THE OUTLOOK OF FOREIGN DIRECT INVESTMENT BY JAPANESE MANUFACTURING COMPANIES - PROSPECTS OF OVERSEAS BUSINESS OPERATIONS AFTER THE ASIAN ECONOMIC CRISIS -

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The purpose of this survey is to identify the current and future trends of foreign direct investment by Japanese manufacturing companies. This year's survey, taken over from the Research Institute for International Investment and Development under the former EXIM Japan, is the eleventh of an annual series that began in 1989.

This year's survey examines, as a special topic, the prospect of business recovery and investment strategy after the Asian economic crisis, as perceived by Japanese manufacturing companies with affiliates in ASEAN4 (Thailand, Indonesia, Malaysia, the Philippines) and Korea.

Given growing interest in the overseas business operations of middle-ranked and small- and medium-sized enterprises (SMEs: companies with a capital of less than 1 billion yen) in recent years, distinct characteristics in overseas operations in this group are also examined in the Appendix.

EXECUTIVE SUMMARY

1. PROJECTED FDI FOR FY1999 AND MEDIUM-TERM OUTLOOK OF JAPANESE MANUFACTURING COMPANIES.

- According to the survey respondents, projected foreign direct investment (FDI) in FY 1999 is down 18.3% compared with actual figures in FY 1998, showing a consecutive decline from the previous year's survey. The decline in the amount of FDI is largely due to the factor that "an adequate number of overseas bases have been set up for now".
- Although FDI shrinks in amount, very few companies have plans to "roll back" their existing bases. The companies that have "plans to undertake FDI over the medium term (of three years)" account for about 70%, a similar figure as was seen in the previous surveys. This implies that a majority of companies has intentions to sustain overseas operations over the forthcoming years. Over the medium-term, the companies have plans to gradually raise their overseas production ratio.
- Having already set up a great number of overseas bases, Japanese manufacturing companies are putting more emphasis on "the expansion of the existing production/sales bases" rather than "the establishment of new production/sales bases." This trend is particularly prominent in the operation of Asia.

2. OVERSEAS BUSINESS ACTIVITIES OF JAPANESE MANUFACTURING COMPANIES AFTER THE ASIAN ECONOMIC CRISIS (ASEAN4 AND KOREA)

- As a whole (averaging across the five countries of ASEAN4 and Korea), Japanese manufacturing companies anticipate that their affiliates affected by the Asian economic crisis would surpass the pre-crisis level in sales and profits around FY 2002 and FY 2004 respectively. By industry, companies in chemicals and textiles foresee favorable prospects, while automobiles (assembled vehicle) and general machinery are facing a tough situation. More or less affiliates in the five countries are experiencing a smooth recovery of sales and profits. Even in Indonesia, which is viewed with some concern because of the delay in economic recovery, expectations are equally high for the recovery of both sales and profits.

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- When asked about investment strategy after the Asian economic crisis, most companies respond that they would "maintain overseas bases" or "strengthen overseas bases." Only a slight share of companies responds that they would "decrease overseas bases or shift their focus to other regions." Of those responded "strengthen overseas bases," a predominant share of companies cites "expansion of the existing facilities." This is followed by "diversification of product lines" and "strengthening of sales bases." These findings indicate that they would continue to strengthen business activities in Asia.

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OVERVIEW OF THE SURVEY METHOD AND PROFILE OF RESPONDENT COMPANIES

1. SURVEY METHOD

This survey covered 786 Japanese manufacturing companies that have three or more overseas affiliates, including at least one production base as of the end of October 1998. The questionnaire was mailed out on July 1, 1999. 472 valid responses were received from July to August. The effective response rate is 60.1%, the largest figure in the past series of the survey. (The previous year's survey covered 749 manufacturing companies, receiving 455 valid responses, or the effective response rate of 60.7%.) (Table I-1-1)

"Overseas affiliates" in this survey are defined as the first-tier overseas affiliates, or companies incorporated overseas in which Japanese parent companies have 10% or more equity stake, and the second-tier overseas affiliates, or companies incorporated overseas in which the first-tier Japanese overseas affiliates have more than 50% equity stake.

2. PROFILE OF RESPONDENT COMPANIES

The number of overseas affiliates owned by the 472 companies amounts to 7,225[1], half of which (3,558) are production bases. A breakdown of production bases by region shows that 927 affiliates (26.1%) are located in ASEAN4[2], 677 (19.0%) in US-Canada, 628 (17.7%) in China, 525 (14.8%) in NIES[3], 384 (10.8%) in EU, and 127

1 According to the database of the Toyo Keizai Shimpo Inc., the number of overseas affiliates owned by the Japanese manufacturing companies in the whole world stood at 13,353 as of the end of October 1997.
2 ASEAN4: Thailand, Indonesia, Malaysia, and the Philippines
3 NIES: Korea, Taiwan, Hong Kong, and Singapore

affiliates (3.6%) in other Asian countries (including India and Viet Nam). Over 60% of the overseas production bases are located in the Asian region.

The number of the companies with a capital of more than ¥1 billion is 372 (78.9%), while those having more than 1,000 employees amount to 278 (58.9%).

Breakdown by industry shows that the following three industries constitute 48.9% of the total: electrical equipment and electronics (87 companies), automobiles (76 companies), and chemicals (68 companies) (Table I-2-1 to Table I-2-5).

Table I-1-1 Outline of Respondent Companies

(Unit: No. of companies, %)

	FY89	FY90	FY91	FY92	FY93	FY94	FY95	FY96	FY97	FY98	FY99
Number of companies surveyed	437	506	551	614	652	700	718	722	743	749	786
Number of companies responded	247	277	298	314	338	382	422	432	445	455	472
Response rate	56.5	54.7	54.1	51.1	51.8	54.6	58.8	59.8	59.9	60.7	60.1
Number of overseas affiliates	3,950	4,594	4,617	5,269	5,428	5,385	6,496	6,730	6,978	6,654	7,225

Table I-2-1 Paid-in Capital of Respondents

			No. of Companies	%
	<	¥100 million	35	7.4%
¥100 million	<	¥500 million	46	9.7%
¥500 million	<	¥1 billion	19	4.0%
¥1 billion	<	¥5 billion	101	21.4%
¥5 billion	<	¥10 billion	65	13.8%
	> =	¥10 billion	206	43.6%
Total			472	100.0%

Table I-2-2 Annual Sales of Respondents

			No. of Companies	%
	<	¥50 billion	206	43.8%
¥50 billion	<	¥100 billion	73	15.5%
¥100 billion	<	¥200 billion	62	13.2%
¥200 billion	<	¥300 billion	38	8.1%
¥300 billion	<	¥500 billion	30	6.4%
¥500 billion	<	¥1,000 billion	30	6.4%
	> =	¥1,000 billion	31	6.6%
Total			470	100.0%

Note: Two companies don’t respond this figure.

Table I-2-3 Number of Employees of Respondents

				No. of Companies	%
	< =	300	people	58	12.3%
301	to	500		41	8.7%
501	to	1,000		95	20.1%
1,001	to	2,000		97	20.6%
2,001	to	5,000		102	21.6%
5,001	to	10,000		40	8.5%
10,001	to	30,000		29	6.1%
	> =	30,001		10	2.1%
Total				472	100.0%

Table I-2-4 Number of Respondents by Industry

Industry	No. of Companies
Foodstuffs	25
Textiles	18
Chemicals	68
Petroleum & rubber	14
Ceramics, cements, & glass	15
Steel	17
Nonferrous metals	16
Metal products	23
General machinery	44
[Assembled product]	33
[Components]	11
Electrical equipment & electronics	87
[Assembled product]	30
[Components]	57
Automobiles	76
[Assembled vehicle]	12
[Components]	64
Precision Machinery	19
Others	50
Total	472

TableI-2-5 Number of Overseas Affiliates by Type of Base/Region

	NIES	ASEAN4	China	Other Asian Countries	US-Canada	Latin America	EU	Former Soviet Union and Eastern Europe	Central Europe	Others	Total
Production bases	525	927	628	127	677	190	384	8	18	74	3,558
(Joint venture)	297	589	484	102	168	67	102	5	6	32	1,852
Sales bases	559	253	135	41	580	122	790	34	28	135	2,677
R&D bases	18	17	10	3	90	4	38	0	0	4	184
Others	112	80	35	6	286	49	186	4	5	43	806
Total	1,214	1,277	808	177	1,633	365	1,398	46	51	256	7,225

Note: NIES: Singapore, Korea, Taiwan, Hong Kong
ASEAN4: Thailand, Malaysia, the Philippines, Indonesia
Central Europe: Poland, Hungary, Czech, Slovakia

II. PROJECTED FDI FOR FY1999 AND OVERSEAS BUSINESS PERFORMANCE

1. ACTUAL FDI IN FY 1998 AND PROJECTED FDI FOR FY 1999

The projected foreign direct investment in FY 1999 is down 18.3% from the actual record in FY 1998 (out of 383 companies providing both figures of FY 1998 and FY 1999). Since the previous year's survey also registered a 23.4% decline in the projected investment for FY 1998, this trend marks a decrease for two consecutive years[4]. Few companies, however, are in a position of a negative retreating attitude. As shown by Table II-1-1, companies having withdrawn since FY 1997 do not add up a significant number across all the regions (Table II-1-2).

Although a decline of the projected FDI continues in nearly all industries including automobiles (assembled vehicle and components), electrical equipment & electronics (assembled product), and chemicals, there is an exceptional case of the rebound of the projected FDI (40.2%) in electrical equipment and electronics (components).

By region[5], the projected FDI for FY1999 decreases

Table II-1-1 Rates of Increase in Projected FDI, Changing Pattern Over Time

	Rates of Increase of Projected FDI in the Past Surveys
FY 1993 Survey	▲ 25.2
FY 1994 Survey	9.3
FY 1995 Survey	33.4
FY 1996 Survey	39.1
FY 1997 Survey	1.4
FY 1998 Survey	▲ 23.4
FY 1999 Survey	▲ 18.3

Table II-1-2 Numbers of Overseas Existing Affiliates and Withdrawn Affiliates

(Unit: affiliates)

	All Regions	NIES	ASEAN4	China	Other Asian Countries	US-Canada	Latin America	EU	Others
Overseas existing affiliates (as of this survey)	7,225	1,214	1,277	808	177	1,633	365	1,398	353
Overseas withdrawn affiliates (since July, 1997)	127	25	24	11	9	29	8	39	6

4 Although excluded from this survey, there was an extraordinarily large-scale FDI of an acquisition project by a Japanese cigarette company for U.S. company's overseas cigarette business in FY 1999. According to the press release, the investment totaling ¥950 billion would be registered for this fiscal year. Because of the special nature of the acquisition project, we have decided not to include the case of this investment in our survey.

5 Percentages here are based on the companies that replied regional breakdown as well as actual FY1998 and projected FY1999 figures.

across all of the regions with the exception of EU. A modest 8.5% increase in EU is seen due to a rise of FDI in automobiles (assembled vehicle) and electrical equipment and electronics (components) (Figures II-1-1, II-1-2).

The industry composition of FDI over time shows that automobiles has continued to account for the largest share. Of the projected FDI for FY 1999 by automobiles, roughly 50% is directed to US, followed by some 20% to EU (Figure II-1-3).

2. FDI AND DOMESTIC CAPITAL INVESTMENT

The projected growth of total investment (FDI plus Domestic Capital Investment) over the actual level of the previous year reached a peak in FY 1995. In FY 1998, it plunged into the negative range, and

Figure II-1-1 Actual Figure in FY 1998 and Projection for FY 1999 by Industry

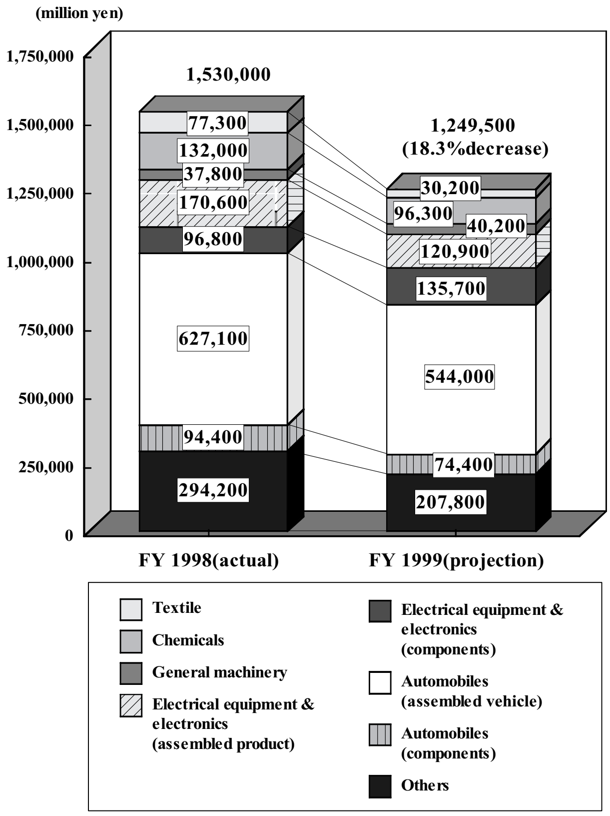


Figure II-1-2 Actual Figure in FY 1998 and Projection for FY 1999 by Region

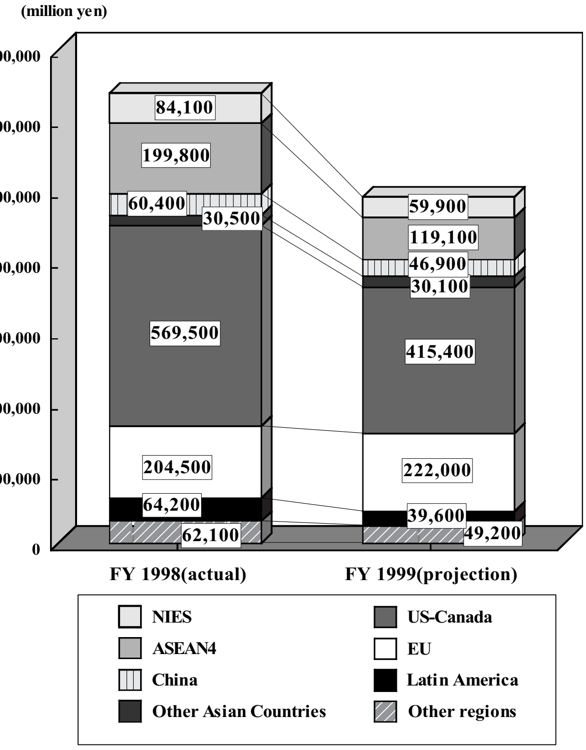
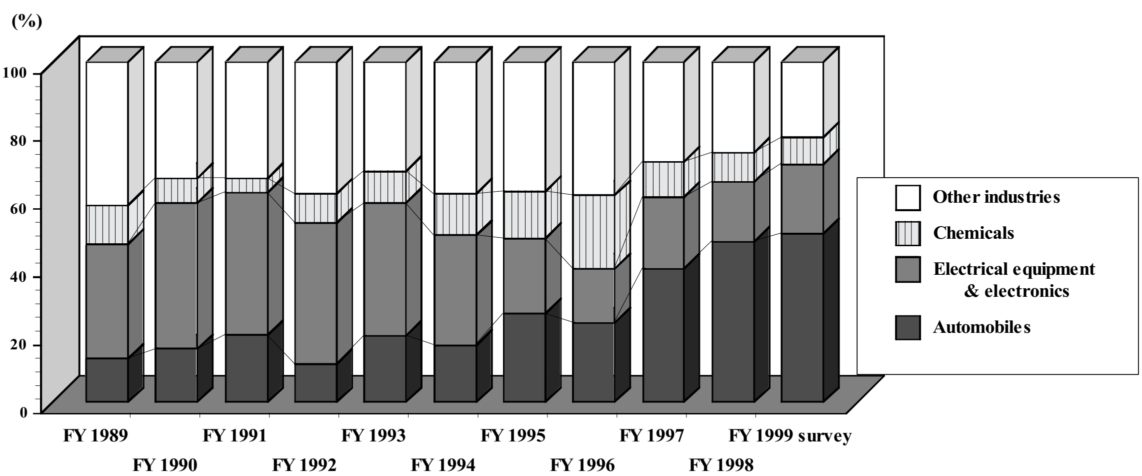


Figure II-1-3 Industry Composition of FDI, Changing Pattern over Time

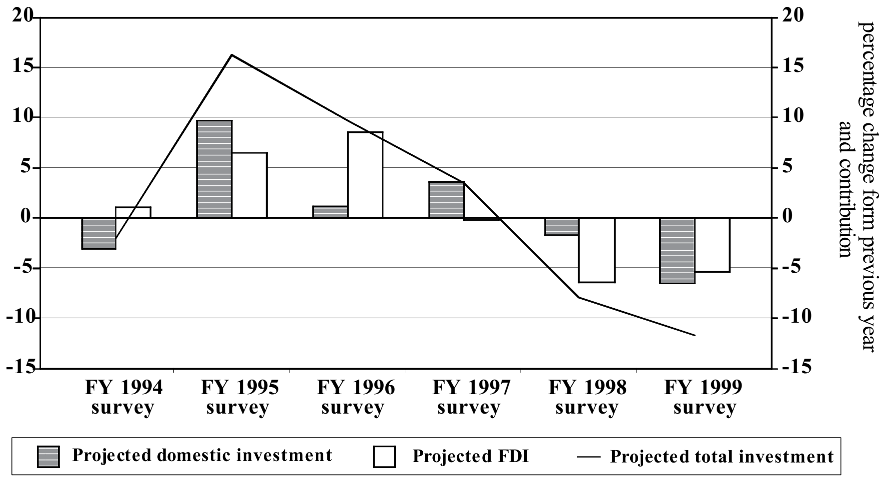


* FY 1989 ~ FY 1998: Actual composition
FY 1999: Projected composition

the consecutive decline is also seen in this year's survey.

When the projected growth of total investment is broken down into the relative contribution of FDI and Domestic Capital Investment, FDI contributes more to a decline in the total projected investment than Domestic Capital Investment in the previous year, showing that a decline in FDI led the overall trend. In this year's survey, however, both factors contributed equally to the drop in the total investment (Figure II-2-1).

Figure II-2-1 Contributions of FDI and Domestic Investment to the Total Investment Growth, Changing Pattern over Time



3. SELF-EVALUATION OF OVERSEAS BUSINESS PERFORMANCE

Figures II-3-1 and II-3-2 show the self-evaluation of respondent companies in respect of profitability, sales, localization and overall performance in the selected regions and countries. The diamond-graphs indicate the performance of the previous year in comparison with the initial target. The Self-evaluation is based on a 5-point scale, ranging from "1. insufficient" to "5. fairly sufficient," with 3 and above indicating increasing degrees of sufficiency. The scores are averages of the responses. Broken and solid lines respectively denote the results of the previous and this year's survey. Performance by region and country is described below.

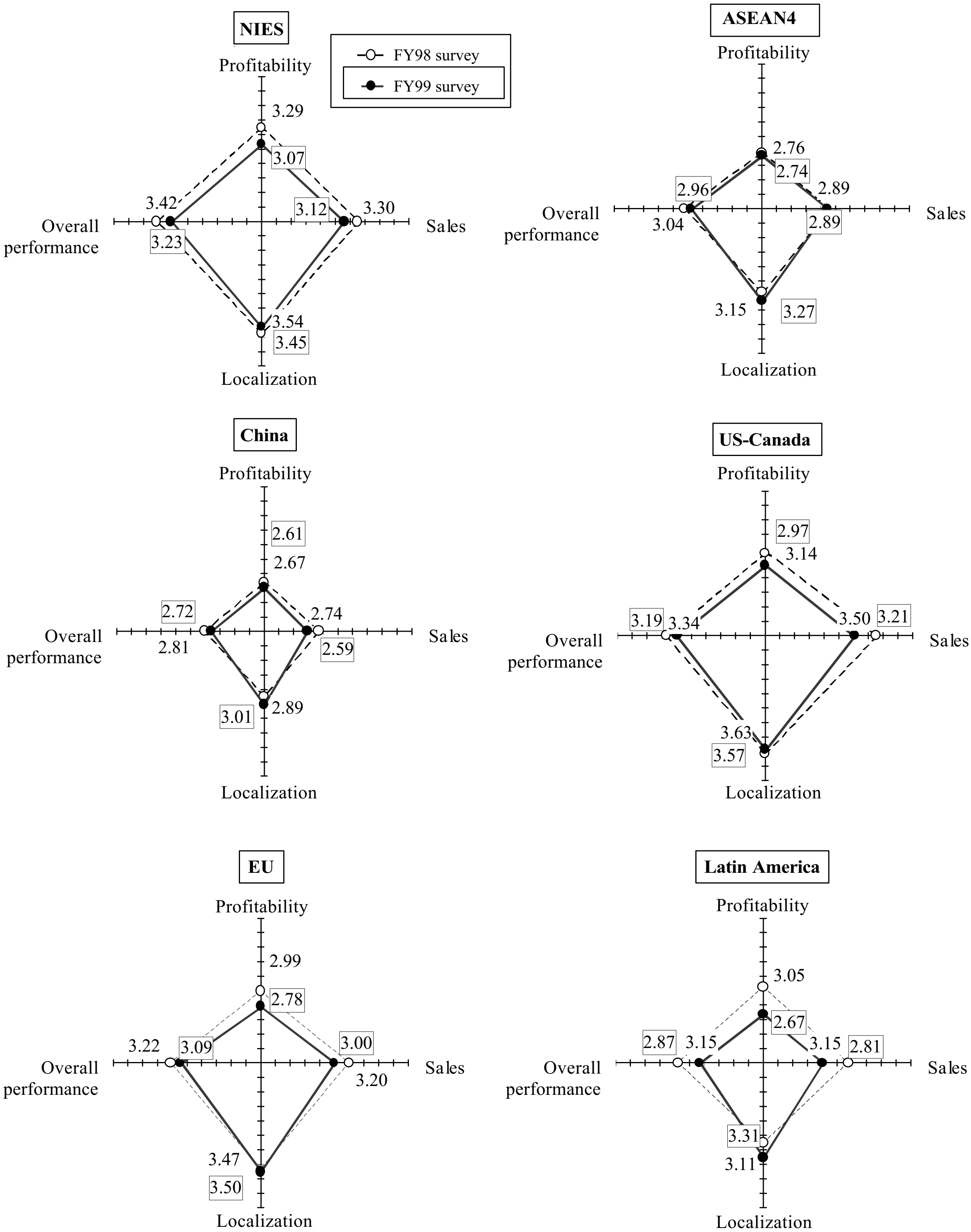
(1) Self-Evaluation of Overseas Business Performance by Region.

