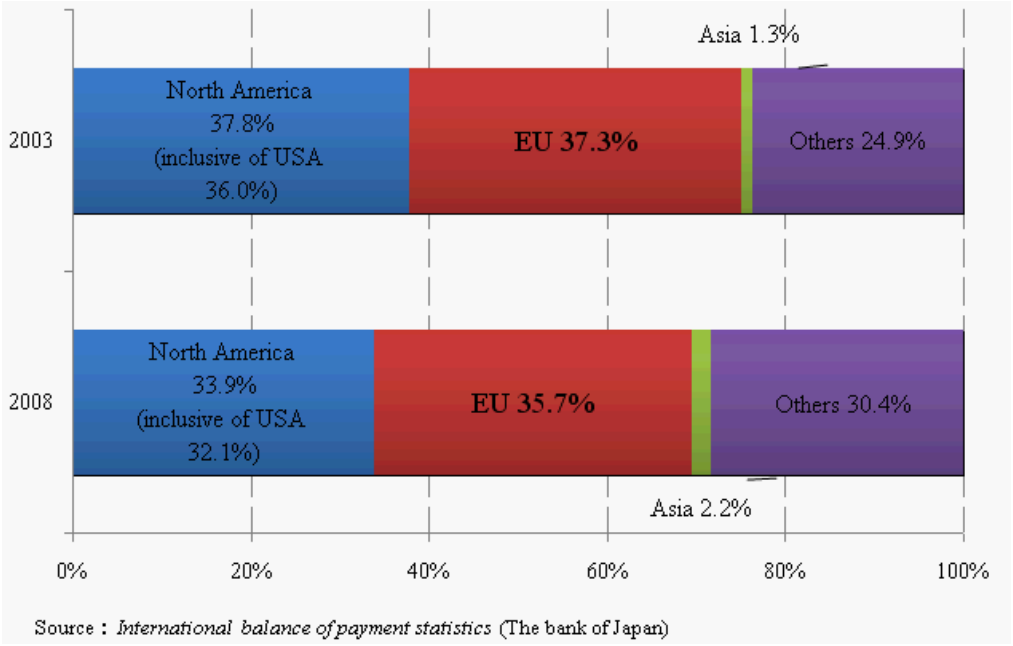
Note: Foreign asset return ratio = Investment revenue/Foreign assets balance
Sources: *International balance of payment statistics*, *Balance of foreign assets and liability statistic* (The Ministry of Finance)
Balance of Payment and International Investment position (The department of commerce - Economic analysis bureau)
Balance of Payments: The Pink Book (The England statistic bureau) and Bundesbank statistics.

Figure 3-1-1-39 Constitution of assets categorized by mode of investments



Source: *International balance of payment statistics* (The bank of Japan)

Figure 3-1-1-40 Structure of Securities Investments by Place of Investment

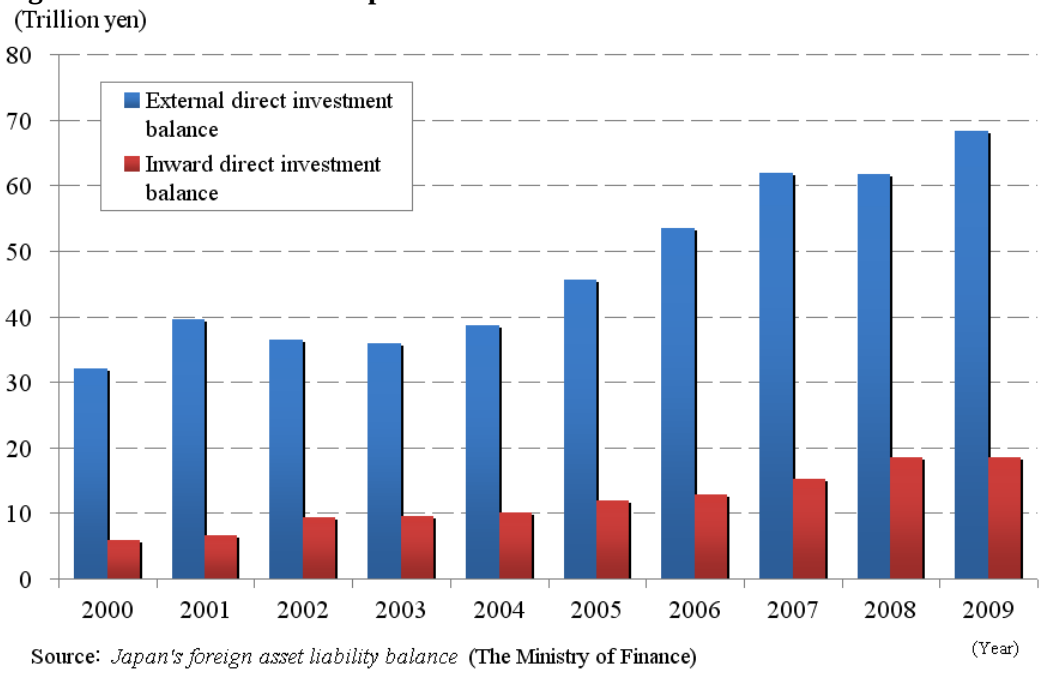


Source : *International balance of payment statistics* (The bank of Japan)