The Asian economic crisis substantially depressed the self-evaluation of overseas business performance in ASEAN4 across all measures in the FY1998 survey. Sub-par performance, or below 3, continues

Table II-3-1 Self-Evaluation of FDI Performance by Region, Changing Pattern over Time

		FY 1995 survey	FY 1996 survey	FY 1997 survey	FY 1998 survey	FY 1999 survey	No. of companies
NIES	Profitability	3.17	3.24	3.31	3.29	3.07	289
	Sales	3.26	3.29	3.42	3.30	3.12	
	Localization	3.54	3.52	3.49	3.54	3.45	
	Overall performance	3.43	3.42	3.40	3.42	3.23	
ASEAN4	Profitability	3.15	3.20	3.21	2.76	2.74	525
	Sales	3.26	3.31	3.28	2.89	2.89	
	Localization	3.39	3.34	3.28	3.15	3.27	
	Overall performance	3.32	3.32	3.35	3.04	2.96	
China	Profitability	2.75	2.55	2.65	2.67	2.61	223
	Sales	2.76	2.72	2.70	2.74	2.59	
	Localization	2.96	2.95	2.94	2.89	3.01	
	Overall performance	2.85	2.82	2.85	2.81	2.72	
US-Canada	Profitability	2.72	2.88	3.07	3.14	2.97	314
	Sales	3.08	3.22	3.35	3.50	3.21	
	Localization	3.54	3.64	3.58	3.63	3.57	
	Overall performance	3.11	3.27	3.25	3.34	3.19	
EU	Profitability	2.52	2.81	2.99	2.99	2.78	218
	Sales	2.78	3.01	3.23	3.20	3.00	
	Localization	3.26	3.43	3.46	3.47	3.50	
	Overall performance	2.88	3.14	3.31	3.22	3.09	
Latin America	Profitability	2.91	2.89	3.16	3.05	2.67	101
	Sales	2.99	2.91	3.11	3.15	2.81	
	Localization	3.42	3.31	3.27	3.11	3.31	
	Overall performance	3.07	2.99	3.13	3.15	2.87	
Central Europe	Profitability	–	–	–	2.94	3.00	14
	Sales	–	–	–	2.82	3.07	
	Localization	–	–	–	2.88	3.21	
	Overall performance	–	–	–	2.94	3.00	

Figure II-3-1 Self-Evaluation of FDI Performance by Region



(In relation to the initially set goal) 1.Insufficient 2. Somewhat insufficient 3.In-between 4.Somewhat sufficient 5.Fairly sufficient in this year in profitability, sales and overall performance without showing any improvement. In NIES, performance falls somewhat in all measures from the previous year. China continues to show poor scores.

In US-Canada, self-evaluation declines slightly on the whole this year. Similar performance is also observed in EU. Further inquiries come to find that the price competition (for example, in automobiles (components)) intensifies significantly in US-Canada this year, resulting in less than initially expected performance (Figure II-3-1 and Table II-3-1).

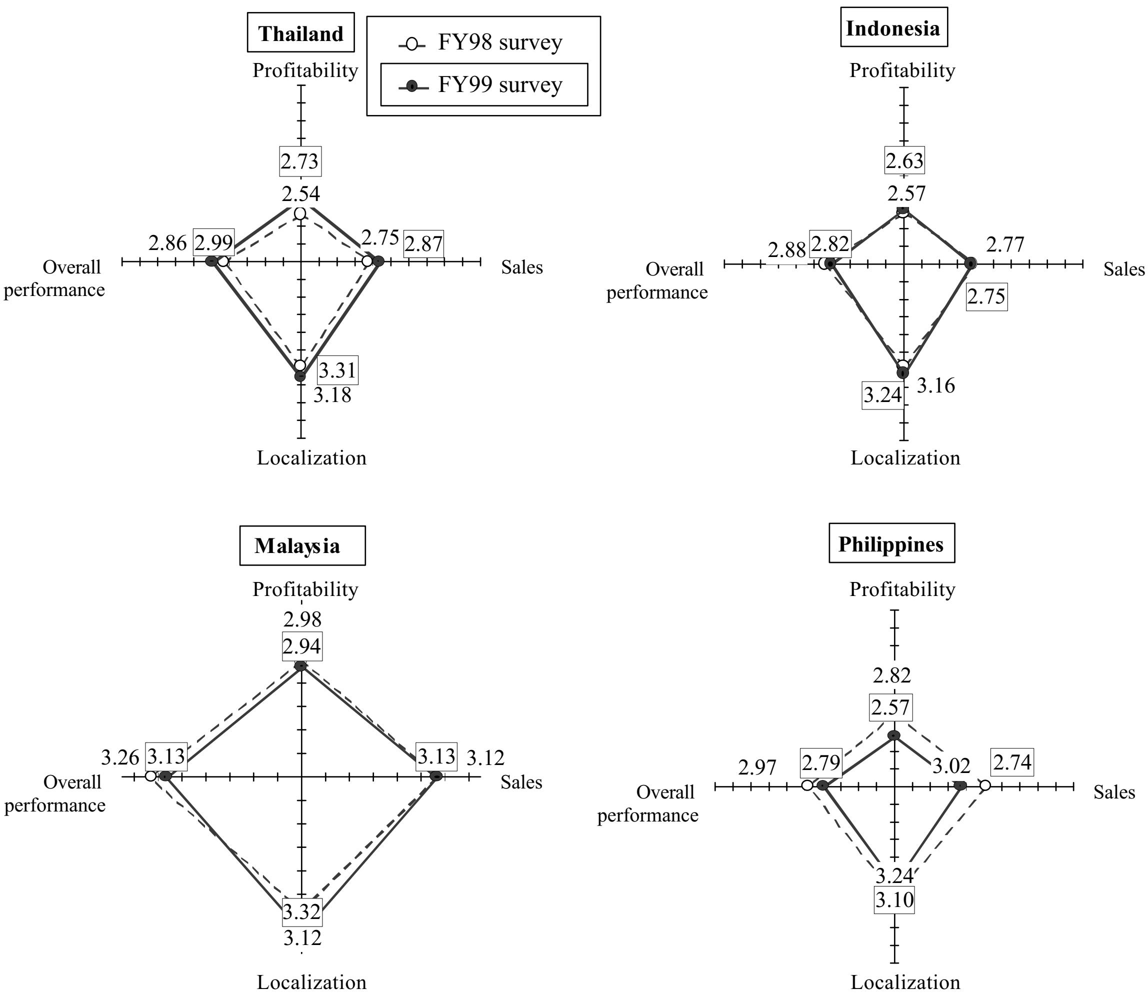
(2) Self-Evaluation of Overseas Business Performance by Country (ASEAN4)

For ASEAN4 countries, self-evaluation declined across the board in the previous year. In particular, self-evaluations were severe in Thailand and Indonesia. The same case of severe self-evaluation was also seen in Malaysia. By contrast, the Philippines was not markedly affected by the crisis.

In this year, a slight improvement is seen in Thailand and Indonesia. Malaysia scores almost the same level as in the previous year. On the other hand, self-evaluation in the Philippines, declines in all measures.

Improvement in Thailand may be attributable to better results in automobiles (components) and steel. These industries were in a severe situation in the previous year, plunging to extremely low business activities. Against this backdrop, a gradual recovery of the demand for automobiles began this year, which apparently led to the improved evaluation (e.g. the scores of profitability improve from 1.83 in FY1998 survey to 2.36 this year in automobiles (components), and from 1.71 to 2.36 in steel). On the other hand, one of the reasons for a setback in the Philippines

Figure II-3-2 Self-Evaluation of FDI Performance by Company (ASEAN4)



(In relation to the initially set goal) 1.Insufficient 2. Somewhat insufficient 3.In-between 4.Somewhat sufficient 5.Fairly sufficient may be that the country was experiencing the side-effect of the Asian economic crisis with a time lag. In particular, self-evaluation declines in automobiles (assembled vehicle) and steel (e.g. the scores of profitability fall from 2.00 in FY1998 survey to 1.60 this year in automobiles (assembled vehicle), and from 4.00 to 1.80 in steel). (Figure II-3-2 and Table II-3-2)

(3) Financing Sources of FDI

Among financing sources of actual FDI in all the regions, "remittance from the parent company" and "local financing" increase in share, while "reinvestment" declines (Figure II-3-3).

This year's survey examines whether Japanese affiliates seeking local financing are affected by the credit crunch of private financial institutions (Japanese financial subsidiaries as well as local financial institutions).

By region, the hardest hit by the credit crunch is seen in ASEAN4, where 30.0% of companies fell the impact of financial squeeze. This is followed by 27.7% in Latin America and 27.2% in China. In ASEAN4, 41.7% of the affiliates in Indonesia has been "affected by the credit crunch", attesting dire financial conditions.

Asked if their business operations are adversely affected by the credit crunch, the majority of Japanese companies across the regions responds that "damage was released by the assistance from the parent company," thus indicating their reliance on the parent company (i.e., remittance from Japan.) On the other hand, some 20% of the companies having affiliates in each region cites "insufficient working capital" as a specific setback they suffer. Only a small number of companies resorts to "downsizing the business bases and other restructuring efforts" or "rolling back the business bases" (Table II-3-3).

Table II-3-2 Self-Evaluation of FDI Performance by Company (ASEAN4), Changing Pattern over Time

	Thailand				Indonesia			
	FY 1997 survey	FY 1998 survey	FY 1999 survey	No. of companies	FY 1997 survey	FY 1998 survey	FY 1999 survey	No. of companies
Profitability	3.21	2.54	2.73	193	2.89	2.57	2.63	122
Sales	3.37	2.75	2.87		2.98	2.77	2.75	
Localization	3.36	3.18	3.31		3.17	3.16	3.24	
Overall performance	3.32	2.86	2.99		3.05	2.88	2.82	
	Malaysia				Philippines			
	FY 1997 survey	FY 1998 survey	FY 1999 survey	No. of companies	FY 1997 survey	FY 1998 survey	FY 1999 survey	No. of companies
Profitability	3.36	2.98	2.94	138	2.90	2.82	2.57	72
Sales	3.54	3.12	3.13		2.85	3.02	2.74	
Localization	3.39	3.12	3.32		3.12	3.24	3.10	
Overall performance	3.50	3.26	3.13		2.98	2.97	2.79	

Figure II-3-3 Financing Sources of FDI, Changing Pattern over Time

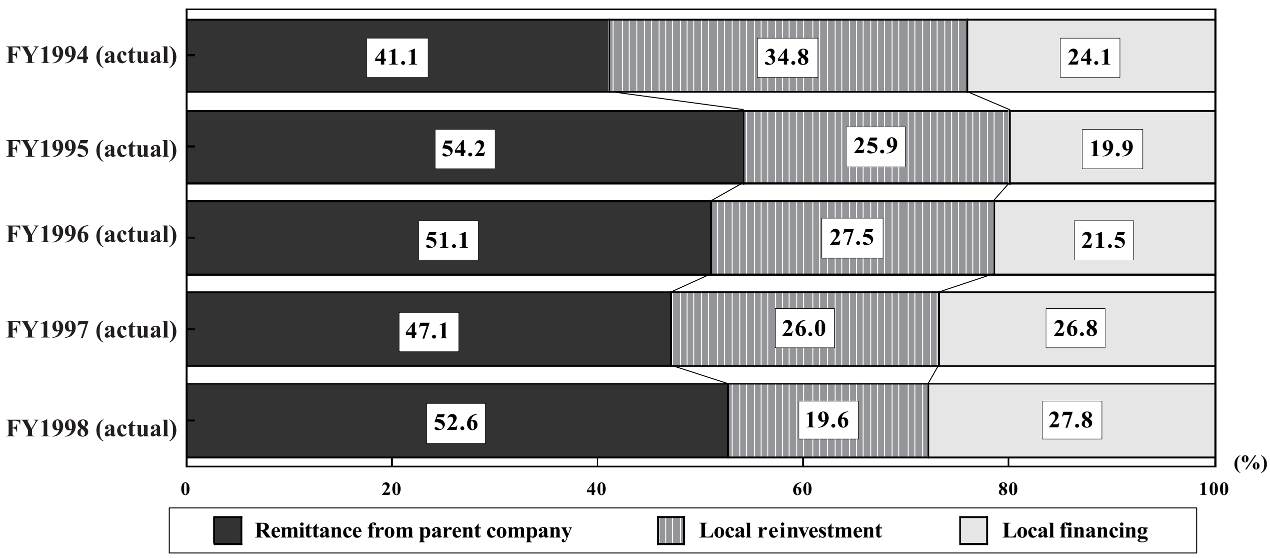


Table II-3-3 Influence of Credit Crunch on Overseas Business Operations

(Unit: %)

	No credit crunch	Affected by the credit crunch	Influence of the credit crunch on overseas business activities (multiple response)				
			1	2	3	4	5
NIES	80.7	19.3	71.4	16.3	4.1	0.0	10.2
ASEAN4	70.0	30.0	73.4	16.2	1.9	2.6	10.4
Thailand	71.4	28.6	73.2	19.6	1.8	1.8	8.9
Indonesia	58.3	41.7	81.3	8.3	2.1	4.2	8.3
Malaysia	74.4	25.6	63.6	18.2	3.0	0.0	15.2
Philippines	77.3	22.7	70.6	23.5	0.0	5.9	11.8
China	72.8	27.2	54.7	28.3	7.5	1.9	11.3
US-Canada	76.9	23.1	60.9	17.2	3.1	0.0	18.8
Latin America	72.3	27.7	60.0	24.0	8.0	4.0	12.0
EU	82.1	17.9	62.9	8.6	5.7	0.0	22.9

1. Damage was released by the assistance from the parent company
2. Insufficient working capital
3. Downsizing the business bases and other restructuring efforts
4. Rolling back the business bases
5. Others

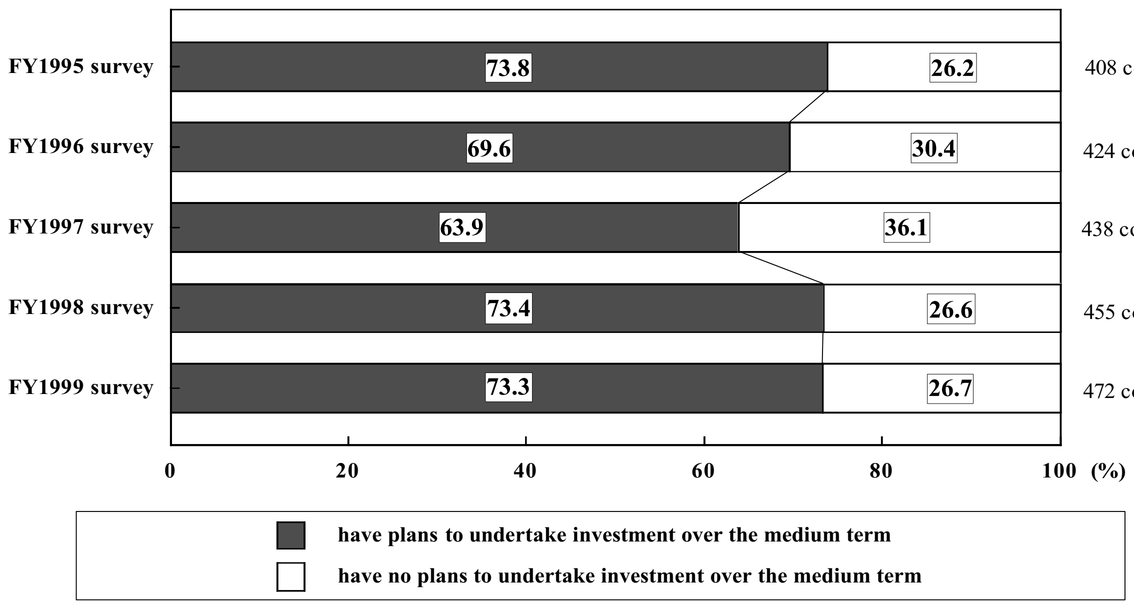
III. MEDIUM-TERM OUTLOOK OF OVERSEAS BUSINESS ACTIVITIES

1. FDI OVER THE MEDIUM TERM

The share of companies having “plans to undertake FDI over the medium term” of next three years (through FY2002) is 73.3%, which deviates little from figures around 70% in the previous surveys. Basically there is no change in shares in each region regarding the planned FDI[6] from the previous years.

Although the amount of FDI declines in FY1999, Japanese companies apparently have a constant intention to continue their efforts to develop overseas businesses (Figure III-1-1, Table III-1-1).

Figure III-1-1 Efforts to Undertake FDI over the Medium Term, Changing Pattern over Time



6 The share of companies that had plans to undertake FDI in any region over the medium term among the total companies responded (472 in this year’s survey).

Table III-1-1 Efforts to Undertake FDI over the Medium Term (by Region), Changing Pattern over Time

(Unit：%)

	NIES	ASEAN4	China	US-Canada	EU
FY 1995 survey	39.6	49.8	46.4	39.3	30.8
FY 1996 survey	36.8	50.0	43.5	44.0	33.6
FY 1997 survey	35.3	46.3	39.1	40.2	30.8
FY 1998 survey	42.4	49.2	41.8	52.5	36.7
FY 1999 survey	34.7	46.2	38.8	47.5	36.2

2. CHANGES IN FDI TYPES AND MODALITIES OVER THE MEDIUM TERM

Japanese manufacturing companies are putting more emphasis on "the expanding of the existing production bases" than "the establishment of production bases" in respect of FDI in the Asian region over the medium term. This trend is particularly significant in ASEAN4 and China. In ASEAN4 countries, the share of companies citing "the establishment of new production bases" keeps plummeting from 45.2% in FY1995 to 33.0% in FY1997 and to 11.2% in FY1999. On the other hand, the share of companies planning "the expansion of the existing production bases" surpasses "the establishment of new production bases" and is still growing: from 68.6% in FY1995, to 64.4% in FY1997, and to 74.8% in FY1999. According to the result of FY 1995 survey, more companies (59.9%) cited "the establishment of the production bases" than those planning "the expansion of the existing production bases" (48.2%) in respect of FDI in China over the medium term. However, the share of "the establishment of new production bases" takes a plunge subsequently (40.6% in FY1997 and 22.0% in FY1999), overtaken by steadily growing "expansion of production bases" (60.0% in FY1997 and 64.7% in FY1999) (Table III-2-1).