(b) Direct investment

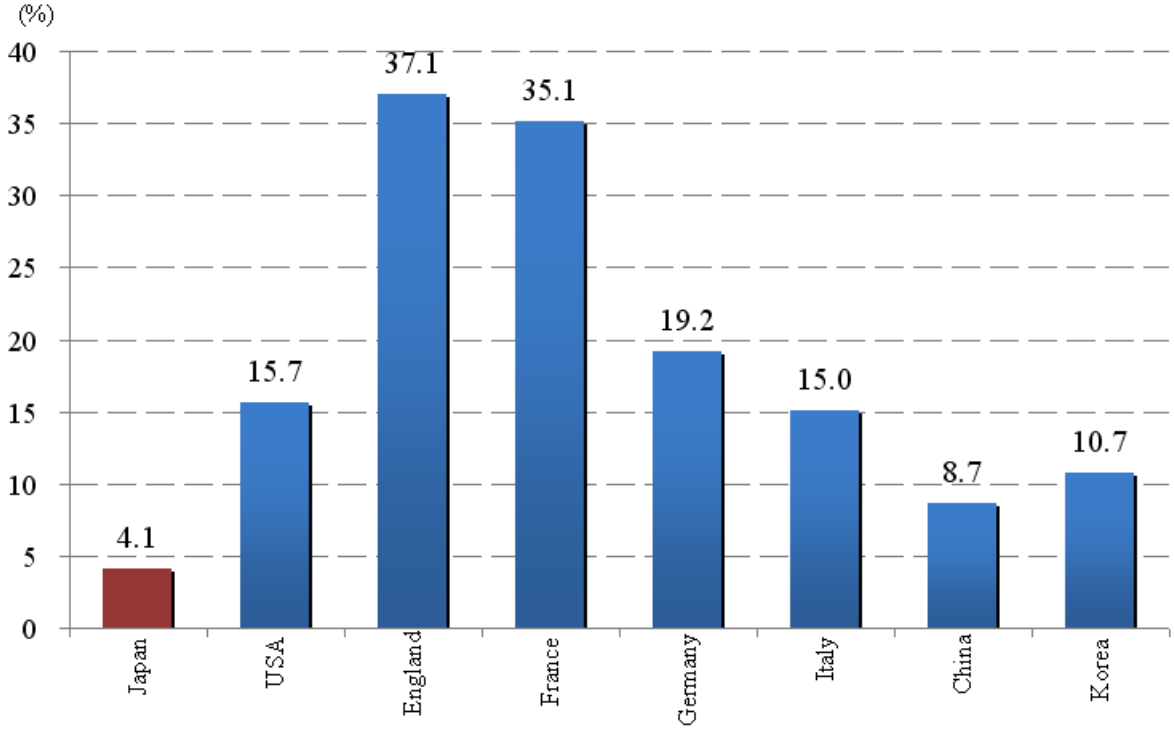
In recent years, Japan's direct investment has been in a trend of expansion, even though its ratio is still low as a type of investment, and both inward and outward direct investments have been increasing yearly. However, inward direct investment is relatively less than outward investment, and the level of our inward direct investment is lower than other countries (see Figure 3-1-1-41 and 3-1-1-42).

Figure 3-1-1-41 Trend of Japan's external and inward direct investment balance



Source: *Japan's foreign asset liability balance* (The Ministry of Finance)

Figure 3-1-1-42 Inward direct investment balance against GDP in each country (2008)



Note: As for the EU member countries, investments from EU countries are included.

Column 23 Inward direct investment

Nippon Roballo Co., Ltd., Hibiki Factory, is in Kita Kyushu-city in Fukuoka. It is a subsidiary of the world largest slewing bearing maker, Rothe Erde Company, which has the main office in Germany. The amount of production is the greatest in Germany followed by Japan, the U.S. and China. In Asia, it has production bases in Japan, China and India. The subsidiary in Japan does business in Korea and South East Asia as well as in Japan. It has 70% share of large-diameter slewing bearing in Japan and expanding the business to be used in wind power generators etc.

One of the attractions of Kyushu is a good access in terms of infrastructure and information. Being close to a port is a must for the heaviness of its products, but one of the determinants was the abundance of talented people. The company actively tries to secure the talent in local community.

The company plans to handle new projects, such as medical equipments like CT scan as well as wind power generators. Many have great expectation in this combination of German technology and talented Japanese workers.

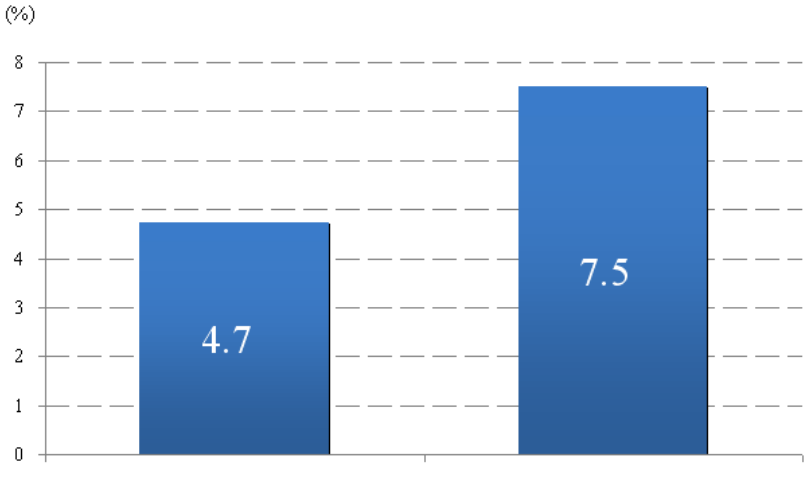
On the other hand, outward direct investment has been increasing steadily and the return on outward direct investment has been rising, too. The average return on outward direct investment in four years from 2000 to 2004 was 4.7% and it rose to 7.5% for the four years from 2005 to 2009 (see Figure 3-1-1-43).

However, when we take a look at Japan's outward direct investment positions and returns by counties and regions, the investment position is concentrated in the U.S. and EU while return rates are better with ASEAN and China. Therefore Japan's investment is not efficient (see Figure 3-1-1-44).

On the other hand, when we look at the fluctuation risk of returns on investment by countries and regions, emerging countries and regions, such as ASEAN, China and Brazil, have higher risks than the U.S. and EU, but they are not conspicuously high (see Figure 3-1-1-45).