Table III-2-1 Types of FDI over the Medium Term by Region, Changing Pattern over Time (multiple response)

(Unit: %)

	NIES			ASEAN4			China			Other Asian Countries		
	95	97	99	95	97	99	95	97	99	95	97	99
Establishment of production bases	16.3	10.3	6.5	45.2	33.0	11.2	59.9	40.6	22.0	64.6	57.5	20.8
Expansion of production bases	53.8	52.4	50.0	68.6	64.4	74.8	48.2	60.0	64.7	16.5	28.7	54.2
Establishment of sales bases	13.8	10.3	13.0	15.7	10.5	4.9	17.8	18.8	12.7	19.0	18.4	10.4
Expansion of sales bases	24.4	20.6	30.5	13.3	11.5	8.3	14.2	13.9	12.1	13.9	9.2	16.7
Establishment / expansion of R&D bases	5.6	3.2	4.5	4.3	4.7	1.9	1.0	1.2	4.6	2.5	1.1	2.1
Establishment / expansion of financial bases	3.8	1.6	(note)	0.5	0.0	(note)	0.0	0.0	(note)	0.0	0.0	(note)
Establishment / expansion of regional headquarters	10.0	10.3	19.5	4.8	2.1	7.3	2.0	3.0	7.5	1.3	0.0	6.3
Establishment / expansion of parts-procurement bases	11.3	9.5		5.7	6.3		6.6	4.2		2.5	0.0	
Others	4.4	5.6	8.4	1.4	3.7	5.8	1.0	1.8	5.2	6.3	5.7	14.6

	US-Canada			EU			Latin America		
	95	97	99	95	97	99	95	97	99
Establishment of production bases	14.2	15.1	11.1	22.4	12.4	14.1	22.2	29.7	12.3
Expansion of production bases	62.3	58.6	54.6	42.4	51.3	39.9	51.9	45.9	53.8
Establishment of sales bases	10.5	13.8	5.3	12.0	11.5	12.3	13.0	17.6	10.8
Expansion of sales bases	22.2	21.1	30.0	33.6	34.5	33.7	16.7	20.3	15.4
Establishment / expansion of R&D bases	9.9	17.1	14.0	4.8	9.7	9.2	1.9	1.4	1.5
Establishment / expansion of financial bases	1.2	0.7	(note)	2.4	1.8	(note)	0.0	0.0	(note)
Establishment / expansion of regional headquarters	4.9	7.2	17.4	7.2	10.6	12.9	0.0	1.4	6.2
Establishment / expansion of parts-procurement bases	1.9	2.6		3.2	1.8		0.0	4.1	
Others	6.2	3.3	6.3	8.0	7.1	7.4	3.7	8.1	9.2

Note: Since last year's survey, "Establishment/expansion of financial bases," "Establishment/expansion of regional headquarters," and "Establishment/expansion of parts-procurement bases" were integrated to form "Establishment/expansion of region headquarters (financing, sales, procurement)"

Table III-2-2 shows the breakdown by modality of the planned FDI over the medium term for each region. In NIES, 100% ownership continues to account for a larger share than joint ventures. The same trend is observed in ASEAN4, where joint ventures decrease in share (from 63.4% in FY 1995 to 50.8% in FY 1999), while 100% ownership rises (from 42.0% in FY 1995 to 48.2% in FY 1999). This may be attributable to the relaxation of regulations on the ownership by the foreign capital in ASEAN4, particularly in Thailand, after the Asian economic crisis. In US-Canada and EU, the share of wholly owned affiliates is always domestic. Recently, several companies have resorted to mergers and acquisitions in Europe and US-Canada. While "100% ownership" and "joint venture" constitute a predominant portion of investment modalities, while some companies, though small in number, resort to "M&A." By region, 8.7% of companies have plans to launch business operations through "M&A" in EU, while the comparative figure in US-Canada is 7.3% (according to FY 1999 survey). By industry, "M&A" is cited in electrical equipment & electronics (assembled product), chemicals, and others. Meanwhile, it should be kept in mind that since "M&A" entails a number of sensitive issues, companies often proceed with preparatory work confidentially and make a formal announcement upon completion of preparation (Table III-2-2).

Table III-2-2 Modalities of FDI over the Medium Term by Region, Changing Pattern over Time (multiple response)

	NIES			ASEAN4		
	95	97	99	95	97	99
100% ownership	57.2	45.4	56.7	42.0	37.1	48.2
Joint venture	46.9	59.7	47.5	63.4	74.2	50.8
M&A	(note)	(note)	0.7	(note)	(note)	2.6
Equity participation	4.8	5.9	5.7	5.9	2.8	5.8

	China			Other Asian Countries		
	95	97	99	95	97	99
100% ownership	31.4	30.4	41.4	34.7	30.9	31.8
Joint venture	72.3	77.2	62.3	61.3	69.1	65.9
M&A	(note)	(note)	0.6	(note)	(note)	4.5
Equity participation	5.8	2.5	4.9	10.7	2.5	6.8

	US-Canada			EU		
	95	97	99	95	97	99
100% ownership	71.1	67.6	69.4	71.9	63.8	70.7
Joint venture	29.5	35.8	26.9	28.9	40.0	24.7
M&A	(note)	(note)	7.3	(note)	(note)	8.7
Equity participation	5.4	7.4	2.6	7.0	12.4	6.7

	Latin America		
	95	97	99
100% ownership	55.3	31.8	58.3
Joint venture	46.8	53.0	41.7
M&A	(note)	(note)	5.0
Equity participation	4.3	10.6	5.0

(Note) A new alternative, "M&A", are created in this year's survey, separate from "Equity participation".

3. CHANGES IN THE AMOUNT OF FDI OVER THE MEDIUM TERM

The companies having plans to undertake FDI over the medium term are also examined whether they would increase or decrease the amount of FDI during that period in comparison with their records in the past 3 years. In FY 1996 survey, the companies that responded they would "increase FDI over the medium term" had a 71.2% share. But the share has shrunk drastically year-by-year, declining to 64.6% in FY 1997 and 38.1% in FY1998. In contrast, the companies that would "decrease the amount of FDI" continue to increase from the previous 19.2% to 39.0% this year.

As seen in the Section 2 above, Japanese manufacturing companies are shifting their focus of FDI activities from "the establishment of new production/sales bases" to "the efficient utilization of the existing bases." This shift led to a decrease in the amount of FDI over the medium term. (Figure III-3-1)

In fact, among the companies with plans to decrease the amount of FDI, the largest 63.0% cite "an adequate number of overseas bases have been set up for now. In the previous year's survey, "the local market shrank due to the recession of the recipient country's economy" and "uncertainty over the local currency" held substantial shares (50.0% and 33.3% respectively), particularly in ASEAN4, under the effects of the Asian economic crisis. However, their shares decline to 21.3% and 13.3% respectively in this year's survey. In the meantime, there is a greater sentiment that the stage of setting up new overseas bases is in nearly completion (Table III-3-1).

Figure III-3-1 Changes in the Amount of FDI over the Medium Term, Changing Pattern over Time

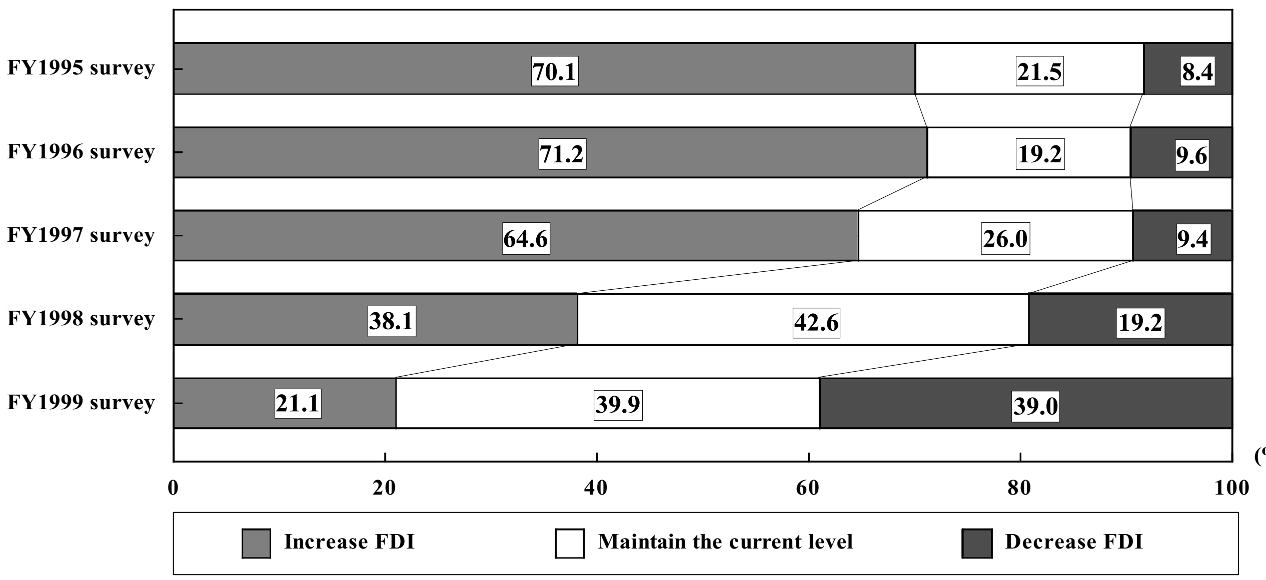


Table III-3-1 Reasons for Decrease in FDI over the Medium Term (multiple response)

(Unit: %)

	All regions		ASEAN4	
	FY1998 survey	FY1999 survey	FY1998 survey	FY1999 survey
So far not achieved the expected results from operating overseas	14.8	15.8	13.0	14.7
An adequate number of overseas bases have been set up for now	57.6	63.0	50.0	68.0
The local market shrank due to the recession of the recipient country's economy	24.0	14.5	50.0	21.3
Uncertainty over the local currency	14.4	7.9	33.3	13.3
Uncertainty over the local political and social situation	8.3	5.8	16.7	12.0
Restructuring of existence production bases	10.5	11.5	11.1	4.0
Given economic downturn, a focus is on strengthening domestic bases	10.0	11.8	11.1	13.3

By region, large proportions of companies are planning to "increase the amount of FDI" in Europe: Central-Eastern Europe (Central and Eastern Europe, and the countries in the former Soviet Union) and EU (44.4% and 31.0% respectively). By industry, positive investor sentiment toward a specific region is seen in electrical equipment and electronics(assembled products) and automobiles (components) for the Central-Eastern Europe and in chemicals and automobiles (components) for EU. In Asia, a relatively large share of companies cites that they would "increase the amount of FDI" in China (Figure III-3-2).

- Addendum: Regions where an increase in FDI is planned over the medium term and the reasons

The share of the companies with the plans to "increase the amount of FDI over the medium term" has been decreasing in the past several years. However, when these responses were broken down by region and examined over time, those planning FDI in EU over the medium term continue to increase their share from 15.1% in the survey of FY1998 to 16.6% in the survey of FY 1999. The comparable share for Asia also turns around from a decline to a slight increase from 49.6% in the survey of FY 1998 to 51.2% in the survey of FY 1999. The share for China recovers, rising to 20.3% in the survey of FY 1999 from 17.4% in the survey of FY 1998, representing the largest share in all the regions (Figure III-3-3).

Figure III-3-2 The Amount of FDI over the Medium Term (by Region)

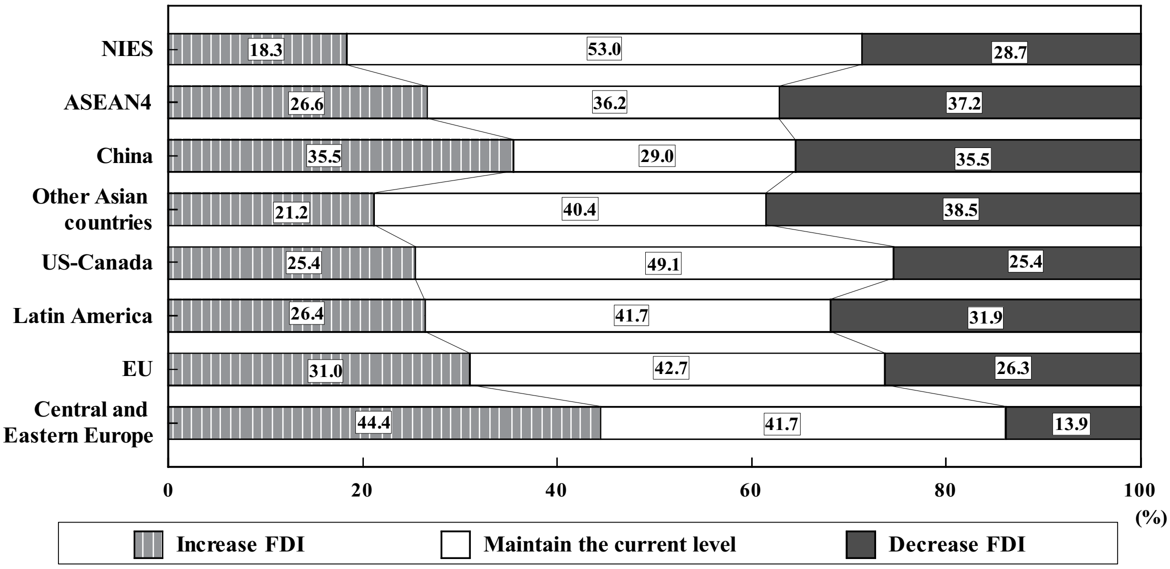
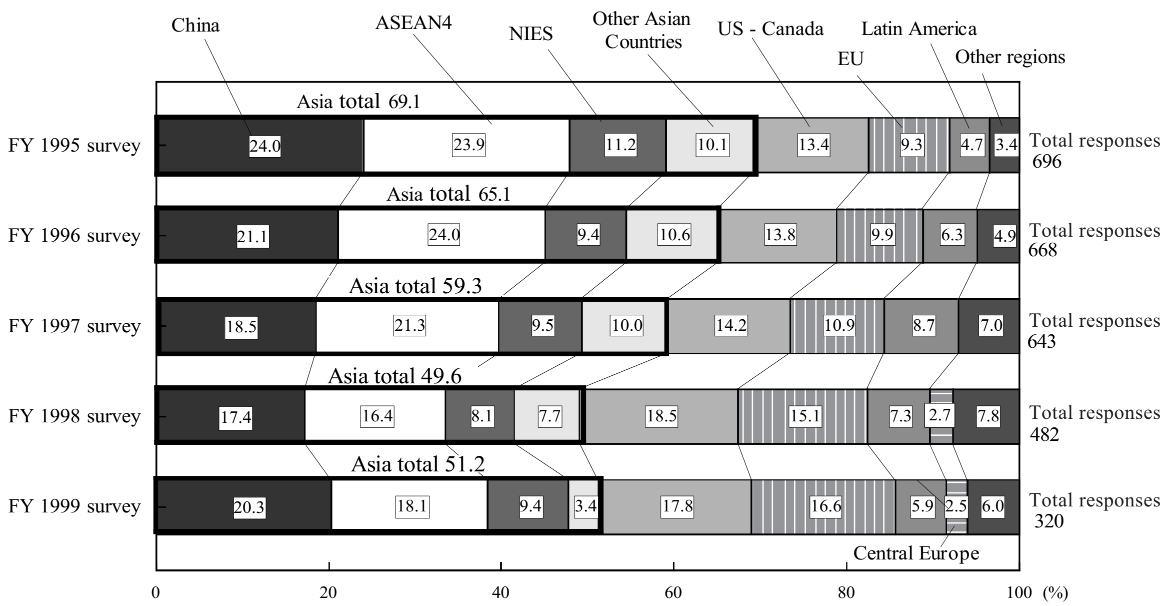


Figure III-3-3 Trends of FDI Increase by Region over the Medium Term



Among the reasons for increasing the amount of FDI, “maintain and expand the sales volume in the local market” is most numerous in the major regions, followed by “explore a new market.” Large shares of the companies looking to ASEAN4 and China as their FDI destinations cite “exports to the third countries” and “exports (re-imports) to Japan.” This reflects a major role of the recipient countries as export bases. Also, the companies cite “access to inexpensive labor” in these recipient countries. On the other hand, Japanese FDI to US-Canada and EU over the medium term are predominantly based on local market-oriented reasons such as “maintain and expand the sales volume in the local market,” “explore a new market,” “develop new products designed for the local market needs” and “supply parts to assembly manufacturing companies” (Table III-3-2).

Table III-3-2 Reasons for Increase in FDI over the Medium Term (multiple response)

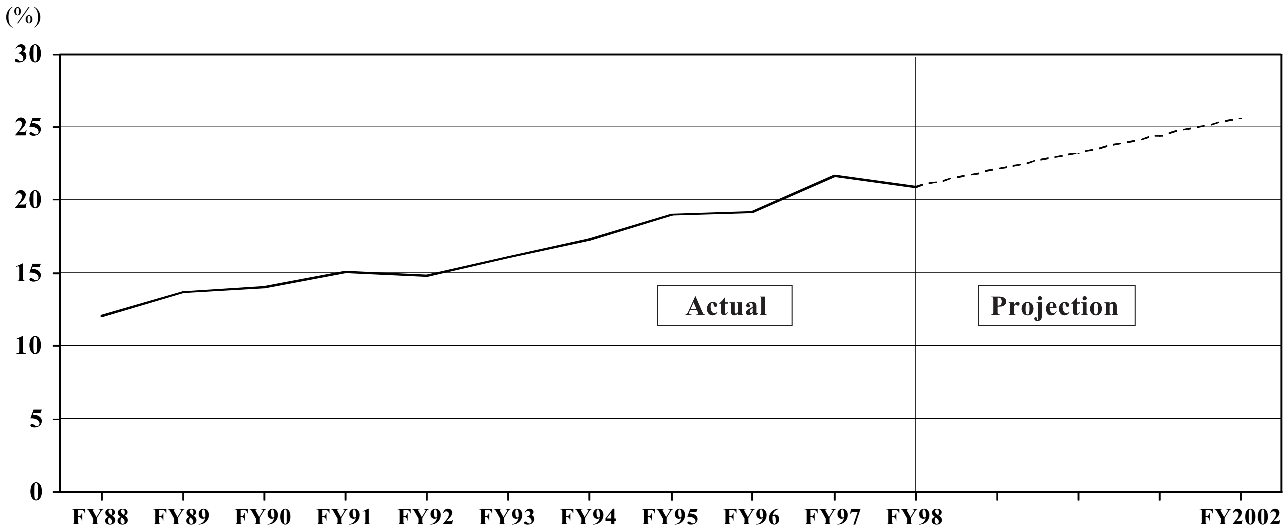
(Unit: %)

	All regions	China	ASEAN4	US-Canada	EU
Maintain and expand the sales volume in the local market	67.1	68.8	64.4	74.5	70.6
Explore a new market	44.3	48.4	42.4	45.5	45.1
Exports to the third countries	18.0	20.3	35.6	9.1	5.9
Develop new products designed for the local market needs	15.8	14.1	16.9	21.8	19.6
Access to inexpensive labor	15.5	29.7	33.9	0.0	0.0
Supply parts to assembly manufacturing companies	15.5	14.1	23.7	18.2	15.7
Spread production bases overseas (horizontal division of labor)	14.9	14.1	27.1	10.9	9.8
Exports (re-imports) to Japan	13.6	23.4	25.4	5.5	2.0

4. OVERSEAS PRODUCTION RATIO: ACTUAL FIGURES AND FUTURE PLANS

As seen in the Section 3 above, Japanese manufacturing companies are looking toward overseas business operations with “a focus on making effective use of the existing overseas bases.” In fact, the actual overseas production ratio[7] has been steadily rising over time. This trend is also seen in future plans (e.g. an actual ratio of 20.9% in FY1998 and a planned ratio of 25.6% in FY2002). It appears that Japanese companies have a positive sentiment for increasing overseas operations (Figure III-4-1).

Figure III-4-1 Changing Overseas Production Ratio and Future plans



7 Overseas production ratio = Overseas production / (Overseas production + Domestic production)

By industry, electrical equipment and electronics (components), textiles, precision instruments had high actual ratios in FY1998 with 33.2%, 32.5% and 27% respectively. In particular, precision instruments plans to boost the overseas production ratio by 8 percentage points over a 4-year period from 27.0% in FY1998 to 35.0% in FY2002, indicating a strong sentiment for moving forward overseas production.

Automobiles (assembled vehicle) plans to raise an actual ratio of 15% in FY 1998 to 20% in FY 2002.

Chemicals, which used to have a relatively low ratio, still have one of the lowest ratios. However, the industry is expecting a 5.5-point increase in the future from actual 14.8% in the survey of FY1998 to 20.3% in the survey of FY2002 (Table III-4-1).

5. EFFECT OF FDI ON DOMESTIC PRODUCTION FACILITIES

Regarding the effect of FDI on domestic production facilities, a predominant 66.6% of the companies respond that "since FDI is conducted to maintain/expand overseas market shares, domestic production facilities will remain intact." Also, 20.3% of companies respond that "though the production of domestically manufactured commodity products will be shifted overseas, domestic production facilities will focus on the manufacturing of higher quality products." On the other hand, the response with "domestic production facilities will be downsized because of replacement by overseas production," accounts for only 9.6%. The basic pattern seems to be a reallocation of production activities between domestic and foreign facilities. Therefore, future FDI would have a minor effect on domestic production facilities. (Figure III-5-1)

The breakdown of the companies by their FDI destination reveals that a higher share of companies having undertaken FDI in ASEAN4 and China responds that "domestic production facilities will be downsized because of replacement by overseas production," compared with those having made direct investment in other regions (18.8% for ASEAN4 and 15.7% for China). On the other hand, the response that "though the production of domestically manufactured commodity products will be shifted overseas, domestic production facilities will focus on the manufacturing of higher quality products," also accounts for a larger share for the companies having made investment in those regions than others (29.8% for ASEAN4 and 32.0% for China). While there is a sign that Japanese FDI to Asia would substitute domestic investment to some extent, the companies have "a focus on higher quality products in domestic production, showing the functional division between Asia and Japan in production activities." (Table III-5-1)

6. PROMISING FDI DESTINATIONS OVER THE MEDIUM AND LONG TERM

(1) Promising FDI Destinations over the Medium Term

China continues to rank the first as a promising FDI destination over the medium term (next 3 years), followed by U.S. However, the number of respondents has been diminishing over the years (342 in FY 1997, 299 in FY 1998, and 278 in FY 1999). It should be noted that those citing China have also been dwindling (from 219 to 163 to 153 respectively).

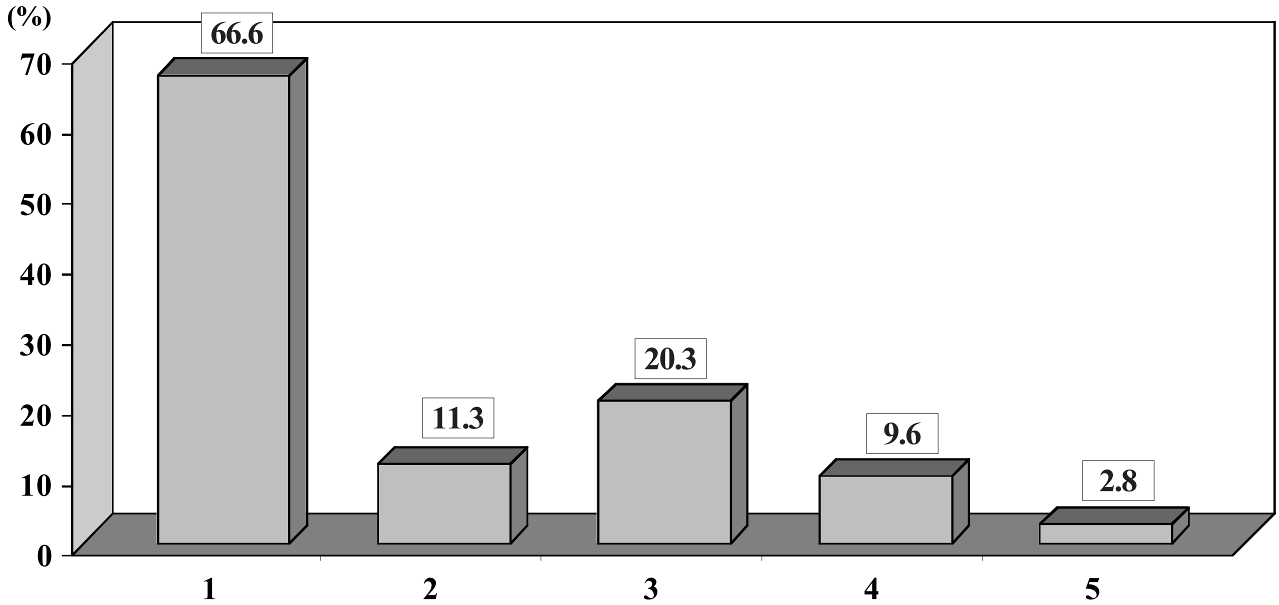
Although there are no major changes in rankings among ASEAN4 countries, it is noteworthy that more companies cite Thailand this year than the previous year. U.K. ranks the seventh. All the responses citing EU as a promising FDI destination add up to 85 companies, revealing a

Table III-4-1 Planned Increases in Overseas Production Ratio by Industry in FY 1999 Survey

(Unit: %)

	FY 1998 actual (A)	FY 1999 projected (B)	FY 2002 planned (C)	Increase (C-A)
Electrical equipment & electronics (components)	33.2	34.4	38.1	4.9
Electrical equipment & electronics (assembled product)	20.2	21.5	25.4	5.2
Steel	19.0	19.0	23.0	4.0
Textiles	32.5	34.4	37.5	5.0
Precision Machinery	27.0	30.3	35.0	8.0
Automobiles (components)	20.5	21.7	25.5	5.0
Automobiles (assembled vehicle)	15.0	15.0	20.0	5.0
Chemicals	14.8	16.9	20.3	5.5
General Machinery	16.3	17.1	20.0	3.7

Figure III-5-1 Effect of FDI on Domestic Production Facilities (multiple response)



1. Since FDI is conducted to maintain/expand overseas market shares, domestic production facilities will remain intact.
2. Since the contents of overseas manufactured products are different from those of domestically manufactured products, our domestic production facilities will remain intact.
3. Though the production of domestically manufactured commodity products will be shifted overseas, domestic production facilities will focus on the manufacturing of higher quality products.
4. Domestic production facilities will be downsized because of replacement by overseas production.
5. Others.

Table III-5-1 Effect of FDI on Domestic Production Facilities by Region (multiple response)

(Unit: %)

	NIES	ASEAN4	China	US-Canada	EU
1. FDI is conducted to maintain/expand overseas market shares.	69.4	54.8	57.0	76.7	73.2
2. The contents of overseas manufactured products are different from that of domestically manufactured products.	9.5	12.0	7.6	11.4	13.1
3. Domestic production facilities will focus on the manufacturing of higher quality products.	25.9	29.8	32.0	9.4	12.4
4. Domestic production facilities will be downsized.	6.1	18.8	15.7	4.0	4.6
5. Others	2.7	1.0	3.5	3.5	3.3

significant and sustained interest in this region (Table III-6-1).

- **Addendum: Promising FDI destinations by industry over the medium term.**

Given limitation in the number of responded companies, it is difficult to grasp the overall trend. Therefore, three major industries (chemicals, electrical equipment and electronics, and automobiles) are examined briefly. Chemicals cite similar countries as promising destinations as in the aggregate data. It is noteworthy that Viet Nam ranks the third from the perspective of electric equipment and electronics. In automobiles, China ranks the third, while U.S. ranks the first and Thailand the second. In automobiles, U.K. and France have higher rankings compared with other industries. This trend seems to be a reflection of the industry's approach to overseas business operations in EU, taking into account of the monetary unification and the market integration.

Automobile component Manufactures are increasingly looking on Thailand as a promising FDI destination (e.g.10 companies in FY 1998 and 22 companies in FY 1999). This increase might be attributed by better business environment for automobile manufacturing companies and emerging signs of demand recovery in Thailand. (Table III-6-2)

Table III-6-1 Promising FDI Destinations over the Medium and Long Term (multiple response)

	Promising Destinations for Investment on Medium Term (next three years)														
	FY1999 Survey	Respondents	Share (%)	FY 1998 survey	Respondents	Share (%)	FY 1997 survey	Respondents	Share (%)	FY 1996 survey	Respondents	Share (%)	FY 1995 survey	Respondents	Share (%)
Rank		278	100		299	100		342	100		351	100		336	100
1	China	153	55	China	163	55	China	219	64	China	240	68	China	248	74
2	U.S.A	108	39	U.S.A.	124	41	U.S.A.	123	36	Thailand	126	36	Thailand	122	36
3	Thailand	76	27	Thailand	68	23	Indonesia	97	28	Indonesia	119	34	Indonesia	110	33
4	India	42	15	Indonesia	49	16	Thailand	84	25	U.S.A.	112	32	U.S.A.	108	32
5	Indonesia	41	15	India	46	15	India	77	23	Vietnam	96	27	Vietnam	95	28
6	Vietnam	30	11	Philippines	43	14	Vietnam	66	19	Malaysia	71	20	Malaysia	73	22
7	Malaysia	25	9	Malaysia	42	14	Philippines	47	14	India	64	18	India	57	17
8	Philippines	25	9	Vietnam	41	14	Malaysia	46	13	Philippines	45	13	Philippines	52	15
9	U.K.	25	9	Brazil	34	11	Brazil	28	8	Singapore	34	10	Singapore	32	10
10	Brazil	21	8	U.K.	31	10	Taiwan	28	8	U.K.	23	7	U.K.	24	7
										Taiwan	23	7			

	Promising Destinations for Investment on Long Term (next ten years)														
	FY1999 Survey	Respondents	Share (%)	FY 1998 survey	Respondents	Share (%)	FY 1997 survey	Respondents	Share (%)	FY 1996 survey	Respondents	Share (%)	FY 1995 survey	Respondents	Share (%)
Rank		259	100		237	100		269	100		264	100		274	100
1	China	170	66	China	150	64	China	196	73	China	195	74	China	215	78
2	U.S.A.	77	30	U.S.A.	80	34	India	98	36	India	103	39	Vietnam	113	41
3	India	71	27	India	59	25	U.S.A.	83	31	Vietnam	87	33	India	98	36
4	Thailand	61	24	Indonesia	47	20	Vietnam	64	24	U.S.A.	81	31	U.S.A.	83	30
5	Vietnam	47	18	Thailand	45	19	Indonesia	57	21	Indonesia	64	24	Indonesia	66	24
6	Indonesia	46	18	Vietnam	42	18	Thailand	44	16	Thailand	63	24	Thailand	66	24
7	Brazil	36	14	Brazil	32	14	Brazil	30	11	Malaysia	31	12	Myanmar	40	15
8	Malaysia	20	8	Philippines	30	13	Philippines	29	11	Myanmar	29	11	Malaysia	35	13
9	philippines	20	8	Malaysia	17	7	Malaysia	25	9	Philippines	28	11	Philippines	31	11
10	Mexico	17	7	U.K.	14	6	Myanmar	14	5	Mexico	16	6	U.K.	16	6

Table III-6-2 Promising FDI Destinations over the Medium and Long Term by Industry (multiple response)

	Promising Destinations for Investment on Medium Term (next three years)											
	All Industries			Chemicals			Electrical equipment & electronics			Automobiles		
		Respondents	Share (%)		Respondents	Share (%)		Respondents	Share (%)		Respondents	Share (%)
Rank		278	100		42	100		49	100		51	100
1	China	153	55	China	22	52	China	28	57	U.S.A.	28	55
2	U.S.A.	108	39	U.S.A.	22	52	U.S.A.	14	29	Thailand	24	47
3	Thailand	76	27	Thailand	10	24	Vietnam	9	18	China	22	43
4	India	42	15	Indonesia	9	21	Singapore	8	16	U.K.	15	29
5	Indonesia	41	15	India	6	14	India	8	16	India	12	24
6	Vietnam	30	11	Singapore	5	12	Thailand	8	16	Brazil	8	16
7	Malaysia	25	9	Malaysia	5	12	Philippines	7	14	France	6	12
8	Philippines	25	9	Taiwan	4	10	Indonesia	7	14	Philippines	6	12
9	U.K.	25	9	Korea	3	7	Malaysia	6	12	Vietnam	5	10
10	Brazil	21	8	Vietnam	3	7	Other 5 countries	3	6	Mexico	5	10
										Indonesia	5	10

(Addendum)

(Unit: companies)

Industry	China	U.S.A.	Thailand	India	Indonesia	Vietnam	Malaysia	Philippine	U.K.	Brazil	Total
Foodstuffs	9	8	2	1	1	2	0	0	0	1	24
Textiles	6	2	3	3	5	1	1	0	0	0	21
Lumber & wooden products	0	0	0	0	0	0	0	0	0	0	0
Pulp & paper	3	0	1	0	1	0	0	1	0	0	6
Chemicals	22	22	10	6	9	3	5	0	1	2	80
[Chemicals excl. pharm.]	19	18	10	6	8	2	5	0	1	1	70
[Pharmaceuticals]	3	4	0	0	1	1	0	0	0	1	10
Petroleum & rubber	5	2	0	2	1	2	0	0	0	0	12
Ceramics, cements, & glass	6	3	3	0	3	1	2	0	1	1	20
Steel	7	5	5	1	1	0	2	2	1	3	27
Nonferrous metals	6	3	5	1	1	0	2	2	1	0	21
Metal products	5	2	3	2	0	1	2	2	0	0	17
General machinery	14	7	6	3	2	2	1	1	1	3	40
[Assembled product]	8	2	3	1	2	2	1	1	1	1	22
[Components]	6	5	3	2	0	0	0	0	0	2	18
Electrical equipment & electronics	28	14	8	8	7	9	6	7	3	3	93
[Assembled product]	6	4	0	2	0	1	1	0	2	1	17
[Components]	22	10	8	6	7	8	5	7	1	2	76
Transport equipment (excl. autos)	1	3	1	1	0	1	1	1	1	0	10
Automobiles	22	28	24	12	5	5	1	6	15	8	126
[Assembled vehicle]	3	1	2	0	2	0	0	0	1	0	9
[Components]	19	27	22	12	3	5	1	6	14	8	117
Precision Machinery	6	4	2	1	1	1	0	1	1	0	17
[Assembled product]	5	4	2	1	1	1	0	1	1	0	16
[Components]	1	0	0	0	0	0	0	0	0	0	1
Others	13	5	3	1	4	2	2	2	0	0	32
Total	153	108	76	42	41	30	25	25	25	21	546

By focusing on the shares of the responded companies holding operational bases and concurrently having concrete plans for FDI, it comes to obvious that the case of the top 4 promising countries is featured by the high expectations among the responded companies holding operational bases with the share of more than 70%.

In other words, there is a tendency that the companies under business operation through overseas affiliates regard the recipient country as a promising FDI destination.

The share of companies having investment plans among promising countries is 34.6% for those citing China, 44.4% for U.S., 39.5% for Thailand, 40.0% for the Philippines, and 52.0% for U.K. It is noteworthy that the share for China is lower than that of other countries.

The shares of companies having investment plans in India and Viet Nam are small, while their respective ranks remaining the fourth and the fifth. (Tables III-6-3 and III-6-4).

Table III-6-3 Shares of Companies Having Overseas Affiliates in Each Promising FDI Destination

(Unit: companies, %)

Rank	Promising company	The number of companies regarding as promising	The number of companies having affiliates	Share
1	China	153	109	71.2
2	U.S.A.	108	96	88.9
3	Thailand	76	60	78.9
4	India	42	9	21.4
5	Indonesia	41	34	82.9
6	Viet Nam	30	12	40.0
7	Malaysia	25	16	64.0
8	Philippines	25	15	60.0
9	U.K.	25	15	60.0
10	Brazil	21	11	52.4

* Share: The number of companies having affiliates/the number of companies regarding as promising

Table III-6-4 Shares of Companies Having Investment Plans in Each Promising FDI Destination

(Unit: companies, %)

Rank	Promising company	The number of companies regarding as promising	The number of companies having investment plans	Share
1	China	153	53	34.6
2	U.S.A.	108	48	44.4
3	Thailand	76	30	39.5
4	India	42	10	23.8
5	Indonesia	41	11	26.8
6	Viet Nam	30	5	16.7
7	Malaysia	25	8	32.0
8	Philippines	25	10	40.0
9	U.K.	25	13	52.0
10	Brazil	21	3	14.3

* Share: The number of companies having investment plans/the number of companies regarding as promising

(2) Reasons for FDI by country

Table III-6-5 describes reasons for making FDI in the ten most promising countries over the medium term.

For China, the most promising country, the respondents citing "market size and growth potential" account for 88.2%, significantly higher than "exports (re-imports) to Japan" and "exports to the third countries" (15.7% and 21.6% respectively), reflecting their major emphasis on the local market. Meanwhile, "access to inexpensive labor" is also a major reason with a 58.2% share, revealing high expectations for affordable labor despite recent concerns over rising wage levels in the coastal regions.

As for U.S., "market size and potential growth" accounts for 88.9% as a reason for FDI, clearly demonstrating a leaning toward the local market. Numerous companies also cite "develop new products suitable for the local market needs" and "supply parts to assembly manufactures" (37.0% and 35.2% respectively). In response to further inquiries, some of respondents point out that "identification of diverse consumer needs and speedy reaction to demands are the key to winning intense competition." A similar trend is seen for FDI in UK, where Japanese companies are building supply bases for the entire region of EU in anticipation of the "progress in the regional integration" (24.0%).

Among the reasons common across all the countries of ASEAN4 are "market size and potentiality for economic growth" (59.2% in Thailand, 63.4% in Indonesia, 40.0% in Malaysia, and 32.0% in the Philippines), and "exports to the third countries," (53.9% in Thailand, 36.6% in Indonesia, 44.0% in Malaysia, and 40.0% in the Philippines). For Indonesia and the Philippines, "use of inexpensive labor" is the largest single reason for FDI (75.6% and 76.0% respectively) (Table III-6-5).

Table III-6-5 Reasons for FDI by Country (multiple response)

Reasons for FDI (Unit: companies)

	China	U.S.A.	Thailand	India	Indonesia	Viet Nam	Malaysia	Philippines	U.K.	Brazil
Market size and potential growth	135	96	45	33	26	13	10	8	15	19
Exports (re-imports) to Japan	24	7	21	5	9	8	3	3	1	0
Exports to the third countries	33	5	41	7	15	5	11	10	6	3
Supply parts to assembly manufactures	33	38	33	13	8	6	5	9	12	11
Access to inexpensive labor	89	1	35	23	31	24	10	19	1	5
Availability of inexpensive parts/materials	30	3	4	11	7	6	2	1	1	1
Incentives for FDI/deregulation by the recipient country	8	0	8	7	3	4	6	0	1	1
Develop new products suitable for the local market needs	22	40	6	2	6	2	3	1	8	2
Acquisition of technology/know-how in the recipient country	1	15	0	4	1	0	0	0	3	0
Compliance with the progress of regional integration	1	6	9	0	2	0	4	0	6	3
Others	1	4	2	2	0	1	1	0	0	0

Reasons for FDI (share) (Unit: %)

	China	U.S.A.	Thailand	India	Indonesia	Viet Nam	Malaysia	Philippines	U.K.	Brazil
Market size and potential growth	88.2	88.9	59.2	78.6	63.4	43.3	40.0	32.0	60.0	90.5
Exports (re-imports) to Japan	15.7	6.5	27.6	11.9	22.0	26.7	12.0	12.0	4.0	0.0
Exports to third countries	21.6	4.6	53.9	16.7	36.6	16.7	44.0	40.0	24.0	14.3
Supply parts to assembly manufactures	21.6	35.2	43.4	31.0	19.5	20.0	20.0	36.0	48.0	52.4
Access to inexpensive labor	58.2	0.9	46.1	54.8	75.6	80.0	40.0	76.0	4.0	23.8
Availability of inexpensive parts/materials	19.6	2.8	5.3	26.2	17.1	20.0	8.0	4.0	4.0	4.8
Incentives for FDI/deregulation by the recipient country	5.2	0.0	10.5	16.7	7.3	13.3	24.0	0.0	4.0	4.8
Develop new products suitable for the local market needs	14.4	37.0	7.9	4.8	14.6	6.7	12.0	4.0	32.0	9.5
Acquisition of technology/know-how in the recipient country	0.7	13.9	0.0	9.5	2.4	0.0	0.0	0.0	12.0	0.0
Compliance with the progress of regional integration	0.7	5.6	11.8	0.0	4.9	0.0	16.0	0.0	24.0	14.3
Others	0.7	3.7	2.6	4.8	0.0	3.3	4.0	0.0	0.0	0.0

(3) Concerns in undertaking FDI

Table III-6-6 tabulated concerns in undertaking FDI in the ten countries perceived as the most promising FDI destination over the medium term.

For China, respondents express their concerns over "(frequent and abrupt changes in) local legal systems"(64.7%), followed by "(ambiguous application of) local legal system" (60.8%), "local infrastructure" (53.6%), and "(frequent and abrupt changes in) local taxation system" (53.6%). While China has been regarded as a promising market, more than the majority of companies are facing these problems with a feeling that how difficult it is to do business in China.

In respect of concerns in U.S. and U.K., many companies cite "intense competition with local companies" (45.4% and 56.0% respectively). Especially in U.S., some companies point out in response to further inquiries, "despite the economic boom, the price competition is intense among rival companies ."

For Thailand, Malaysia and Brazil, "stability of local (or regional) currency" is cited as a major concern by a substantial share of the respondents (61.8%, 44.0% and 76.2% respectively). For Indonesia, the largest share of 82.9% cites "local political and social situation." This is partly due to the fact that the survey was conducted from July to August 1999, a period when uncertainty was mounting over volatile political and social situations with the problem of East Timor and the presidential election.

For India, Viet Nam and the Philippines, at the top of the concerns is "local infrastructure," which accounts for 59.5%, 60.0% and 52.0% of the responses respectively (Table III-6-6).

Table III-6-6 Concerns in Undertaking FDI by Country (multiple response)

	1	2	3
China	(Frequent and abrupt changes in) local legal systems (64.7%)	(Ambiguous application of) local legal systems (60.8%)	Local infrastructure (53.6%) (Frequent and abrupt changes in) local taxation systems (53.6%)
U.S.A	Intense competition with local companies (45.4%)	Shortage of Japanese employees for overseas affiliates (27.8%)	Acquisition of middle-class employees in the recipient country (20.4%)
Thailand	Stability of local (or regional) currency (61.8%)	Acquisition of middle-class employees in the recipient country (35.5%)	Intense competition with local companies (26.3%) Shortage of Japanese employees for overseas affiliates (26.3%)
India	Local infrastructure (59.5%)	Local political and social situation (54.9%)	Lack of information on the investment climate of the recipient country (40.5%)
Indonesia	Local political and social situation (82.9%)	Stability of local (or regional) currency (73.2%)	Local infrastructure (31.7%)
Viet Nam	Local infrastructure (60.0%)	(Incompleted) local legal systems (53.3%)	Underdevelopment of the local supporting industry (43.3%) Acquisition of middle-class employees in the recipient country (43.3%)
Malaysia	Stability of local (or regional) currency (44.0%)	Local political and social situation (32.0%)	Less progress of deregulation for FDI in the recipient country (24.0%) Availability of local financing (24.0%) Acquisition of middle-class employees in the recipient country (24.0%) Rise of local wage (24.0%)
Philippines	Local infrastructure (52.0%)	Local political and social situation (44.0%)	Stability of local (or regional) currency (40.0%)
U.K.	Intense competition with local companies (56.0%)	Acquisition of middle-class employees in the recipient country (28.0%) Shortage of Japanese employees for overseas affiliates (28.0%)	Stability of local (or regional) currency (20.0%)
Brazil	Stability of local (or regional) currency (76.2%)	Local political and social situation (52.4%)	Availability of local financing (47.6%)

(4) Promising FDI Destinations over the Long Term

As undertaken in the previous survey, this year's survey also inquires promising countries for FDI from a long-term perspective (next ten years). China ranks the first, followed by U.S. and India. While the number of the companies looking at China as a promising destination over the medium term decrease, more companies consider China as a promising destination over the long-term than in the previous year's survey (e.g. from 150 in FY1998 to 170 in FY1999). Similar case also seen for India (e.g. 59 to 71 respectively) (Table III-6-1).

Although Central Europe (Poland, Hungary, Czech and Slovakia) is not on the top ten list as promising countries over the long term, the attentions to these countries are on the trend of increase. The number of companies citing Central European countries are 7 in FY 1997, 31 in FY 1998, and to 36 in FY 1998 (i.e., breakdown of 36 responses by country: 15 for Poland, 10 for Hungary, 8 for Czech and 3 for others). By industry, electrical equipment and electronics (both assembled product and components), automobiles (components) show keen interest to these countries (Table III-6-7).