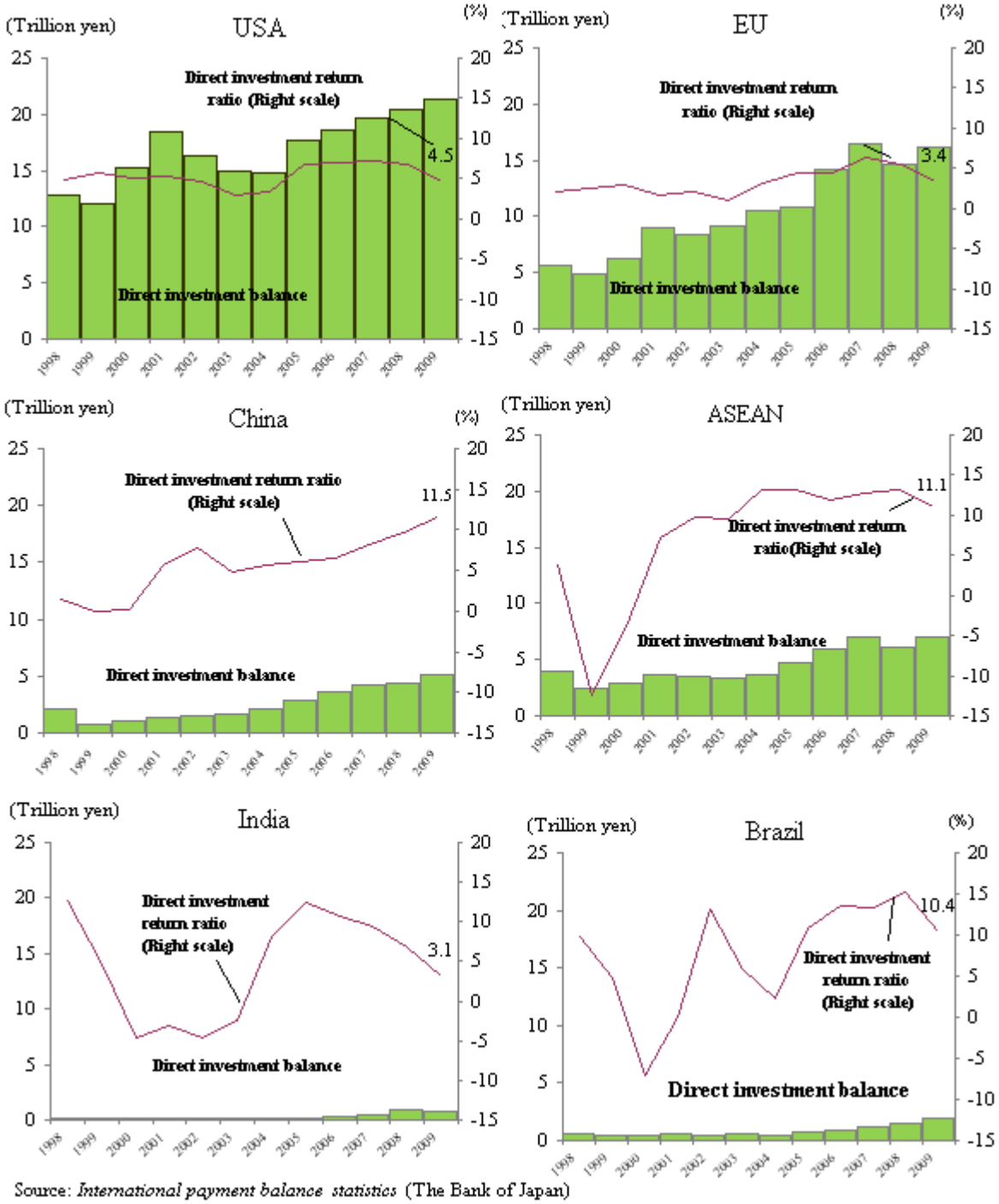
Environment of investments is different depending on the country or industry. We think it is important to find growing regions and field, and transfer investment destinations if necessary.

Figure 3-1-1-43 External direct investment - ratio of return



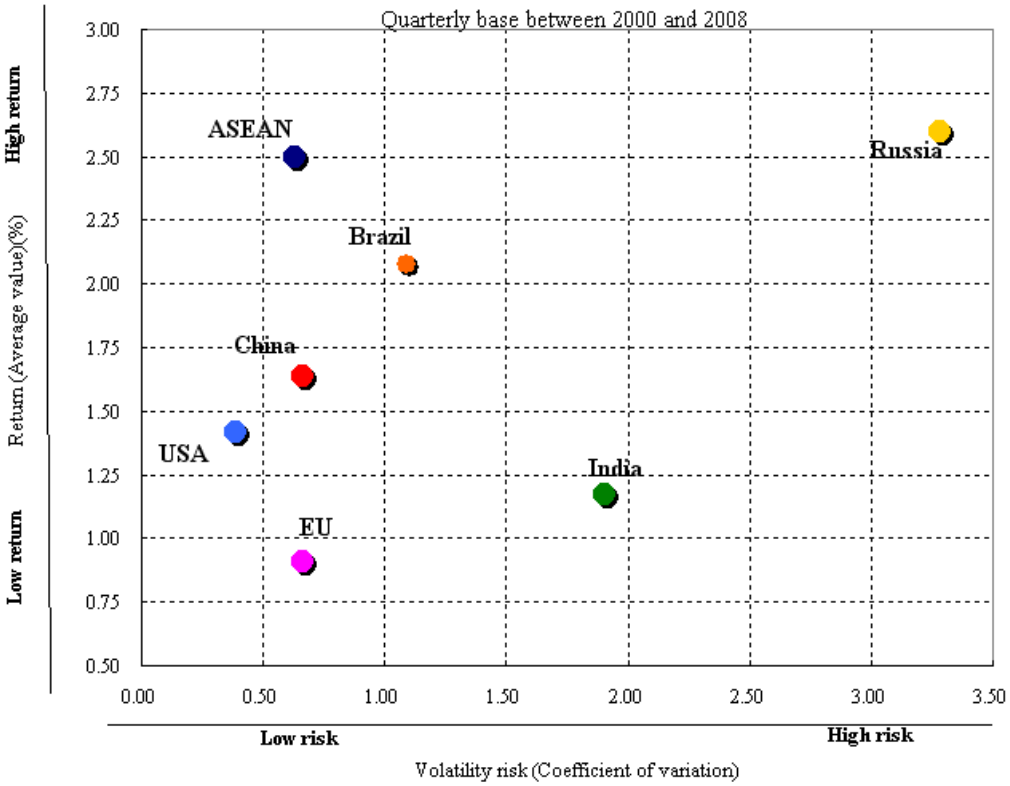
Source: *External asset liability balance* (The Ministry of Finance)
International balance of payment statistics (The Bank of Japan)

Figure 3-1-1-44 Changes in Japan's foreign asset balance and direct investment return ratio by invested country



Source: *International payment balance statistics* (The Bank of Japan)

Figure 3-1-1-45 Japan's risk return characteristics of external direct investments categorized by counterparty country



Note:Based on the quarterly time serial data of external direct investment return ratio of 2000~2008. The volatility risk(Coefficient of variation) was figured out using the following formula: Coefficient of variation= Standard deviation/Averge value
Source: *Statistic of international balance of payment categorized by region* (The Ministry of Finance)
International balance of payment statistic (The Bank of Japan)

(G) Business trend in overseas development

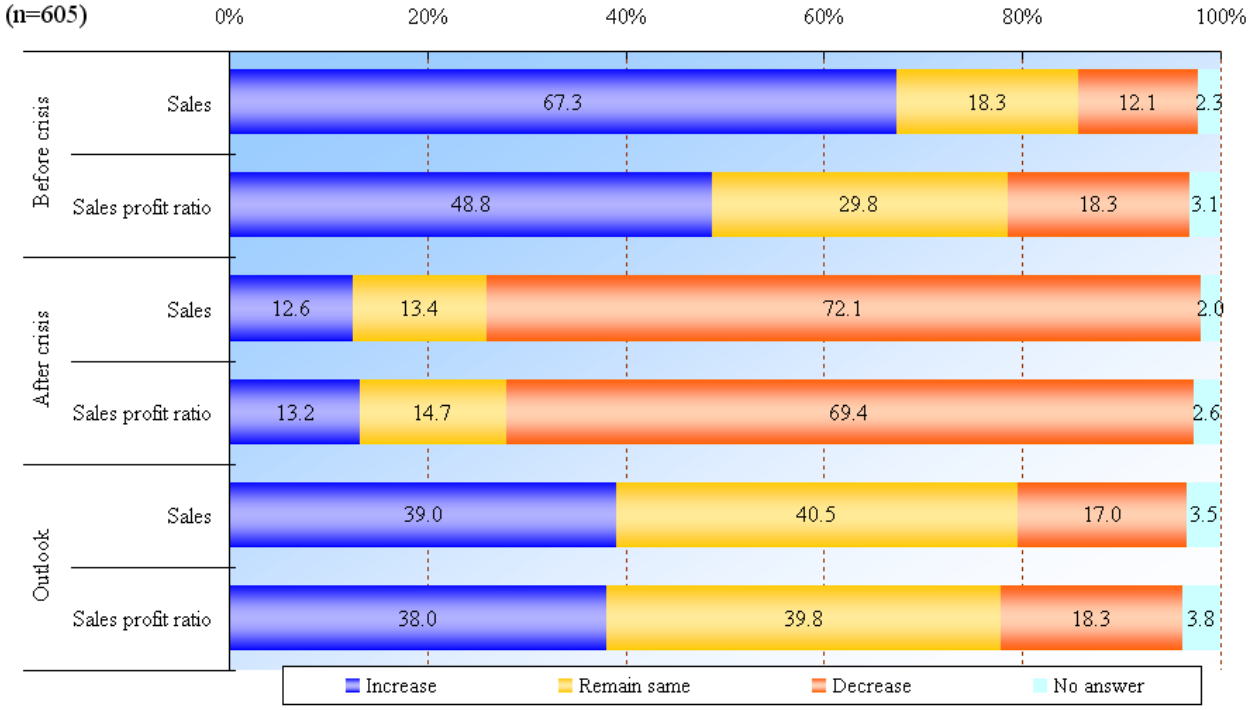
(a) Multi-polarizing overseas development after the global economic crisis

Here, we verify how Japan's direction of overseas development changed after the global economic crisis (after the fiscal year of 2008) and how we foresee the future (for about three years) from the survey conducted by Japan Economic Foundation.

Japan's business performance has been significantly deteriorated by the global economic crisis. However, the perspective on the future performance has been in a trend of recovery (see Figure 3-1-1-46). In addition, when we see countries and regions where current overseas sales are high, and the ones where future sales are predicted to be high, even though many companies predict sales expansion in North America, the expectation is not so high and so is Europe.