Table III-6-7 Promising FDI Destinations over the Medium and Long Term (Countries below 11th, FY 1999 Survey) (multiple response)

Medium Term		Long Term	
Country	No. of companies	Country	No. of companies
Taiwan	20	Poland	15
Singapore	18	Taiwan	14
Mexico	16	Singapore	14
Germany	16	U.K.	14
Korea	15	Germany	14
France	10	France	10
Hong Kong	8	Hungary	10
Poland	8	Myanmar	9
Myanmar	6	Russia	9
Spain	6	Czech	8
Australia	6		

IV TRENDS OF OVERSEAS BUSINESS ACTIVITIES

1. SALES STRATEGIES BY PRODUCTION BASE IN FY1998

In respect of sales strategies (for all industries), a focus is placed on sales in the region as well as in the country where FDI took place. For example, in U.K. and U.S., regional sales account for dominant 92.3% and 87.0% respectively. In ASEAN4 countries, regional sales account for 50% to 60%. Moreover, Japanese affiliates in ASEAN4 have a significant share of their sales outside the region.

It is also noteworthy that the share of regional sales declines (e.g.from 68.5% in FY 1998's survey to 63.3% this year's survey). Further inquires found that many companies are "shifting to exports in response to the shrink of local demand by the Asian economic crisis." By industry, this trend is prominent in electrical equipment and electronics (assembled product and components) and general machinery. The share of exports to Japan increased for electrical equipment and electronics (components) and general machinery, while the share of exports to U.S.-Canada increases for electric equipment and electronics (assembled product) (Table IV-1-1).

2. LOCAL PROCUREMENT RATIO

From FY1997 to FY1998 the local procurement ratio[8] of raw materials and parts increased significantly in the majority of industries. The trend is especially significant in ASEAN4, where actual figures increased from 30.5% in FY1997 to 47.5% in FY1998 in general machinery; from 45.8% to 65.0% in electric equipment and electronic products; from 25.9% to 41.0% in electrical equipment and electronics (components); and from 42.9% to 56.5% in automobiles (components). Conversely, automobiles (assembled vehicle) experienced a slight decrease in the ratio and continued to have a relatively low figure (e.g. from 35.0% in FY1997 to 33.0% in FY1998). In addition, not much increase is foreseen in their plans through FY2002 (Table IV-2-1).

By region, U.S.-Canada had the highest 69.5% in FY1998, followed by 61.0% in Central Europe and 58.8% in EU. Generally, the ratio of 50% or higher was achieved. China was the only exceptional case with 47.3%. Moreover, it is noteworthy that the planned increase through FY2002 is as much as 14.0 points in Central Europe and 6.1 points in China.

8 Local procurement ratio = the ratio of the value of raw materials and parts procured in the affiliate-residing country and region to the total value of raw materials and parts procured.

Of raw materials and parts procured locally or regionally, the share of those supplied by Japanese affiliates[9] was the highest 25.9% in ASEAN4 (FY1998). However, the general figure was around 20%, revealing not a significantly high dependence on local Japanese affiliates in purchasing local goods and services (Table IV-2-2).

Table IV-1-1 Sales Strategies by Production Base (ASEAN4)

(Unit: %)

	Sales in the region		Sales out of the region		Japan		US-Canada		EU		Others	
	FY 1998 survey	FY 1999 survey	FY 1998 survey	FY 1999 survey	FY 1998 survey	FY 1999 survey	FY 1998 survey	FY 1999 survey	FY 1998 survey	FY 1999 survey	FY 1998 survey	FY 1999 survey
Chemicals	78.3	81.9	21.7	18.1	7.6	4.4	2.0	0.7	1.8	2.1	10.3	10.9
Electrical equipment & electronics	44.5	35.5	55.5	64.5	23.9	30.6	7.6	12.1	4.5	4.1	19.5	17.7
[Assembled product]	38.7	29.7	61.3	70.3	31.6	29.4	11.3	22.9	7.9	6.8	10.5	11.2
[Components]	47.8	38.5	52.2	61.5	19.6	31.2	5.5	6.4	2.6	2.7	24.5	21.2
Automobiles	82.2	77.9	17.8	22.1	13.3	14.0	1.0	1.0	1.1	1.9	2.4	5.2
[Assembled vehicle]	95.1	93.5	4.9	6.5	2.0	0.0	0.0	0.0	2.4	3.5	0.5	3.0
[Components]	77.1	73.2	22.9	26.8	17.8	18.1	1.4	1.3	0.6	1.4	3.1	6.0
Textiles	46.7	44.8	53.3	55.2	23.3	28.0	13.9	10.4	6.7	8.5	9.4	8.3
General machinery	73.3	41.7	26.7	58.3	12.9	31.9	0.4	5.8	0.0	4.6	13.4	16.0
All Industries	68.5	63.3	31.5	36.7	16.4	19.5	3.2	4.6	2.8	3.0	9.1	9.6

Table IV-2-1 Local Procurement Ratio (by Industry)

(Unit: %)

	All regions					ASEAN4				
	(FY97 survey)	(FY98 survey)	(FY99 survey)			(FY97 survey)	(FY98 survey)	(FY99 survey)		
	FY1996 (actual)	FY1997 (actual)	FY1998 (actual)	FY1999 (projected)	FY2002 (planned)	FY1996 (actual)	FY1997 (actual)	FY1998 (actual)	FY1999 (projected)	FY2002 (planned)
Textiles	43.7	52.4	56.0	56.2	58.2	67.9	47.0	58.3	57.7	58.3
Chemicals	51.9	51.7	58.3	58.7	59.8	43.0	48.3	58.6	58.9	59.8
General machinery	45.2	50.9	52.1	54.5	57.6	45.5	30.5	47.5	48.8	52.5
Electrical equipment & electronics (assembled product)	48.4	50.1	56.1	58.6	62.7	57.5	45.8	65.0	66.6	70.3
Electrical equipment & electronics (components)	34.5	34.7	44.7	46.7	48.3	22.2	25.9	41.0	44.8	46.4
Automobiles (assembled vehicle)	56.7	32.0	32.5	34.0	36.5	-	35.0	33.0	33.0	37.0
Automobiles (components)	51.7	55.7	62.7	64.5	67.8	41.3	42.9	56.5	57.9	61.4
All industries	49.7	51.2	56.4	57.6	59.9	45.9	43.7	53.9	54.9	57.1

Table IV-2-2 Local Procurement Ratio (by Region)

(Unit: %)

	FY 1998 Actual (A)	Ratio of procurement from Japanese affiliates	FY 1999 projected (B)	FY 2002 planned (C)	Increase (C) – (A)
US-Canada	69.5	18.4	70.5	72.0	2.5
EU	58.8	14.6	60.3	60.6	1.8
Latin America	56.0	20.9	58.3	60.8	4.8
NIES	55.2	18.1	56.1	58.4	3.2
ASEAN4	53.9	25.9	54.9	57.1	3.2
China	47.3	18.6	48.7	53.4	6.1
Central Europe	61.0	15.0	69.0	75.0	14.0
All regions	56.4	20.6	57.6	59.9	3.5

9 The ratio of procurement from Japanese affiliates = the ratio of the value of raw materials and parts procured from other Japanese affiliates in the affiliate-residing country and region to the total value of raw materials and parts procured by the affiliates.

V OVERSEAS BUSINESS OPERATIONS AFTER THE ASIAN ECONOMIC CRISIS (ASEAN4 AND KOREA)

This year's survey examines, as a special subject, "prospects of business recovery after the Asian economic crisis" and "investment strategy for the companies that had operational bases in ASEAN4 countries (Thailand, Malaysia, Indonesia and the Philippines) and Korea[10]." These subjects are the follow-up of the previous year's survey on the effect of the Asian economic crisis on Japanese manufacturing affiliates in ASEAN4.

1. PROSPECTS FOR SALES AND PROFITS

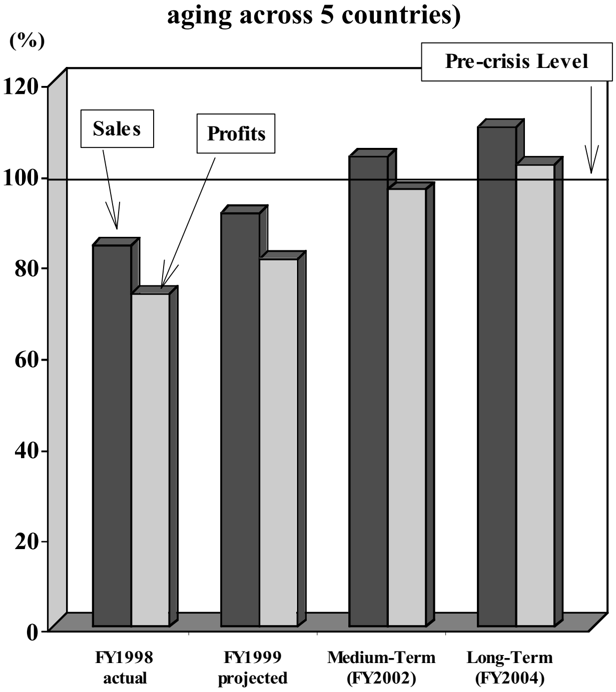
(1) Overall and country-specific prospects

In addition to actual sales volume and profit levels in FY1998 and their projected amounts for FY1999, the survey examines the forecasted timing to return to the pre-crisis levels in the sales and business profits over the medium term (through FY2002) and the long term (through FY2004).

In overall average over five countries, the companies forecast the sales of their affiliates to recover from actual 83.8% of the pre-crisis level (which is assumed to be the baseline of 100) in FY1998 to 90.9% in FY1999, to 103.4% in FY2002, and to 109.8 in FY2004. Business profits are also expected to recover from actual 73.2% to 80.9%, to 96.1%, and to 101.6% respectively. In other words, business performance, which was damaged by the Asian currency crisis, is expected to return to the pre-crisis level within three to five years, with sales leading the way.

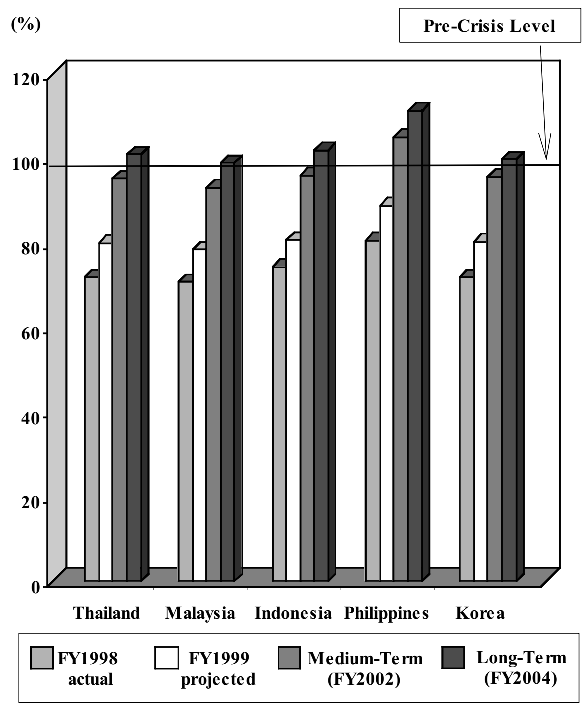
Breakdown of profit forecasts by country shows that the companies having affiliates in Thailand expect steady recovery in profits. (profits: actual record of 71.9% in FY1998, 80.0% for FY1999 in projection, 95.2% in a medium-term forecast, 100.9% in a long-term forecast). Similar expectations for recovery at a similar pace are also held for Indonesia despite some concern over her slow recovery from political stability(profits: actual record of 74.4% in FY1998, 80.8% for FY1999 in projection, 95.9% in a medium term forecast, 101.9% in a long-term forecast). Prospects for business recovery differs more among industries than among other countries, as will be described below. A case in point is Indonesia, where some industries have bleak prospects, while others foresee a brighter future, thereby offsetting each other and, resulting in a smaller gap with other ASEAN4 countries, as a whole. (Figures V-1-1 and V-1-2).

Figure V-1-1 The Outlook of Sales and Profits over the Medium-and Long-Term (averaging across 5 countries)



* Note: (Each figure) averaging across 5 countries, Thailand, Malaysia, Indonesia and Philippines.

Figure V-1-2 The Outlook of Profits over the Medium-and Long-Term (by Country)



10 Of 472 companies responded in this year's survey, those having operational bases in ASEAN4 or Korea amounted to 354. The following analysis is based on their responses.

(2) Prospects by industry

By industry, automobiles (assembled vehicle) has the gloomiest prospect for business profits. Actual profits dived to a petty 15.0% of the pre-crisis level in FY1998, and are expected to take five years or longer to recover to the former level by edging up to 62.5% over the medium term, and to 78.0% over the long-term. Among other industries, general machinery shares the dim sentiment for profits. On the other hand, chemicals, textiles, electrical equipment & electronic parts have more favorable prospects on business profits (Figure V-1-3).

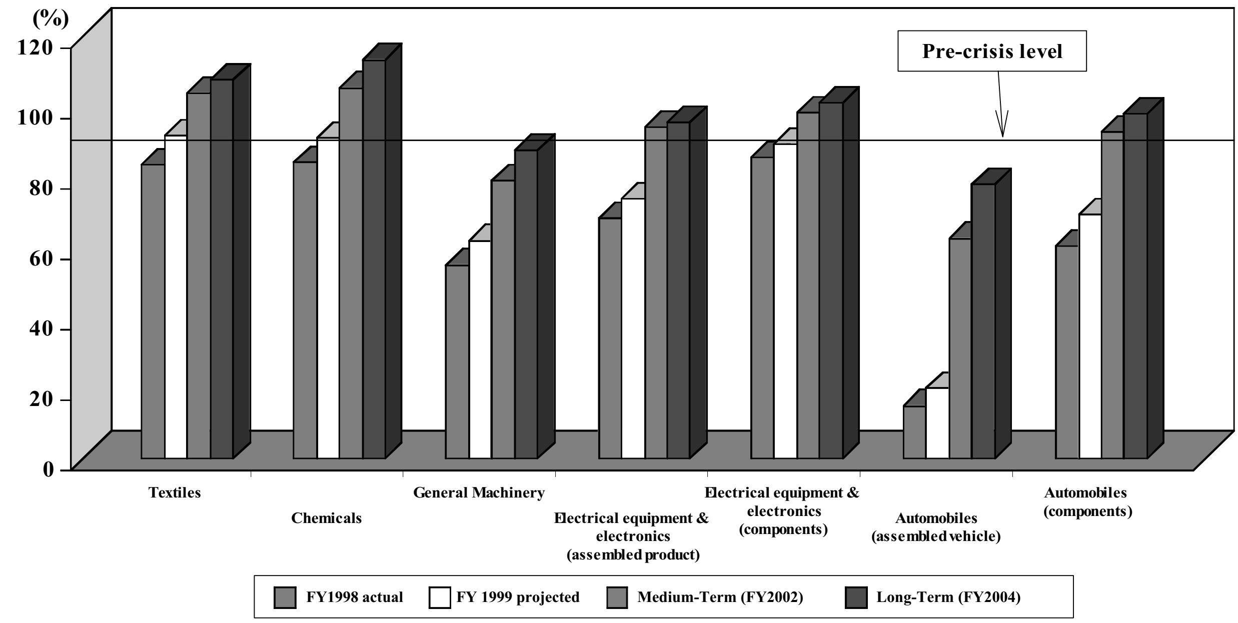
Regarding the reasons that prospects for profits deviate by industry, one may cite relations of "reliance on the local market" and "share of locally procured parts" as major reasons. Figure V-1-4 shows the import ratio[11] and the local procurement ratio[12] of the Japanese affiliates operating in the ASEAN4 region by industry.

Automobiles (assembled vehicle) and steel projected lackluster profits, which are caused by (1) the larger share of sales within ASEAN4 (or the smaller share of exports), and (2) the lower share of locally procured material and parts and higher dependence on imports from outside the region. In other words, while they have been largely affected by the dwindling domestic demand by the Asian economic crisis, they have also been affected by the rising prices of imported materials caused by the devaluation of the local currency.

Meanwhile, the comparatively bright outlook in textiles, electrical equipment and electronic parts may be solely attributable to the high export ratio toward the region outside the ASEAN4. It also appears likely that those industries reinforced sales efforts in an attempt to offset the weakening domestic demand. As for chemicals, although the sales ratio within the ASEAN4 region is high, its sales is composed of a wide range of products from upstream products, including chemical materials, to downstream ones such as plastic moldings and toiletry goods, as well as pharmaceutical products. In particular, favorable profits prospects are seen among the downstream sector. In addition, the high local procurement ratio of raw materials and parts seem to partially help the industry to evade increased import cost caused by the deteriorating local currencies (Figure V-1-4).

Figure V-1-5 plots the "export ratio and local procurement ratio on the basis of ASEAN4 countries", while Table V-1-1 depicts "comparison of the export and local procurement ratios of FY1998 and FY1999 surveys." Table V-1-1 reveals that both figures have increased nearly across the countries and industries. This may be the result of efforts to shift focus to exports and to procure materials in the region in response to lower domestic demand brought about by the Asian economic crisis and to the higher cost of import materials caused by the plunging currency values (Figure V-1-5 and Table V-1-1).

Figure V-1-3 The Outlook of Profits Over the Medium-and Long-Term (by Industry)



11 Export ratio = the ratio of export value to total sales for the affiliates in ASEAN4.

12 Local procurement ratio = the ratio of raw materials and parts procured in the region to the total procurement of raw materials and parts for the affiliates in ASEAN4.

Table V-1-1 Effects of the Local Procurement Ratio and The Export Ratio on Profitability, Changing Pattern Over Time (FY98, FY99)

(Unit:%)

	ASEAN4				Thailand				Malaysia				Indonesia				Philippines			
	Local procurement ratio		Export ratio		Local procurement ratio		Export ratio		Local procurement ratio		Export ratio		Local procurement ratio		Export ratio		Local procurement ratio		Export ratio	
The year of survey:(FY)	98	99	98	99	98	99	98	99	98	99	98	99	98	99	98	99	98	99	98	99
Textiles	52.5	58.3	53.3	55.2	48.0	58.3	45.0	50.0	15.0	-	100.0	-	45.0	55.0	66.7	100.0	-	70.0	-	5.0
Chemicals	53.4	58.6	21.7	18.1	55.5	63.5	25.9	20.5	60.4	43.6	29.7	20.6	45.8	59.1	10.8	13.4	80.0	58.3	10.0	0.0
Steel	24.1	36.9	14.1	9.2	22.5	32.8	16.0	20.0	33.3	40.0	2.0	1.4	26.4	35.0	1.7	3.3	50.0	45.0	53.3	7.5
General Machinery	32.9	51.7	26.7	58.3	33.9	37.2	17.8	56.5	52.5	71.7	22.4	64.2	32.1	68.3	38.0	50.0	23.3	58.3	55.0	61.7
Electrical equipment & electronics (assembled product)	47.7	58.7	61.3	70.3	51.3	51.3	53.9	64.5	51.0	61.4	81.7	64.0	48.3	67.5	27.5	75.0	46.7	57.5	60.0	76.0
Electrical equipment & electronics (components)	27.1	40.7	52.2	61.5	28.6	45.0	43.5	50.2	22.6	50.0	52.5	61.2	18.0	40.5	56.8	61.8	22.5	21.4	62.9	78.3
Automobiles (assembled vehicle)	40.0	41.4	4.9	6.5	53.0	55.0	11.7	18.6	41.0	20.0	0.0	0.0	43.3	43.0	0.4	6.7	41.0	35.0	8.3	0.0
Automobiles (components)	43.4	55.6	22.9	26.8	46.4	64.1	14.5	17.2	21.3	50.5	8.7	29.4	42.1	48.5	19.4	22.1	35.0	46.8	69.5	60.2
All Industries	45.2	53.8	31.5	36.6	46.4	58.0	27.4	31.8	45.5	54.8	31.8	36.1	39.2	52.2	30.5	38.2	40.0	43.5	42.9	48.5

Figure V-1-4 Effects of the Local Procurement Ratio and The Export Ratio on Profitability by Industry (ASEAN4)