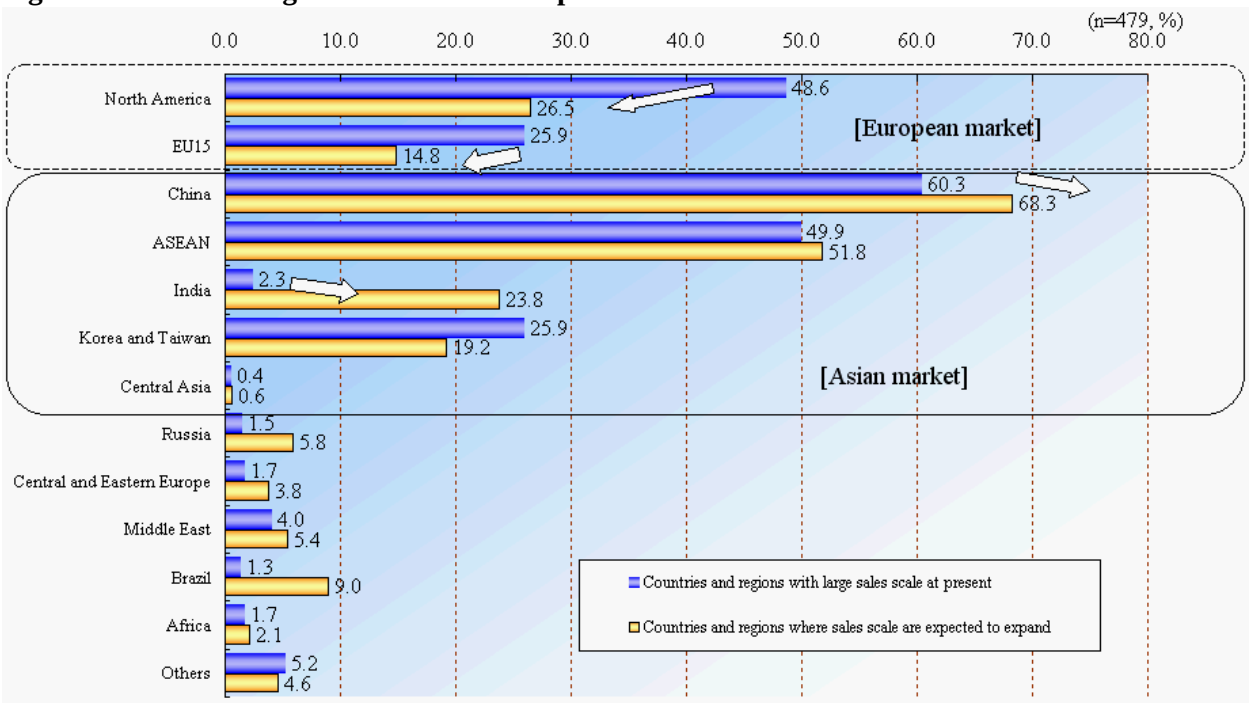
On the other hand, many businesses predict sales expansion in China and ASEAN. Moreover, there are many companies, which anticipate India to increase sales as much as North America (see Figure 3-1-1-47). Japanese businesses have been suffering from demand reduction and slow recovery of western markets as well as the domestic market's maturity and slump. They re-recognize the importance of western market, where they can secure profits, but also multi-polarize their target to emerging countries, where we expect expansion of the sales scale.

Figure 3-1-1-46 Changes in sales and profit before and after the world economic crisis



Note: The sum is not necessarily be a 100% due to round-off calculations.
Source: *Reserch on multilateral trading rules of the future* (The foundation of international economics)

Figure 3-1-1-47 Changes in sales volume at present and in the future



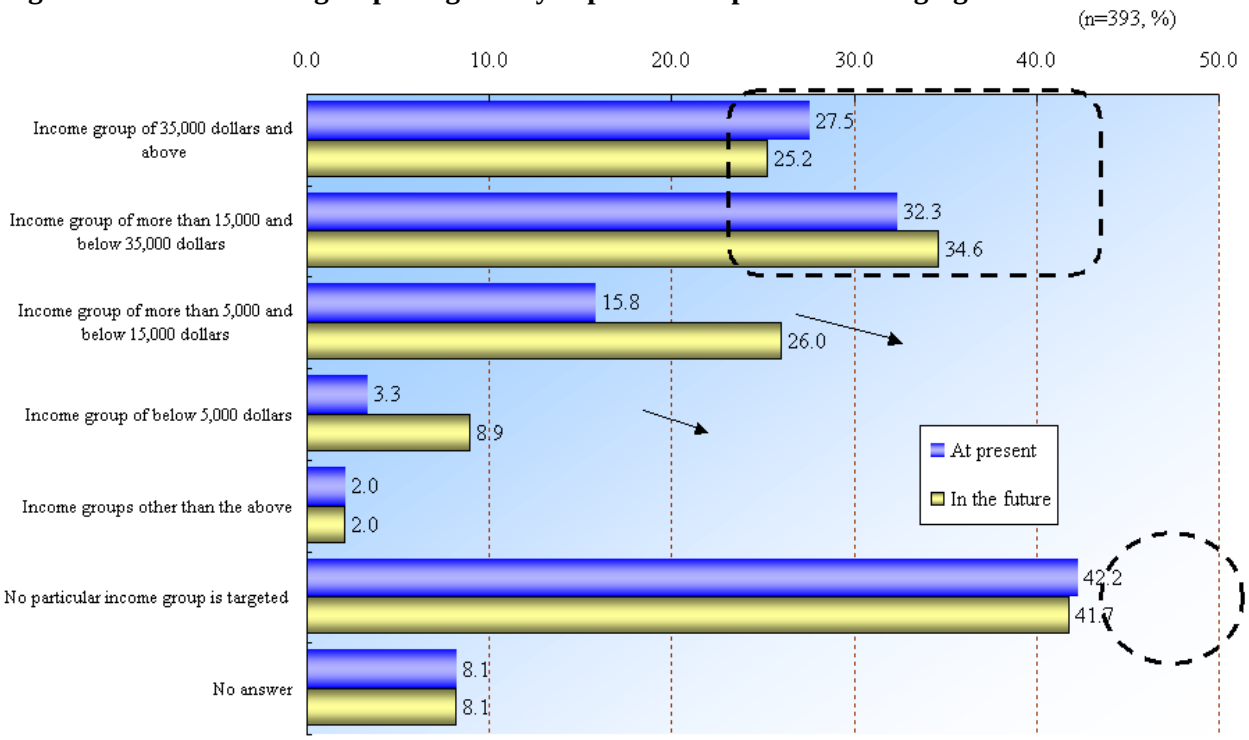
Note : The sum is not necessarily be a 100% due to round-off calculations.
Source: *Research on multilateral trading rules of the future* (The foundation of international economics)

Let's take a look at Japanese companies' targets by income bracket in the markets of emerging countries. Companies that target lower middle class, which disposable income per household is from 5,000 dollars

to less than 15,000 dollars, and upper-middle class, which disposable income per household is from 15,000 dollars to less than 35,000 dollars, are increasing from 32.6% at present to 34.6% in the future and from 15.8% at present to 26.0% in the future, respectively. We can see the trend that Japanese businesses' aim toward middle classes in the future (see Figure 3-1-1-48). Middle class of emerging countries is rapidly expanding the scale. Population of middle class (Disposable income: from 5,000 dollars to less than 35,000 dollars) in the emerging countries[22]was 1.54 billion in 2009 and is estimated to become 2.86 billion by 2020.