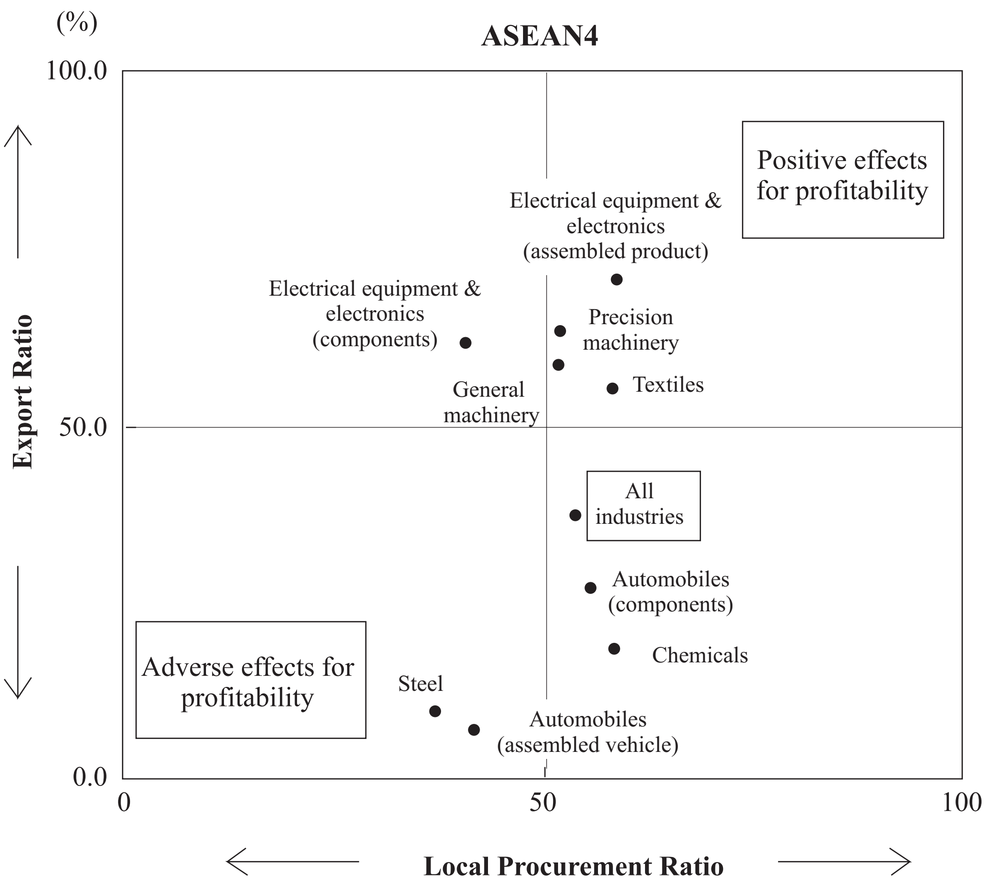
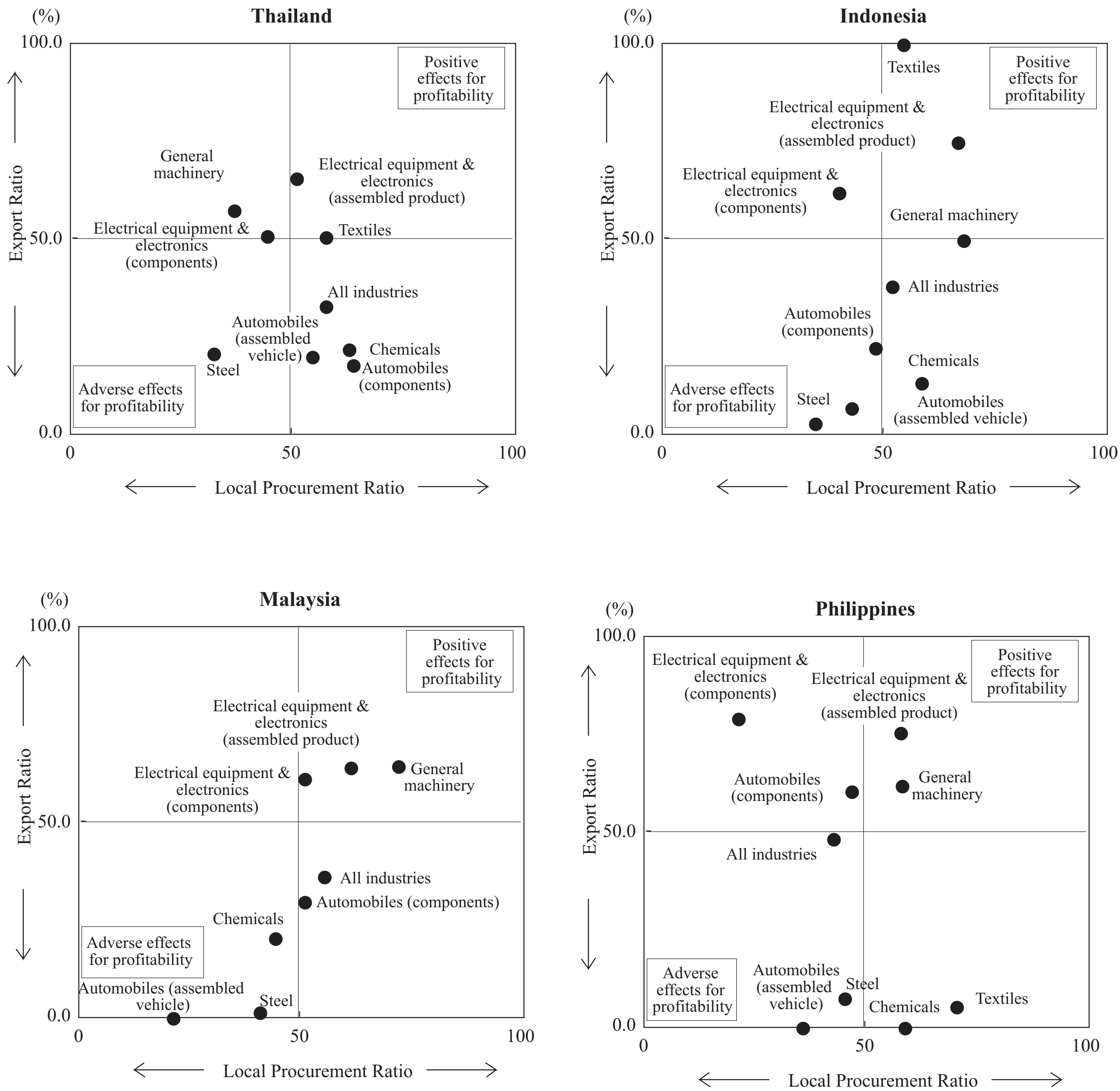


Figure V-1-5 Effects of the Local Procurement Ratio and The Export Ratio on Profitability (Thailand, Indonesia, Malaysia, the Philippines)



2. CAPACITY UTILIZATION

Capacity utilization in capital facilities was examined for actual records in FY1998 and projections for FY1999, assuming the pre-crisis level to be 100.

In the aggregate, actual record in FY1998 was 79.2%, and projection for FY1999 was 86.0%. By industry, automobiles (assembled vehicle) experienced a substantial drop in capacity utilization, operating far below the pre-crisis level, with 31.8% in FY1998 and 38.6% projected for FY1999. In other industries, automobiles (components), general machinery and steel suffered a decline in capacity utilization. A smaller decline is seen in electrical equipment and electronics (assembled product and components), textiles and chemicals (Table V-2-1).

3. RESPONSE IN BUSINESS OPERATIONS AND FINANCIAL MANAGEMENT

(1) Response in Business Operations

The most numerous response to the Asian economic crisis in business operations is to "exert more sales efforts in the local market," which accounts for 74.6%. Among other responses are: "shift product lines in Japan or the third country to local production" (22.6%); "maintain the overseas bases by pushing forward restructuring" (21.4%); and "strengthen exports by shifting to products with export specification" (16.1%).(Figure V-3-1).

In particular, the companies replying that they would push forward restructuring show significant shares: automobiles (assembled vehicle) (61.5%) and automobiles (components) (30.4%), electric equipment and electronic products (27.3%) and steel (25.8%) (Figure V-3-2).

The industries, with a large share of response as "push forward restructuring," are further examined. A different restructuring approach is observed between electrical equipment and electronics (assembled products), steel, automobiles (assembled vehicle) and automobiles (components). In steel, automobiles (assembled vehicle) and automobiles (components), "reduction in local employees" and "reduction in the employees dispatched from Japan" account for substantial shares, which reveal an approach to whether the current tough market conditions through reduction in workers.

In electrical equipment and electronics (components), a sizable share of companies (40.0%) is "reorganizing the bases," whereas "reduction in the employees dispatched from Japan" claimes a relatively small share (26.7%). On the other hand, there are not a few companies (20.0%) citing "since the existing bases are important as export bases, vigorous investment will continue," revealing a sustained effort toward business operations by increasing efficiency including measures such as consolidation of the existing bases (Table V-3-1).

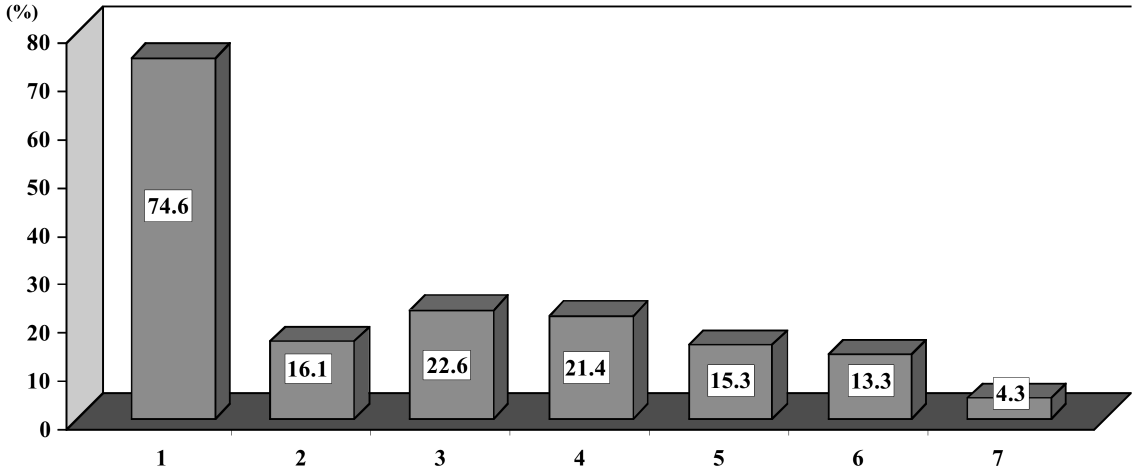
A further question asking "challenges in making a shift toward exports" is given to the companies that responded they would "strengthen exports" as a way to meet challenging business conditions. According to Figure V-3-3, "difficulty in securing clients for exports" and "competition is intense because of currency depreciation among ASEAN countries" each account for 37.4%, and "difficulty in changing to the export-oriented product specification" accounts for 19.1%. There is, however, a response, "export shift is proceeding well without particular problems," at 27.8% in many cases in electrical equipment and electronics (components) and automobiles (components) (Figure V-3-3).

Table V-2-1 Capacity Utilization

(Unit:%)

	ASEAN4＋Korea		Thailand		Indonesia		Malaysia		Philippines		Korea	
	FY 1998 (actual)	FY 1999 (projected)	FY 1998 (actual)	FY 1999 (projected)	FY 1998 (actual)	FY 1999 (projected)	FY 1998 (actual)	FY 1999 (projected)	FY 1998 (actual)	FY 1999 (projected)	FY 1998 (actual)	FY 1999 (projected)
Textiles	89.3	95.0	90.0	97.5	92.8	91.7	105.0	105.0	85.0	95.0	65.0	95.0
Chemicals	85.4	93.6	85.0	92.8	80.0	90.6	90.0	100.0	105.0	100.0	86.5	93.5
Steel	72.1	78.6	73.3	80.0	67.5	67.5	75.0	85.0	75.0	90.0	-	-
General Machinery	71.5	78.0	76.4	85.0	91.7	95.0	65.0	77.5	35.0	25.0	65.0	69.0
Electrical equipment & electronics (assembled product)	91.2	91.2	93.8	88.8	95.0	102.5	90.6	92.8	91.0	91.0	81.7	78.3
Electrical equipment & electronics (components)	94.3	98.8	92.1	98.6	90.0	92.5	97.7	102.3	105.0	108.3	88.3	91.7
Automobiles (assembled vehicle)	31.8	38.6	35.0	48.3	16.4	19.3	27.5	35.0	53.0	57.0	-	-
Automobiles (components)	62.8	74.1	56.2	68.5	55.0	59.0	68.3	78.3	87.9	102.1	64.3	78.3
All Industries	79.2	86.0	76.6	85.3	76.5	81.6	81.7	88.6	86.4	91.2	80.2	86.9

Figure V-3-1 Future FDI Strategies in Coping with Challenges in the Asian Economic Crisis (multiple response)



1. Exert more sales efforts in the local market
2. Strengthen exports by shifting to products with export specification
3. Shift product lines in Japan or the third country to local production
4. Maintain the overseas bases by pushing forward restructuring
5. No specific strategies. Awaiting the recovery of the local market
6. Intend to undertake FDI positively for the reason that the overseas affiliates as export bases
7. Others

Figure V-3-2 Push Forward Restructuring of the Overseas Bases

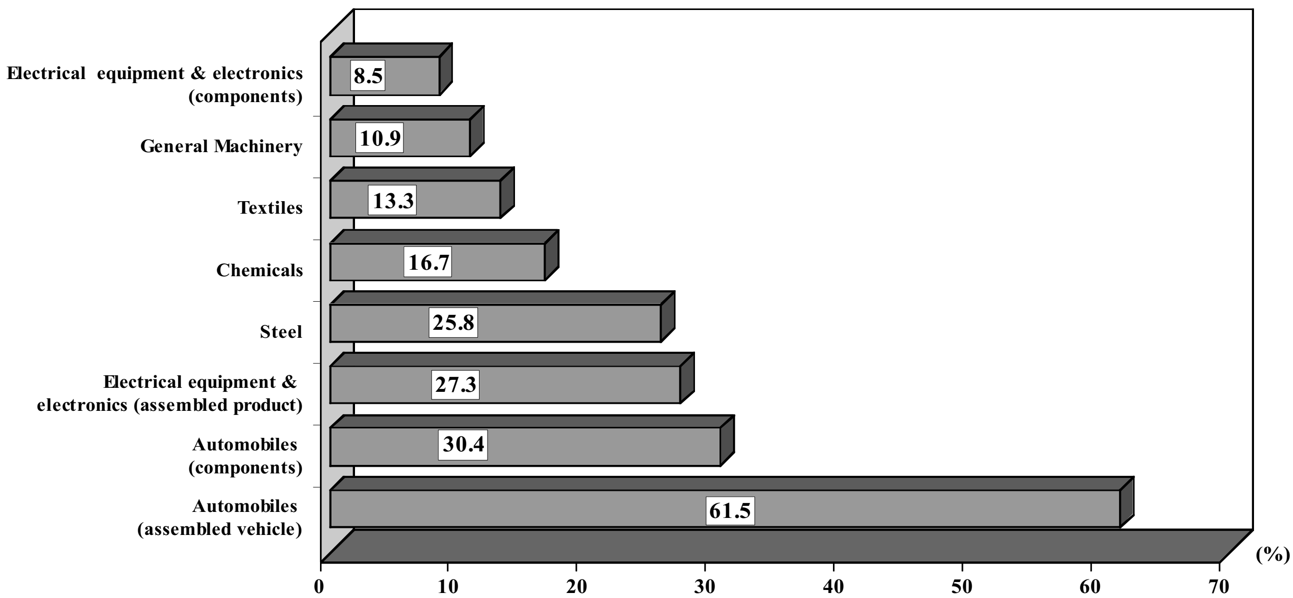


Table V-3-1 Restructuring Approach (Steel, Electrical Equipment and Electronics (assembled product), Automobiles (assembled vehicle and components))

(Unit: %)

	Reduction in local employees	Downsizing the facilities	Reorganizing the bases	Rolling back the business bases	Reduction in the employees dispatched from Japan	Others
Steel	100.0	14.3	14.3	0.0	71.4	14.3
Electrical equipment & electronics (assembled product)	60.0	20.0	40.0	0.0	26.7	0.0
Automobiles (assembled vehicle)	100.0	25.0	18.8	6.3	68.8	6.3
Automobiles (components)	96.4	7.1	14.3	3.6	46.4	0.0

(2) Response in Financial Management

Of Japanese affiliates having business bases in Thailand, 70.3% had undertaken some form of “financial measures” in coping with challenges in the Asian economic crisis. This is the highest share among companies having affiliates in the five countries, followed by 69.1% in Indonesia and 53.3% in Malaysia. In addition, the companies that responded “they would continue to provide some form of financial support” account for 41.5% in Thailand, the highest share, which is followed by 40.3% in Indonesia and 38,4% in the Philippines (Figure V-3-4).

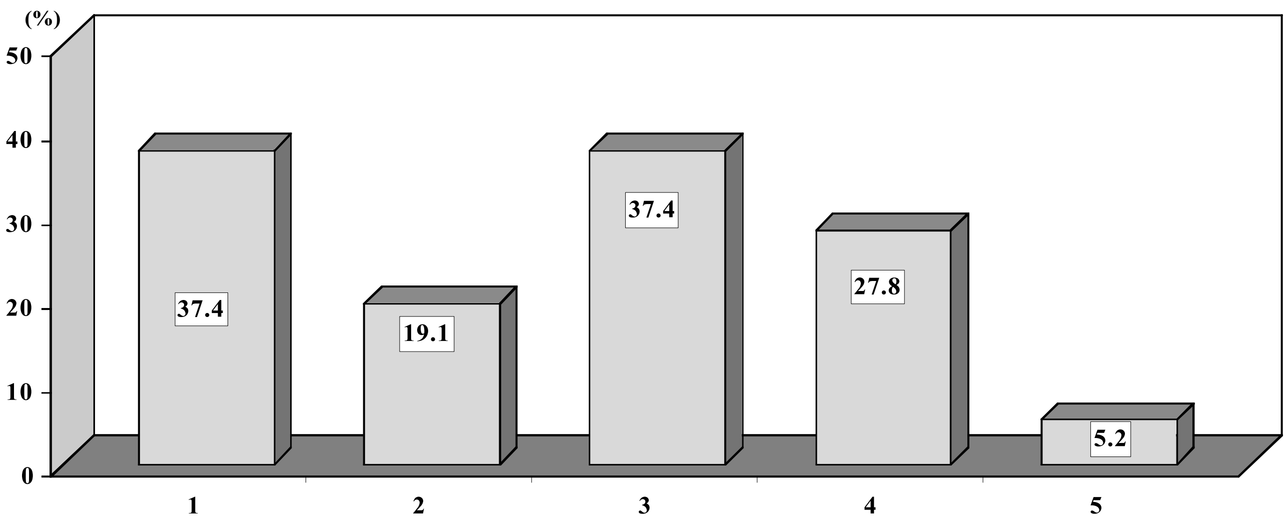
Of the response that they “undertook some financial measures,” the largest 61.0% of companies report that they “re-capitalized (including raising their equity share)” the affiliates. By country, the highest 69.6% of the companies having affiliates in Thailand report that they “re-capitalized” their affiliates, following the relaxation of regulations on equity shares of foreign companies in joint ventures. This is followed by “the parent company provided guarantees to the borrowings made by the affiliates” at 57.9%, “received loans from the parent company” at 45.0%, and “extended payment terms (between parent company and affiliates)” at 33.6%. As for how these measures are funded, “funds available at the parent company” accounts for the highest 51.2%, followed by “local affiliates of Japanese banks (including those in ASEAN4)” for 42.5% and “loans from the parent company” for 24.4% (Table V-3-2, Table V-3-3).

4. EFFECT OF U.S. AND EUROPEAN COMPANIES MOVING INTO ASIA

While crisis-affected Japanese affiliates are struggling to regain profits, U.S. and European companies have reportedly been positively expanding their activities into Asia. Serving as its background, as it was pointed out, is that the crisis-induced depreciation in local currencies and a plunge in asset values of Asian companies amidst economic downturn have created an unprecedented opportunity for gaining a foothold in the region through mergers and acquisitions. The growing presence of U.S. and European companies in Asia has raised concern over their effect on Japanese affiliates in the same region.