On the other hand, high percentage of companies shows interest in targeting upper-middle class (Disposable income: from 15,000 dollars to less than 35,000 dollars) and high class (35,000 dollars and more) in the future as well as at present. Japanese businesses do not necessarily intend to abandon upper-middle class and high class from their target mix, but rather secure the market, then add lower-middle class to make and aim the best mix of markets. Moreover, high-class population is expected to increase to about 600 million in the markets of advanced countries[23] and to reach about 500 million in the markets of emerging countries (see Figure 3-1-1-50).

Figure 3-1-1-48 Income groups targeted by Japanese companies in emerging markets



Note: The sum is not necessarily be a 100% due to round-off calculations.
Source: *Research on multilateral trading rules of the future* (The foundation of international economics)

(b) Production base development to market development

In terms of the approach (attitude) toward market developments in emerging countries, more than 70% of the companies that are developing their businesses in overseas have positive intensions (see Figure 3-1-1-51).

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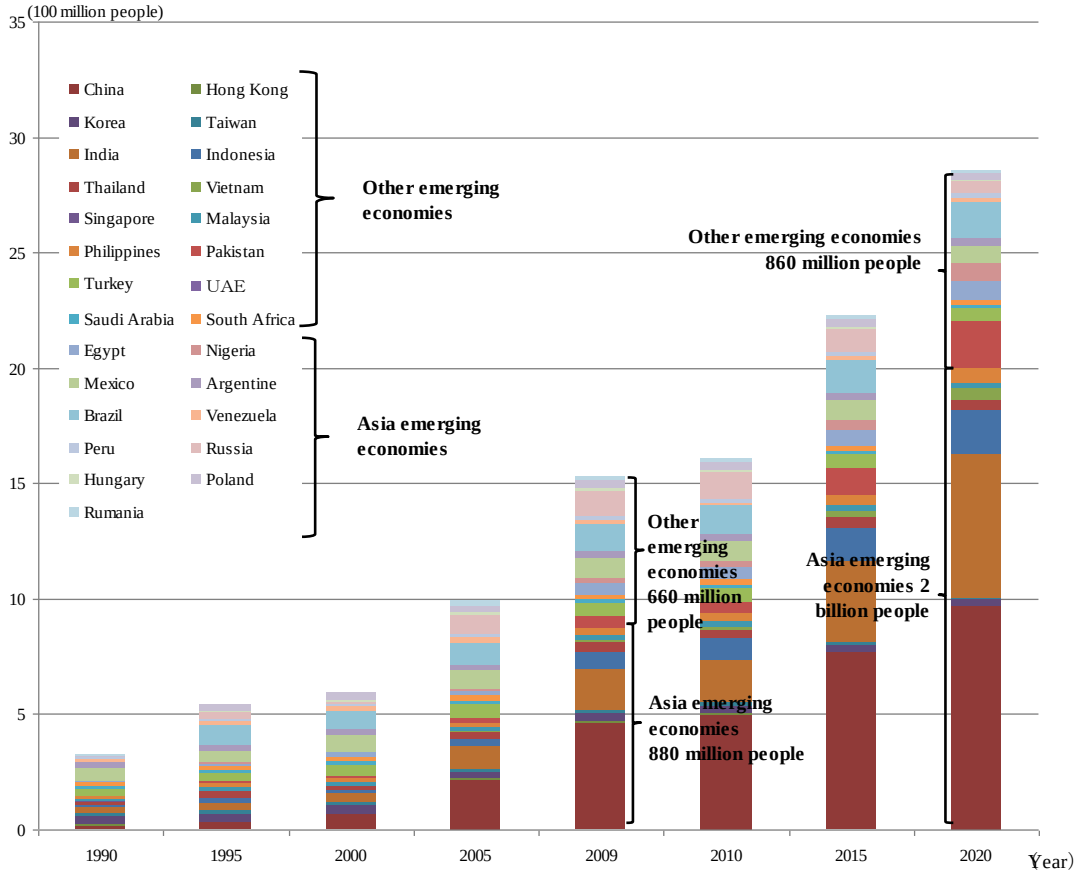
[22] Here, considering economic scale and data restrictions, the data of emerging countries are collected from following 27 subject countries and regions: China, Hong Kong, Korea, Taiwan, India, Indonesia, Thai, Vietnam, Singapore, Malaysia, Philippine, Pakistan, Turkey, United Arab Emulates (UAE), Saudi Arabia, South Africa, Egypt, Nigeria, Mexico, Argentina, Brazil, Venezuela, Peru, Russia, Hungary, Poland and Rumania.

[23] Here, the subject countries are the following G7 countries: U.S.A, Canada, Great Britain, Germany, France, Italy and Japan.