(As of inquiry) on the effect of U.S. and European companies expanding into Asia, 14.7% of the companies respond that “advancement by US and European companies into Asia effects on the market activity.” On the other hand, “advancement by US and European companies into Asia does not effects on the market activity,” “there is not remarkable advancement by US and European companies into Asia” and “there is no effect because our affiliates are oriented to the export activities” respectively account for

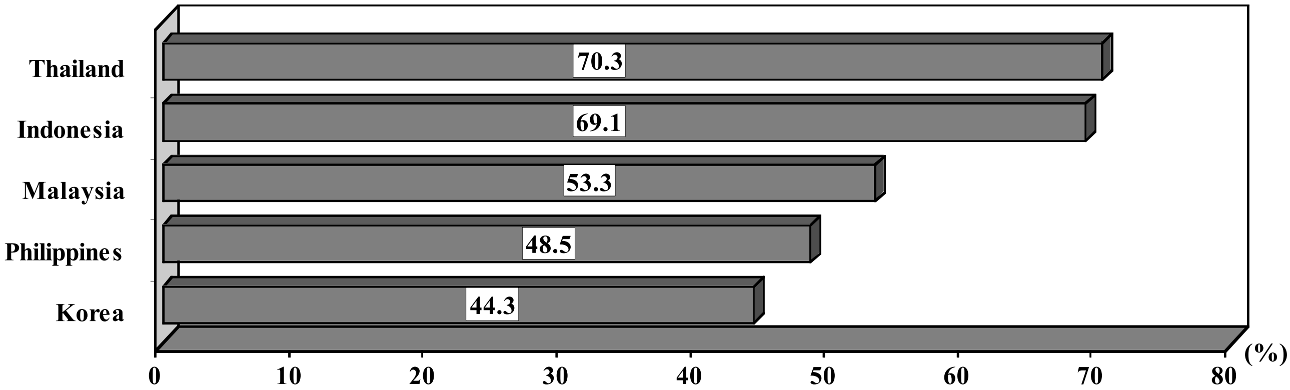
Figure V-3-3 Challenges in Making a Shift Toward Exports (multiple response)



1. Difficulty in securing clients for export
2. Difficulty in changing to the export-oriented product specification
3. Competition is intense because of currency depreciation among ASEAN countries
4. Export shift is proceeding well without particular problems
5. Others

Figure V-3-4 Financial Measures in Coping with Challenges in the Asian Economic Crisis

Undertook some form of financial measures



Plan to provide some form of financial support

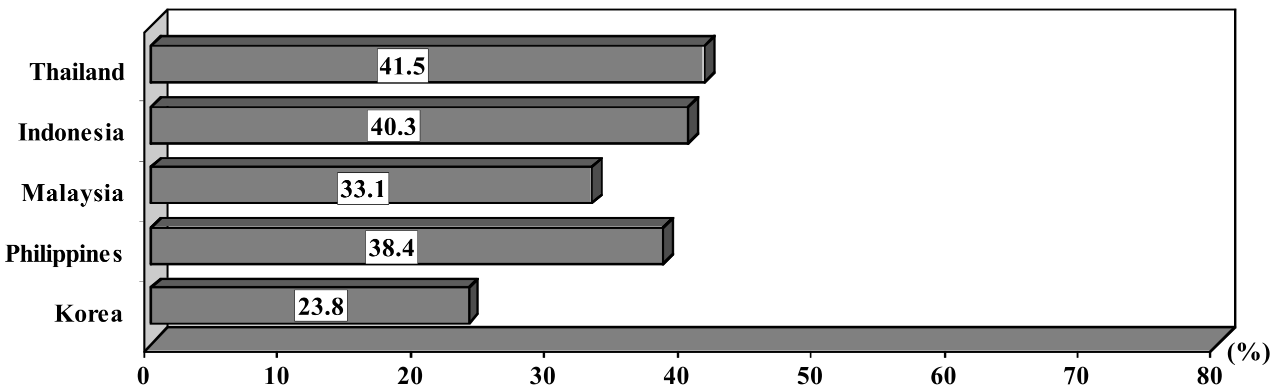


Table V-3-2 Types of the Financial Measures

(%)

	ASEAN4 Korea	Thailand	Indonesia	Malaysia	Philippines	Korea
Recapitalized (including raising their equity share)	61.0	69.6	56.3	60.0	58.3	48.1
Received loans from the parent campany	45.0	47.8	37.9	44.4	60.4	37.0
Extended payment terms (between parent company and affiliates)	33.6	29.8	34.0	38.9	31.3	37.0
The parent company provided guarantees to the borrowings made by the affiliates	57.9	53.4	68.0	62.2	43.8	57.4
Rescheduling of debt (rescheduling by lenders including the parent company)	13.8	13.7	16.5	16.7	12.5	5.6
Converting debt to investment capital	6.8	6.8	4.9	8.9	10.4	3.7
Others	2.9	2.5	4.9	1.1	4.2	1.9

Table V-3-3 Financing Sources

(Unit: %)

	ASEAN4 Korea	Thailand	Indonesia	Malaysia	Philippines	Korea
Funds available at the parent company	51.2	55.0	47.1	48.1	52.1	51.0
Loans from the parent company	24.4	25.5	26.4	19.8	29.2	20.4
Local banks	22.5	19.5	20.7	27.2	14.6	34.7
Local affiliates of Japanese banks	42.5	46.3	48.3	43.2	31.3	30.6
Direct borrowing from Japan (including the lending money by Japanese governmental financial institutions)	14.7	16.1	18.4	14.8	12.5	6.1
Others	1.7	2.0	2.3	1.2	2.1	0.0

26.5%, 41.5% and 15.2%. Judging from these findings, in general, the expansion of U.S. and European companies into Asia does not seem to have a significant effect on Japanese affiliates (Figure V-4-1).

By country where affiliates are under operation , those respond, “advancement by US and European companies into Asia effects on the market activity” reach the highest 19.4% in Thailand, followed by 18.8% in Korea. Since both countries have been moving forward to relax regulations on foreign ownership of domestic companies in the wake of the Asian economic crisis, this may have led U.S. and European companies to more conspicuous activity there. By industry a large share of companies are “feeling the effect” in chemicals (45.8% in Thailand, 50.0% in Malaysia and 27.8% in Korea), electrical equipment and electronics (components) (29.4% in Malaysia), automobiles (30.0% in Thailand). On the other hand, additional inquiries on the extent of the effect rarely find that “there is intense competition with U.S. and European companies.” Instead, the responses heard are more often “competition with other Japanese manufacturing affiliates is more intense” or “as a component manufacturer, U.S. and European product manufacturers moving into the region is, if anything, a positive factor.”

These results suggest that a situation where “the presence of Japanese affiliates in Asia declines in a major way because of U.S. and European companies flocking to Asia” has not arisen yet to bring about general concern.

5. FUTURE INVESTMENT STRATEGIES

As future investment strategies in Asia, “strengthen the overseas bases” accounts for 46.9% of the total companies responded, and “maintain the overseas bases” accounts for 49.4%. Only 3.8% of the companies intend to “decrease the number of overseas bases or have a shift in focus”.

Of those companies that would “strengthen the overseas bases,” the highest 64.9% would “expand the existing facilities,” followed by “diversify product lines” (49.6%) and “strengthen sales bases” (34.6%). On the other hand, “establish new production bases” is a low with 7.8%.

Even after the Asian economic crisis, Asia will invariably be an important location for Japanese manufacturing companies. Nevertheless, there is a strong indication that the focus is shifting to the utilization of the existing bases (Figure V-5-1).

VI. REGIONAL INTEGRATION AND FDI

For the second straight year, the survey also examines the effect of regional integration on direct investment overseas (AFTA, NAFTA, EU, MERCOSUR)[13]. In this year, 254 out of 472 companies respond, or 53.8%, express that “regional integration will affect the company’s overseas business operations.”

Among the markets moving toward regional integration, EU attracts the highest interest and is regarded as having the most substantial effect on the company’s overseas business operations. Although the number of companies citing EU remain173 this year, a decrease from the previous 235, interest in the region is still running high. Last year’s figure may have been particularly high since the survey was conducted in a period preceding the introduction of the single currency Euro in January 1999. By industry, the interest is high in the electrical equipment and electronics, chemicals, and automobiles, following a similar pattern in the previous year. 108 companies express

13 AFTA = ASEAN Free Trade Area. AFTA was agreed upon at the ASEAN Summit Meeting in January 1992, and inaugurated in January 1993 with the introduction of CEPT (Common Effective Preferential Tariff).

Figure V-4-1 The Effects of U.S. and European Companies' Advancement into Asia

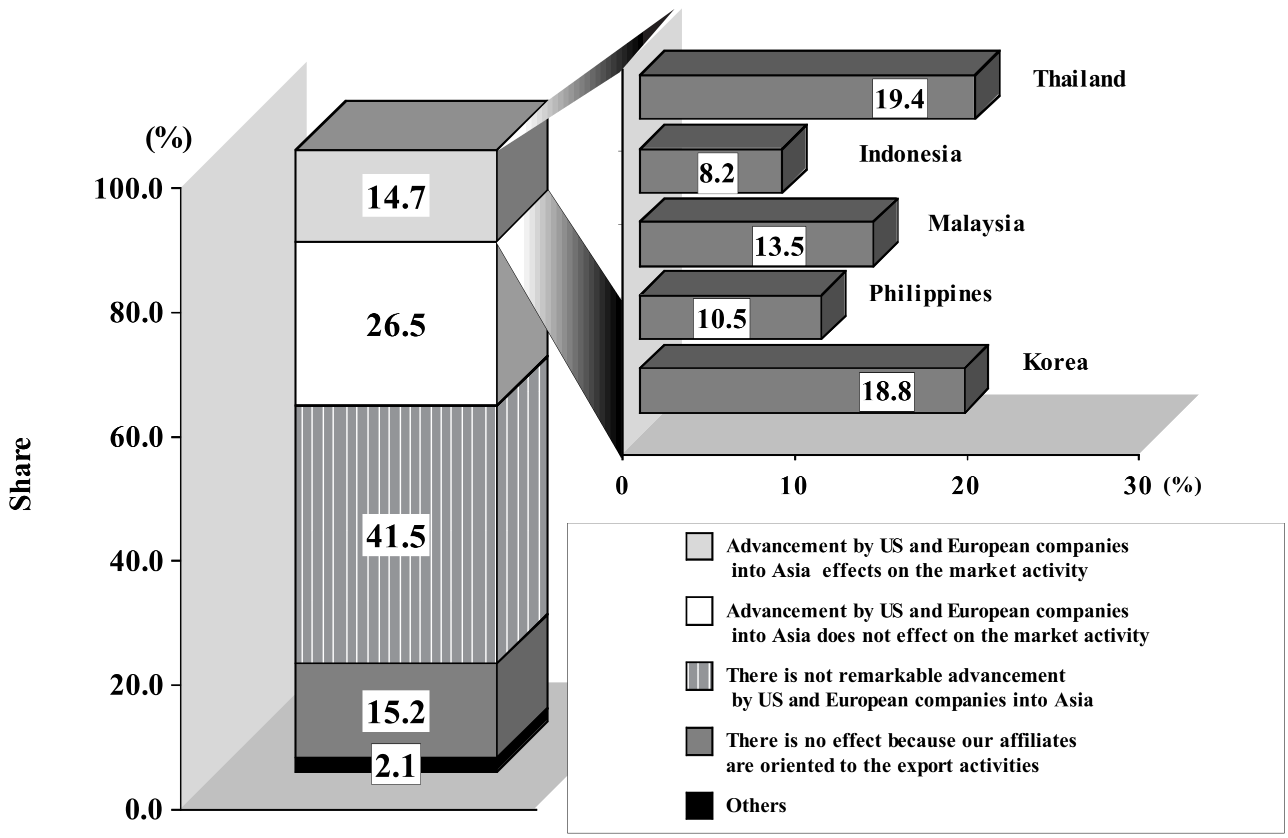
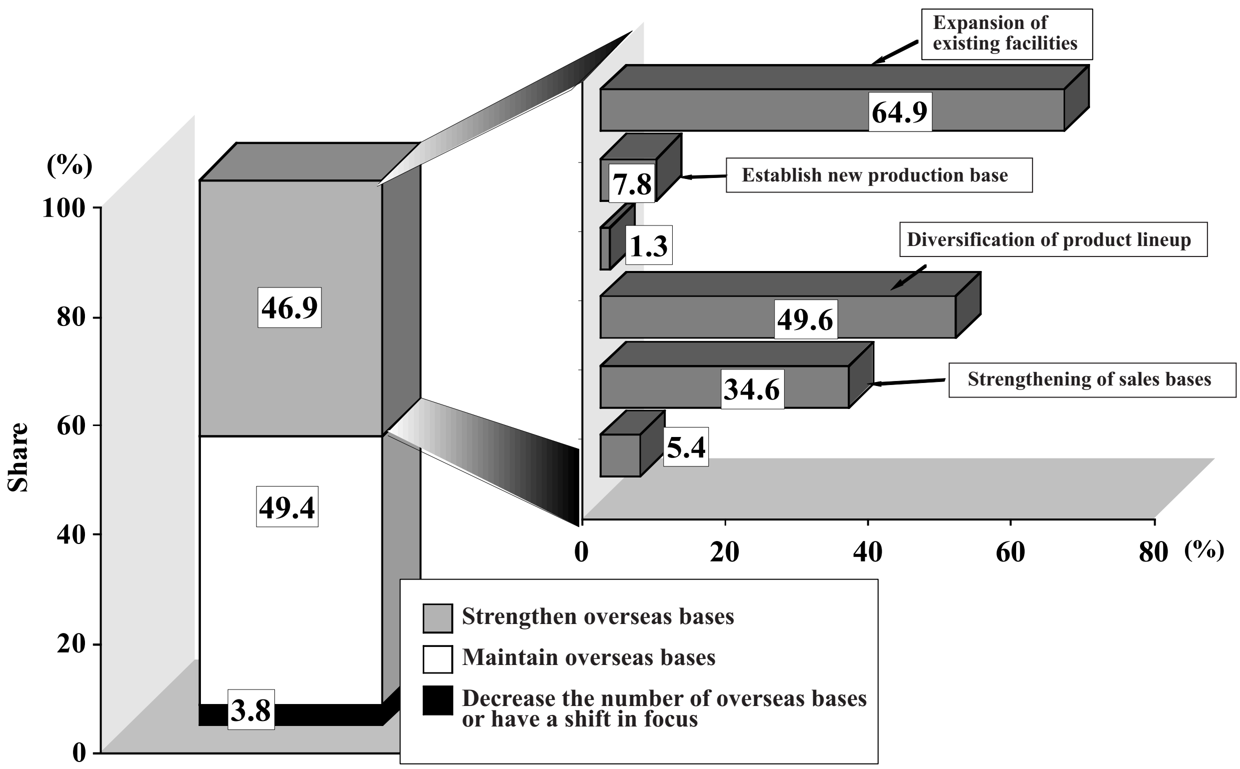


Figure V-5-1 Future FDI Strategies in the Asian Region



interest in AFTA, and 100 companies in NAFTA. In the both regions, the automobile industry shows a significantly high interest. 30 companies express interest in MERCOSUR. AFTA, NAFTA, MERCOSUR attract interest from similar number of companies as in FY1998 (Table VI-1).

As for its effects on investment strategies and responses from the companies, the most numerous reaction across all the regions is “strengthen sales efforts in view of expanded market and intensified competition”. This is followed by “build an intra-regional complementary network system”. Especially, this response accounts for a high 52.5% of the respondents for AFTA. The figure reflects the companies posturing themselves to improve efficiency through reorganization and closer linkage of operational bases in the region in response to the phased reduction of intra-regional tariffs, which is being pursued by the governments of ASEAN countries. For EU, among high response rates are “integrated control and increased efficiency of financing, financial management and foreign exchange operations (intra-regional settlement)” (32.4%) and for “convergence of intra-regional prices (a review of pricing)” (30.6%), both of which reflect the effect of introduction of the Euro on business operations in the region.

Numerous companies pointed out that the following issues are on the future agenda of regional integration for AFTA: “currency stability in the region” (74.5%), “economic and political stability in the region” (66.0%), and “unification of the legal and taxation systems among the member countries” (53.2%). For EU, on the agenda are “unification of the legal and taxation systems among the member countries” (58.6%), “currency stability in the region” (44.1%), and “leveling out economic disparities among the member countries” (43.4%). For NAFTA, many companies cite “currency stability in the region” (42.3%), “leveling out economic disparities among the member countries” (40.8%) and “dealing with changes in the tariff systems among the member countries (including the abolition of the bonded system)” (35.2%), which reflect the abolition of the Maquiladora System in Mexico. For MERCOSUR, “currency stability in the region” (83.3%) is at the top of the agenda, followed by “political and economic stability in the region” (62.5%) (Table VI-2).

NAFTA = North American Free Trade Agreement. Inaugurated by the United States, Canada and Mexico in January 1994.
EU = European Union. EC was renamed EU after the Maastricht Treaty came into effect in November 1993.
MERCOSUR = Mercado Comun del Sur. Its establishment was agreed on at the summit meeting of 4 nations, Brazil, Argentina, Uruguay and Paraguay in March 1991. Inaugurated in January 1995.

Table VI-1 Interest in Regional Integration

	AFTA	NAFTA	EU	MERCOSUR
FY1999 Survey	42.5% 108 companies	39.4% 100 companies	68.1% 173 companies	11.8% 30 companies
Industries express high interest in regional integration	Automobiles 28 companies	Automobiles 26 companies	Electrical equipment & electronics 38 companies	Automobiles 6 companies
	Electrical equipment & electronics 17 companies	Electrical equipment & electronics 23 companies	Chemicals 29 companies	Electrical equipment & electronics 6 companies
	Chemicals 16 companies	Chemicals 12 companies	Automobiles 27 companies	Chemicals 4 companies
FY 1998 Survey	30.6% 105 companies	27.1% 93 companies	68.5% 235 companies	8.2% 28 companies
Industries express high interest in regional integration	Automobiles 26 companies	Automobiles 25 companies	Electrical equipment & electronics 53 companies	Automobiles 5 companies
	Chemicals 17 companies	Electrical equipment & electronics 18 companies	Chemicals 42 companies	General Machinery 5 companies
	Electrical equipment & electronics 12 companies	Chemicals 12 companies	Automobiles 34 companies	Electrical equipment & electronics 4 companies
				Chemicals 4 companies
(reference) Regional Integration				
Inaugration	Jan,1993	Jan,1994	Nov,1993 (effectuation)	Jan,1995
GNP (1997)	$705.2 billion (excluding Brunei and Myanmar)	$8726.7 billion	$8565.5 billion (excluding Luxembourg)	$1133.6 billion
Population (1997)	495.53 million	392.27 million	374.23 million	207.72 million
Member countries	Thailand, Malaysia, Indonesia, Philippines, Singapore, Vietnam, Brunei, Laos, Cambodia, Myanmar	U.S., Canada, Mexico	England, Germany, France, Italy, Netherland, Belgium, Greece, Luxembourg, Denmark, Spain, Portugal, Austria, Finland, Sweden, Ireland	Brazil, Argentina, Urguay, Paraguay

Table VI-2 Effect on the Strategies and Future Agenda of Regional Integration

	AFTA		NAFTA		EU		MERCOSUR	
Effects on investment strategies (multiple response)	101 companies	(%)	95 companies	(%)	170 companies	(%)	29 companies	(%)
Strengthen sales efforts in view of expanded market and intensified competition	63	(62.4)	54	(56.8)	115	(67.6)	17	(58.6)
Examine strategy carefully,including investment destination	23	(22.8)	16	(16.8)	26	(15.3)	8	(27.6)
Establish a new overseas bases	12	(11.9)	13	(13.7)	22	(12.9)	5	(17.2)
Build an intra-regional complementary network system	53	(52.5)	32	(33.7)	55	(32.4)	9	(31.0)
Restructuring the bases in the region	18	(17.8)	20	(21.1)	36	(21.2)	2	(6.9)
Integrated control and increased efficiency of financing, financial management and foreign exchange operations (intra-regional settlement)	16	(15.8)	11	(11.6)	55	(32.4)	0	(0.0)
Convergence of intra-regional prices (a review of pricing)	14	(13.9)	11	(11.6)	52	(30.6)	3	(10.3)
Establishment and enhancement of supervisory holding companies that aim to centralize corporate planning functions	6	(5.9)	9	(9.5)	23	(13.5)	1	(3.4)
Others	2	(2.0)	3	(3.2)	2	(1.2)	1	(3.4)
Future of Agenda of regional integration(multiple response)	94 companies	(%)	71 companies	(%)	152 companies	(%)	24 companies	(%)
Unification of the legal and taxation systems among the member countries	50	(53.2)	29	(40.8)	89	(58.6)	6	(25.0)
leveling out economic disparities among the member countries	29	(30.9)	18	(25.4)	66	(43.4)	11	(45.8)
Unification of the political systems among the member countries	24	(25.5)	8	(11.3)	20	(13.2)	4	(16.7)
Economic and political stability in the region	62	(66.0)	24	(33.8)	32	(21.1)	15	(62.5)
Currency stability in the region	70	(74.5)	30	(42.3)	67	(44.1)	20	(83.3)
Dealing with changes in the tariff systems among the member countries(including the abolition of the bonded system)	36	(38.3)	25	(35.2)	37	(24.3)	8	(33.3)
Others	1	(1.1)	2	(2.8)	1	(0.7)	1	(4.2)

APPENDIX: FDI TRENDS FOR MIDDLE-RANKED AND SMALL- AND MEDIUM- SIZED ENTERPRISES

Yuriko Moritani

The main text summarized FDI trends and projections for all the respondents of the survey. This appendix selects its subset, the Middle-ranked and the Small- and Medium-Sized Enterprises (SMEs), defined as companies whose capital is less than ¥1 billion (80 companies in the survey of FY1998 ,and 100 companies of FY1999), and examines trends in their direct investment activities.

EXECUTIVE SUMMARY

Trends of the Medium-ranked and Small- and Medium-Sized Enterprises (SMEs) in comparison with the Overall Survey Results

- The SMEs are more cautious over their medium-term prospects, in comparison with the entire companies surveyed. A smaller percentage of them have plans to undertake FDI over the medium term, while a higher percentage of companies would reduce FDI over the same term from the actually invested amount in the past 3 years.
- With respect to the types of FDI being contemplated over the medium term, investments for expansion of existing production bases account for a markedly higher share among them for Asia, Europe ,and U.S., compared with all the companies surveyed.
- In the prospects for profits from business operations in the wake of the Asian economic crisis, these companies foresee the recovery as early as 1999, whereas the aggregate response is that profits would return to the pre-crisis level in FY2002 or thereafter.
- With respect to future investment strategy for the Asian region after the Asian economic crisis, the SMEs are putting more emphasis on strengthening their bases than all the companies.
- For this subset of companies, "domestic capital facilities will not be adversely affected" by FDI. However, some respondents, though small in share but larger than for the entire companies surveyed, cite that domestic production facilities would be scaled down.

On the other hand, the companies replying that "despite a shift in production of domestically manufactured products to overseas bases, domestic production will shift to higher value-added products" account for a higher percentage than the aggregate response, apparently revealing the tenacity of these companies in operating business.