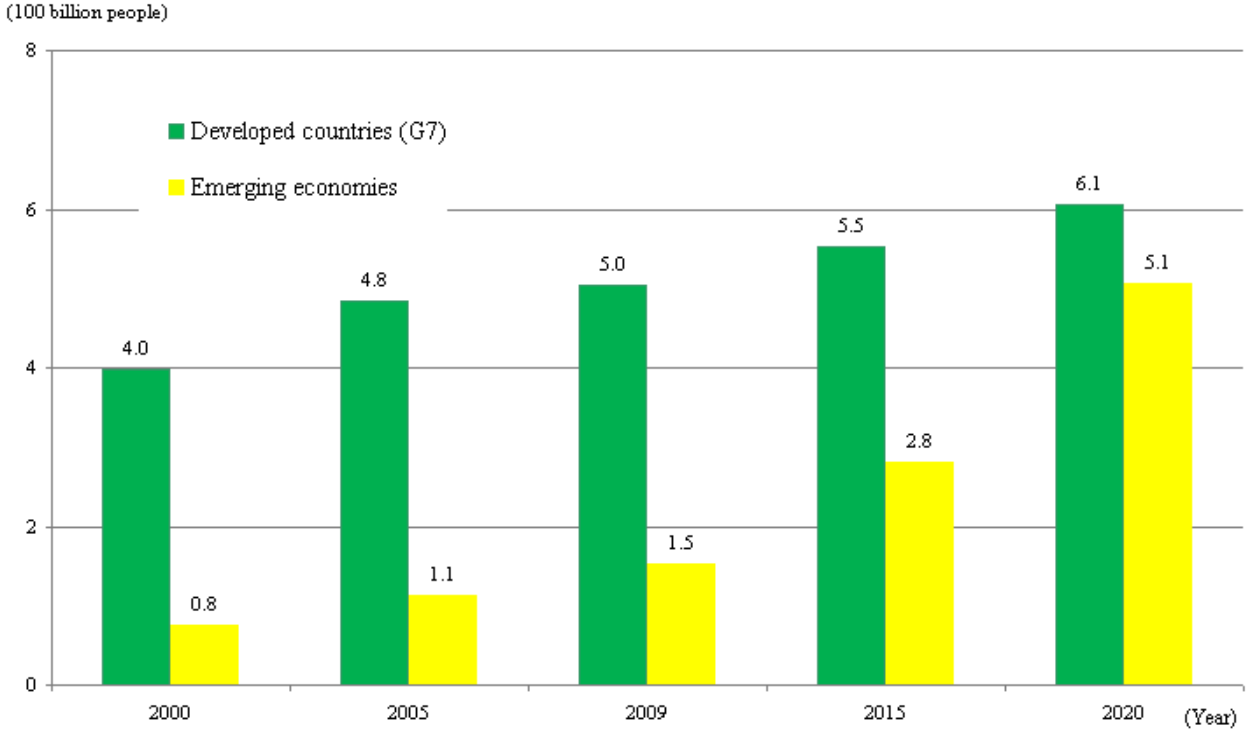
Many company list “China”, “ASEAN” and “North America” as their current direct investment destinations, but they list “India” addition to “ASEAN” and “China” as their new investment destinations from now (see Figure 3-1-1-52).

Figure 3-1-1-49 Changes in middle income group in emerging economies



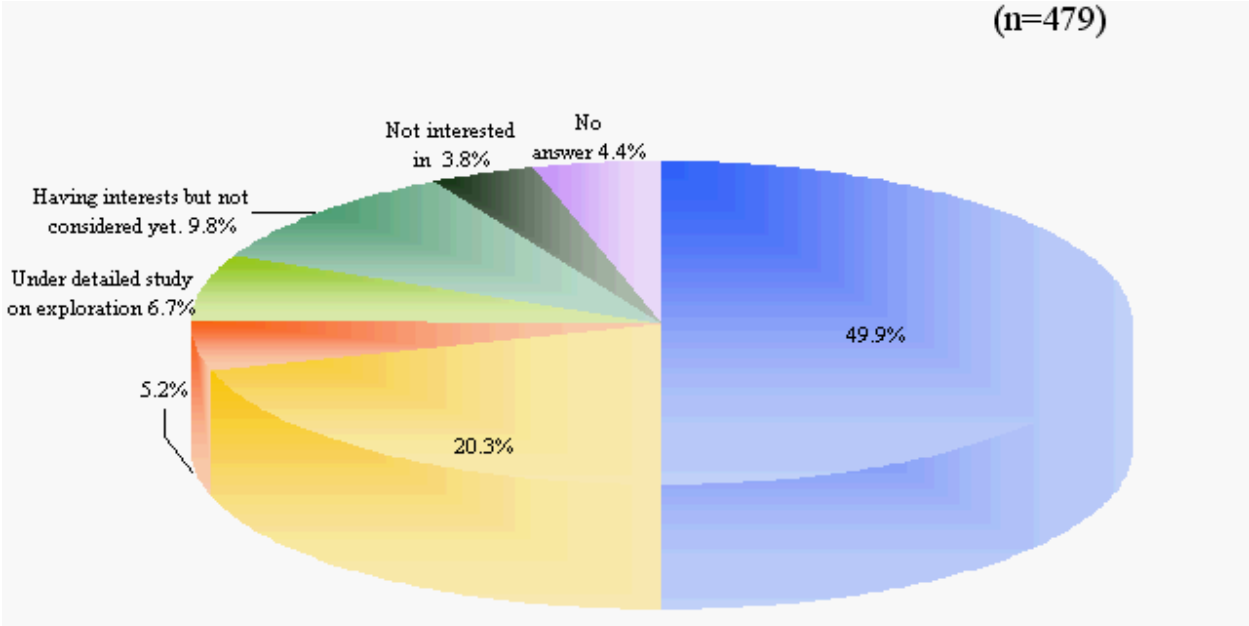
Note: Household population categorized by household disposable income. House household ratio for each income group x population
Brazil and Russia are not included in the 1990 population.
Source: *Euromonitor International 2010*

Figure 3-1-1-50 Changes in and outlook of high class income group in developed countries (G7) and emerging economies



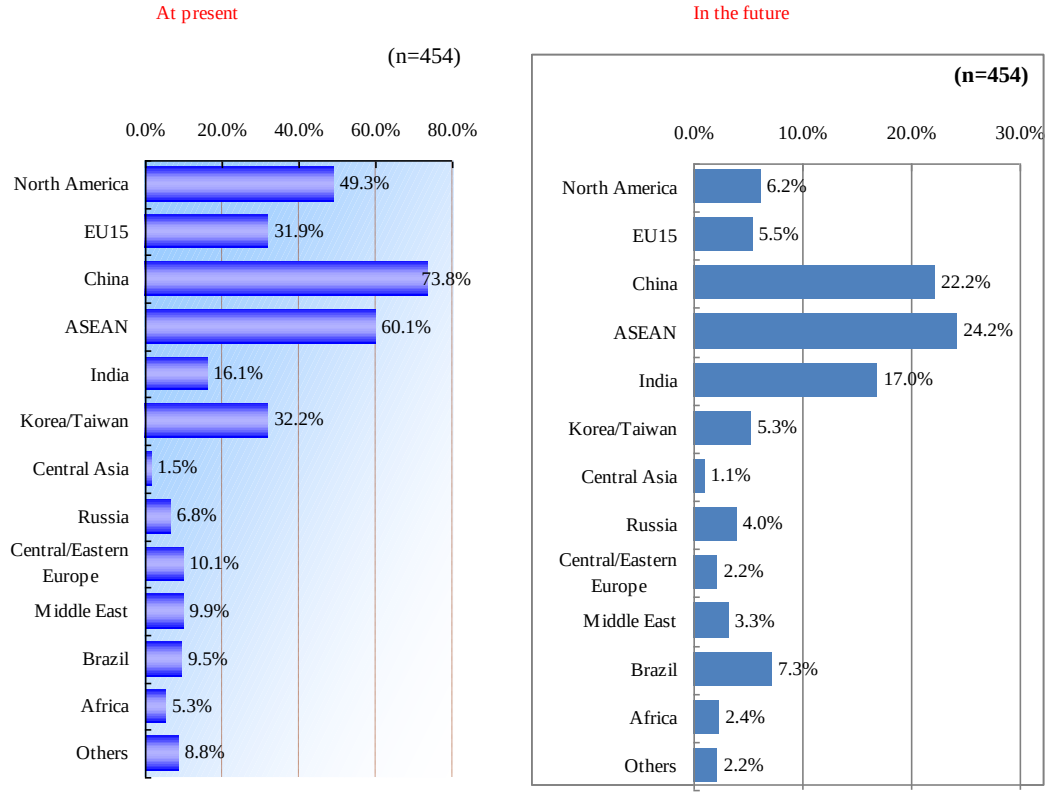
Note: Household population categorized by household disposable income. Household ratio for each income group x population.
Year 2015 and 2020 are estimates by Euromonitor
Source : *Euromonitor International 2010*

Figure 3-1-1-51 Initiative aiming at exploration of emerging markets which are anticipated to grow in the future



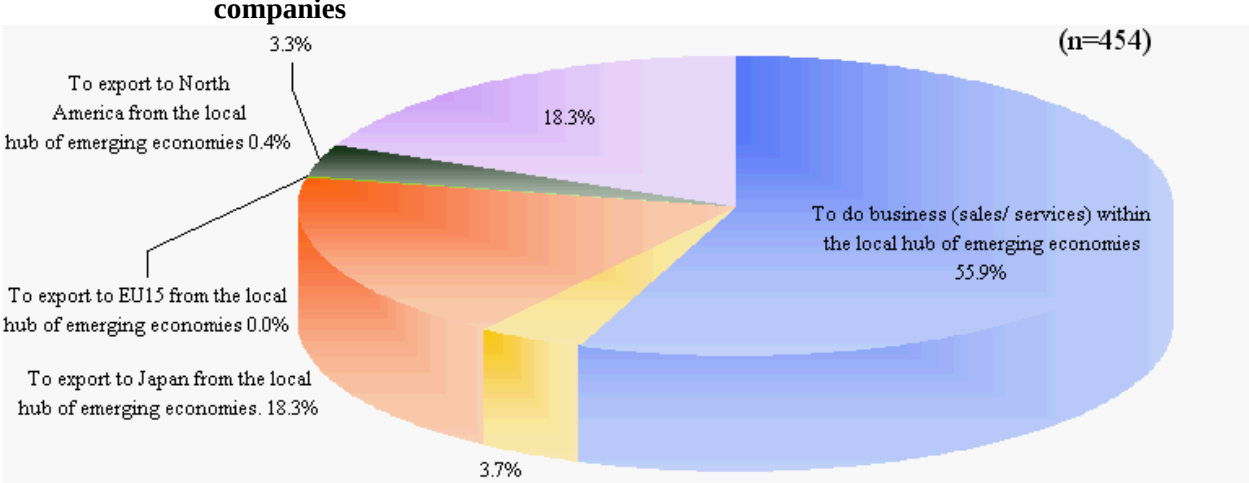
Note: The sum is not necessarily be a 100% due to round-off calculations.
Source: *Research on multilateral trading rules of the future* (The foundation of international economics)

Figure 3-1-1-52 Countries in which Japanese companies invest in direct



Source: *Research on multilateral trading rules in the future* (The foundation of international economics)

Figure 3-1-1-53 Purpose of the direct investments in emerging economies/regions by Japanese companies



Note: The sum is not necessarily be a 100% due to round-of f calculations.

Source: *Research on multilateral trading rules of the future* **(The Foundation of international economics)**

The purpose of direct investment in emerging countries and regions are as follows: More than half, 55.9%, was "To be able to sell our product or provide service in the emerging country, where our

production base is." followed by "To export our products that are made in the emerging country to Japan." 18.3% (see Figure 3-1-1-53). Business developments in the emerging countries used to function mainly as manufacturers' supply and production bases. However, their purpose has been shifting toward market development in the emerging country.

(c) Overseas development of businesses for domestic demand

Additionally, companies that used to be considered as businesses for domestic demand, such as food, retail and services, are becoming more active on overseas business development to catch the foreign demand. According to the Basic Survey of Overseas Business Activities in 2008, number of non-manufacturing companies that has local subsidiary in overseas increased by more than 2,000 companies (31.4%) between 2002 and 2007 (see Figure 3-1-1-54). When we check the ratio change in overseas sales of non-manufacturing companies on the surveys of Japan Economic Foundation, although it is not as much as manufacturing businesses, it has been increasing since 1990. It is showing that overseas development has been steadily progressing (see Figure 3-1-1-55).