CONTENTS

I. PROFILE OF RESPONDENT COMPANIES

There are a total of 667 overseas affiliates for the 100 SMEs that responded to this survey. This is a significant increase from 490 overseas affiliates in the previous year. A breakdown of affiliates by region shows US-Canada leading with 170 affiliates(25.5%), followed by China with 131 (19.6%), NIES14 with 130 (19.5%) and ASEAN4 with 121 (18.1%). However, regional breakdown of production bases finds ASEAN4 ranking the first with 89 affiliates (25.3%), as in the case of the entire companies surveyed. This is followed by China with 88 (25.0%), NIES with 62 (17.6%), and US-Canada with 60 (17.0%). Breakdown by industry shows that the following four industries constitute 48.0% of the SMEs: automobiles (components) (16 affiliates), metal products (13), electrical equipment and electronics (10), and chemicals (excluding pharmaceuticals) (9) (Table A-I-1 ~ A-I-5).

Table A-I-1 Paid-in Capital of Respondents

			No. of Companies	%
	<	¥100 million	35	35.0%
¥100 million	<	¥500 million	46	46.0%
¥500 million	<	¥1 billion	19	19.0%
Total			100	100.0%

Table A-I-2 Annual Sales of Respondents

			No. of Companies	%
	<	¥50 billion	91	91.9%
¥50 billion	<	¥100 billion	4	4.0%
¥100 billion	<	¥200 billion	2	2.0%
¥200 billion	<	¥300 billion	2	2.0%
Total			99	100.0%

Table A-I-3 Number of Employees of Respondents

				No. of Companies	%
	<=	300	people	46	46.0%
301	to	500		19	19.0%
501	to	1,000		24	24.0%
1,001	to	2,000		6	6.0%
2,001	to	5,000		5	5.0%
Total				100	100.0%

Table A-I-4 Number of Respondents by Industry

Industry	No. of Companies
Foodstuffs	6
Textiles	5
Lumber & wooden products	1
Pulp & paper	1
Chemicals	10
[Chemicals (excluding Pharmacentical)]	9
[Pharmacentical]	1
Petroleum & rubber	3
Ceramics, cements & glass	1
Steel	2
Nonferrous metals	2
Metal products	13
General machinery	8
[Assembled product]	5
[Components]	3
Electrical equipment & electronics	11
[Assembled product]	1
[Components]	10
Transport equipment (excl. autos)	1
Automobiles	16
[Assembled vehicle]	0
[Components]	16
Precision Machinery	5
[Precision product]	4
[Precision components]	1
Others	15
Total	100

Table A-I-5 Number of Overseas Affiliates by Type of Base/Region

	NIES	ASEAN4	China	Other Asian Countries	US-Canada	Latin America	EU	Former Soviet Union and Eastern Europe	Central Europe	Others	Total
Production bases	62	89	88	12	60	16	20	0	0	5	352
(Joint venture)	34	49	58	9	15	4	7	0	0	0	176
Sales bases	58	26	42	2	97	14	33	0	0	6	278
R&D bases	0	1	1	0	7	1	0	0	0	1	11
Others	10	5	0	0	6	1	3	0	0	1	26
Total	130	121	131	14	170	32	56	0	0	13	667

II. PROJECTED FDI FOR FY1999 AND SELF-EVALUATION OF OVERSEAS BUSINESS PERFORMANCE

1. FDI IN FY1998 AND PROJECTED FDI FOR FY1999

The FDI projected for FY1999 is down 22.2% from the actual record in FY1998, continuing the downward trend from last year's survey (i.e., according to 82 companies that provided both figures of FY1998 and FY1999). Although the rate of decline has slowed down from the past two years, the decline in recent years is steeper than the aggregate figure (Table A-II-1).

By industry, declines occur primarily in such major industries as automobiles (components), electrical equipment and electronics (components) and chemicals. (Figure A-II-1)

By region, all the regions except EU have a decrease in FDI inflows. FDI in EU increases because of larger investments in the metal products, general machinery (components) and precision instrument products (Figure A-II-2).

Table A-II-1 Rate of Increase of Projected FDI, Changing Pattern Over Time

(Unit: %)

	Small- & Midium-sized Enterprises	Overall survey
FY 1996 survey	7.4	39.1
FY 1997 survey	▲53.7	1.4
FY 1998 survey	▲51.9	▲23.4
FY 1999 survey	▲22.2	▲18.3

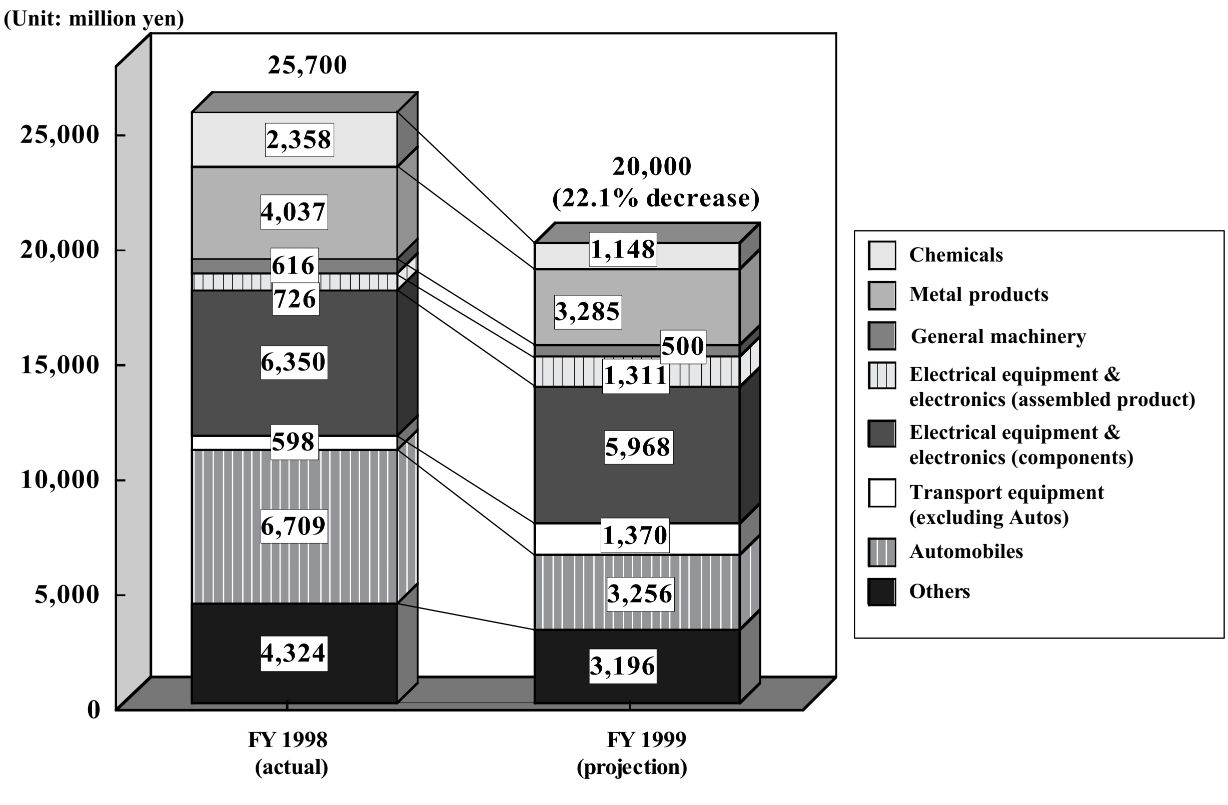
2. FINANCING SOURCES OF FDI

Among financing sources of actual FDI in FY 1998 in all the regions, "reinvestment" and "local financing" increased, while "remittance from the parent company" declined in their respective shares. For the entire companies, the share of "reinvestment" fell (Figure A-II-3).

3. SELF-EVALUATION OF OVERSEAS BUSINESS PERFORMANCE BY REGION

While, for the surveyed companies as a whole, overseas business performance in ASEAN4 did not show any improvement with a lingering effect from the Asian economic crisis, the SMEs record this year a slight improvement in profitability, sales and overall performance. Although their FDI performance in NIES fell in the FY1998 survey, there are various degrees of improvements in all measures this year. Improvements in precision instrument products, general machinery products, and metal products contributed

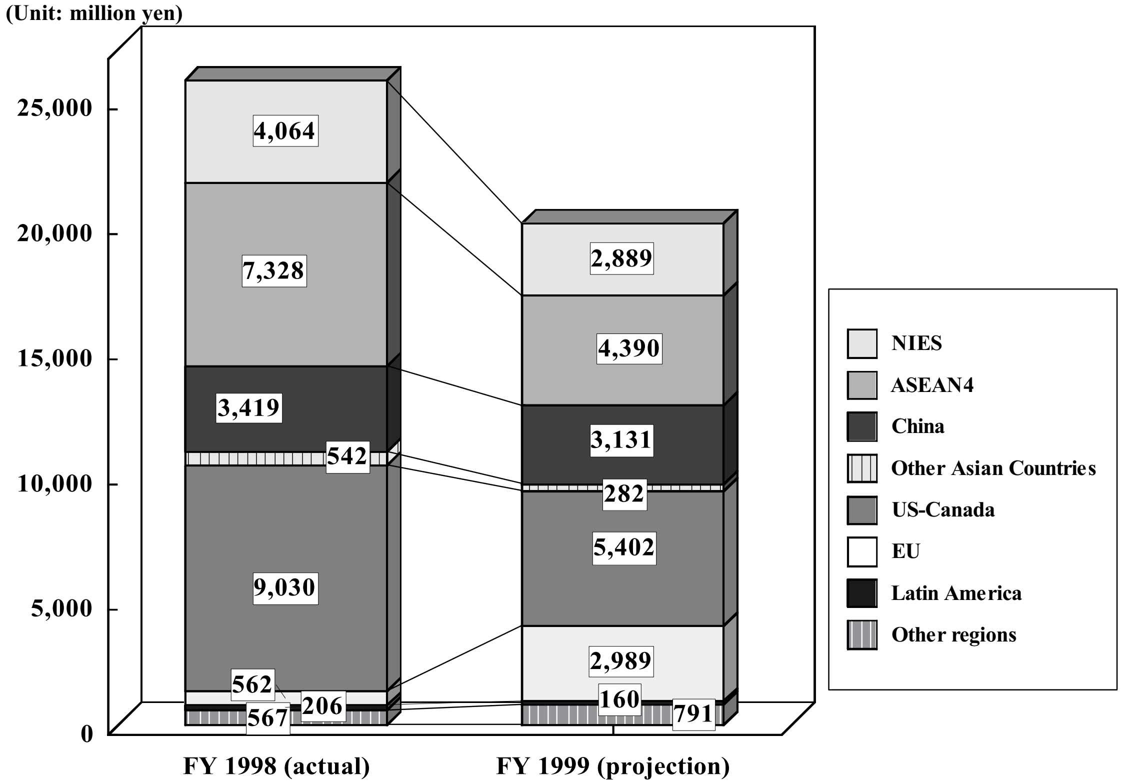
Figure A-II-1 Actual Figure in FY1998 and Projection for FY 1999(by Industry)



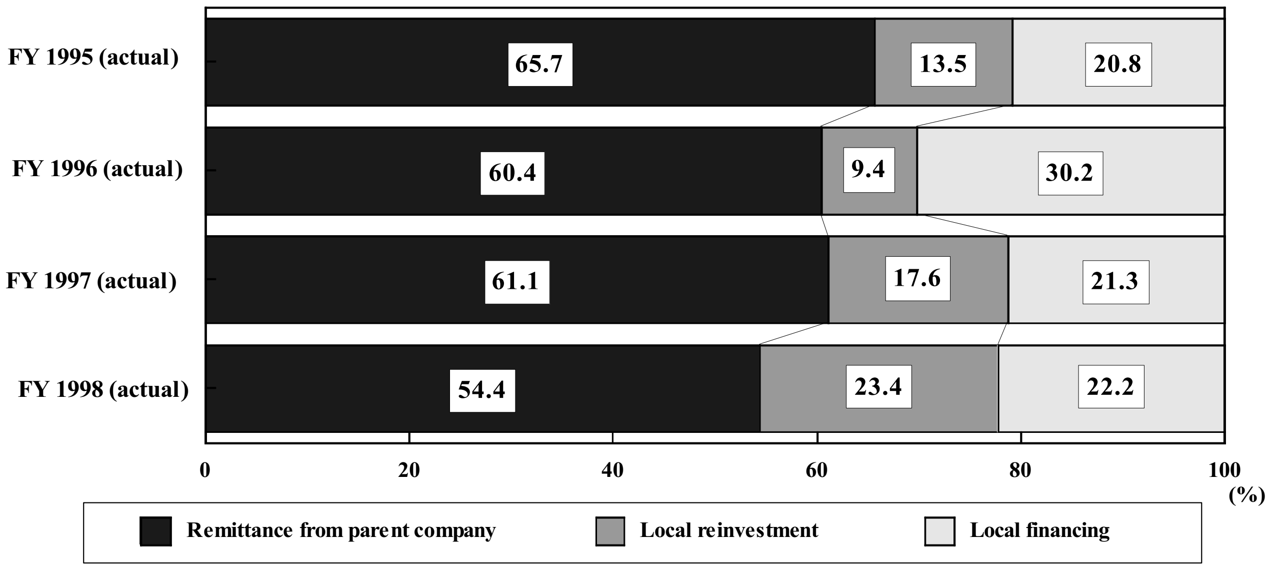
to this result. (Figure A-II-4)

Business performance in China receives lower points than in the other regions, falling slightly in all measures in FY1999 from the previous year. Performance in EU, which improved in the previous year, drops sharply in all measures this year. By industry, electrical equipment and electronics (components), oil and rubber, and automobiles (components) receive low points in EU. US-Canada also receive a slightly lower evaluation overall (Figure A-II-4).

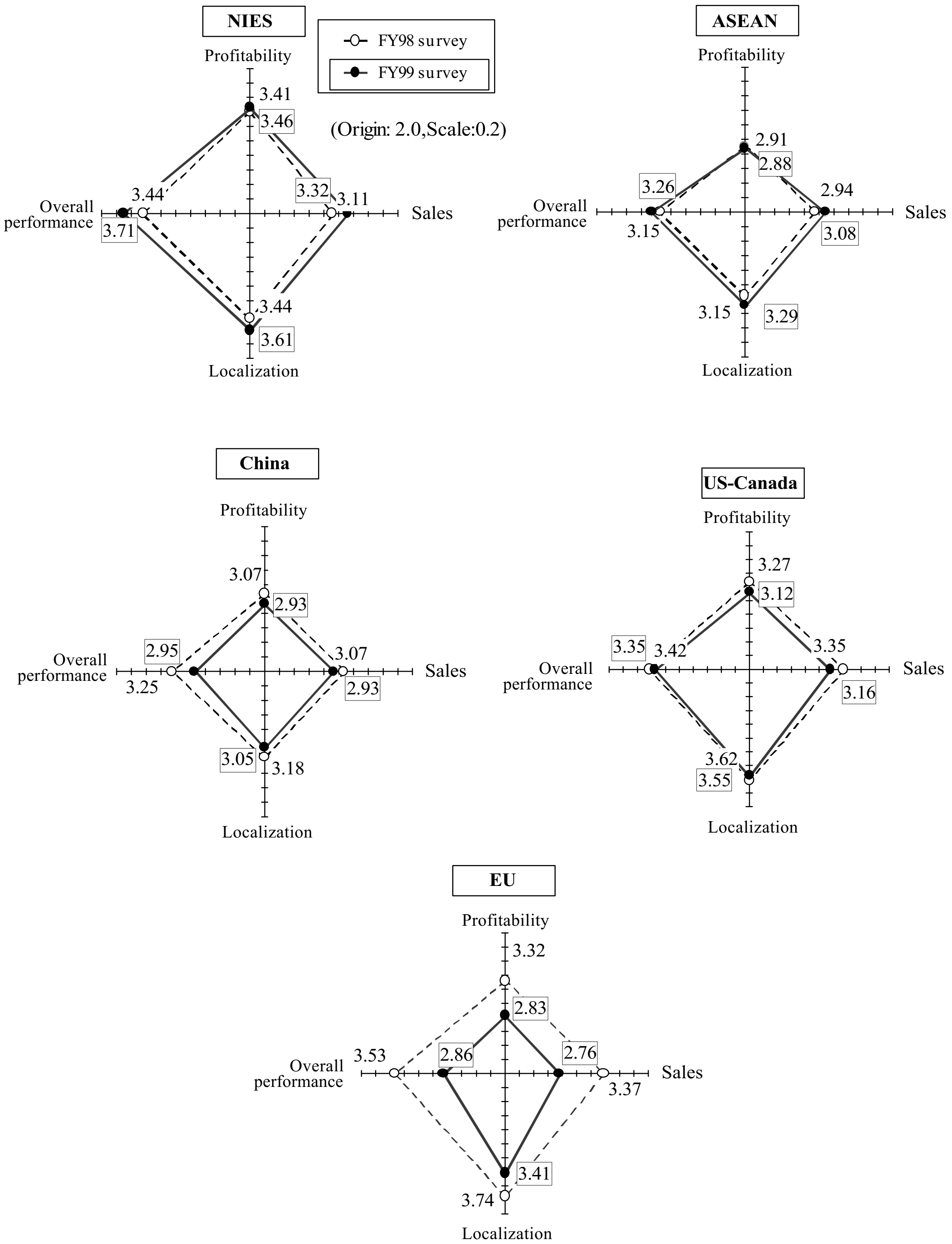
Figure A-II-2 Actual Figure in FY1998 and Projection for FY 1999 (by Region)



FigureA-II-3 Financing Sources of FDI, Changing Pattern Over Time



FigureA-II-4 Self-Evaluation of FDI Performance (by Regions)



(In relation to the initially set goal) 1. Insufficient 2. Somewhat insufficient 3. In-between 4. Somewhat sufficient 5. Fairly sufficient

III. MEDIUM-TERM OUTLOOK OF OVERSEAS OPERATIONS

1. FDI OVER THE MEDIUM TERM

Figure A-III-1 shows that 65.0% of the SMEs replied that they have plans to undertake FDI over the medium term of next 3 years (through FY 2002). This is 8.3 percentage points lower than the comparable figure for the entire companies (FigureA-III-1).

2. CHANGES IN FDI TYPES OVER THE MEDIUM TERM

Among the types of FDI over the medium term, the establishment of production bases declines in Asia as well as in Europe and U.S. In contrast, there is a sizable increase in FDI for expansion of production bases. This trend is more distinct among the SMEs than the entire companies surveyed (Figure A-III-2).

3. CHANGES IN THE AMOUNT OF FDI OVER THE MEDIUM TERM

Only 13.8% of these companies have plans to increase FDI in the next 3 years relative to the actual investment in the past 3 years. This is a further decrease of the companies with positive intentions for FDI from 39.6% in the previous year. The fall is steeper in this group of companies than the entire companies surveyed. The share of companies that planned to decrease FDI increases to 46.2% (Figure A-III-3).

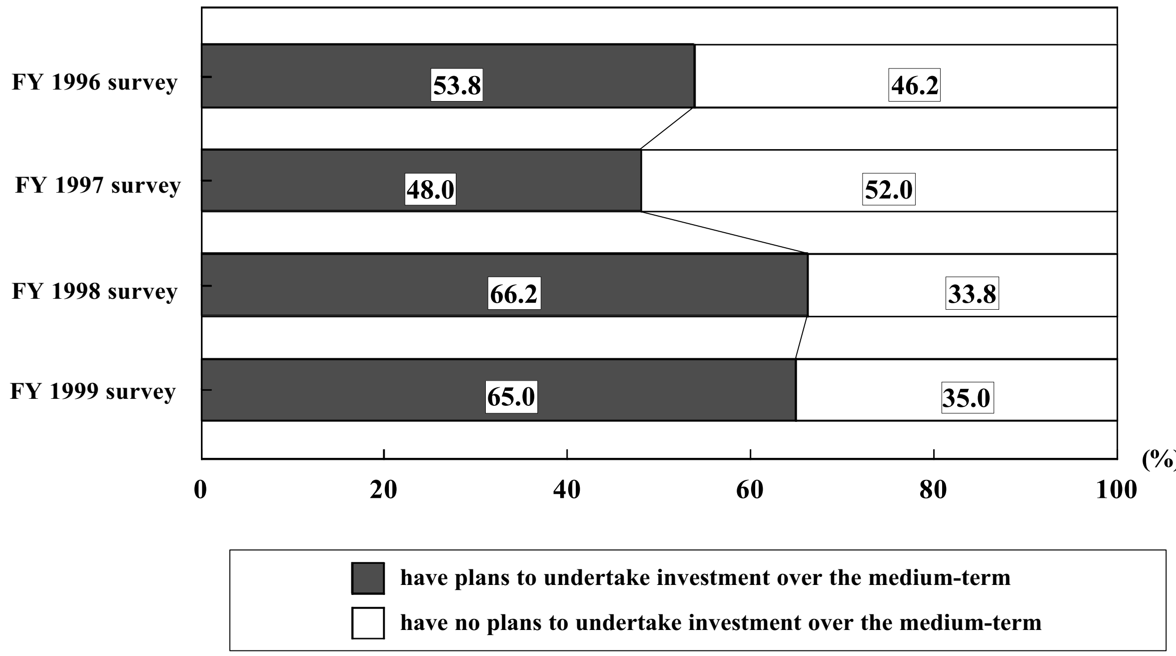
Yet, it is premature to draw a conclusion that these companies have a negative posture toward future FDI from this finding. We have to consider the fact that in FY1995 and FY1996, new production bases had been set up in large numbers; and that the focus of future investment is on the expansion of existing production bases, both of which leads to the decline in the amount of planned investment.

4. REASONS TO DECREASE IN FDI OVER THE MEDIUM TERM

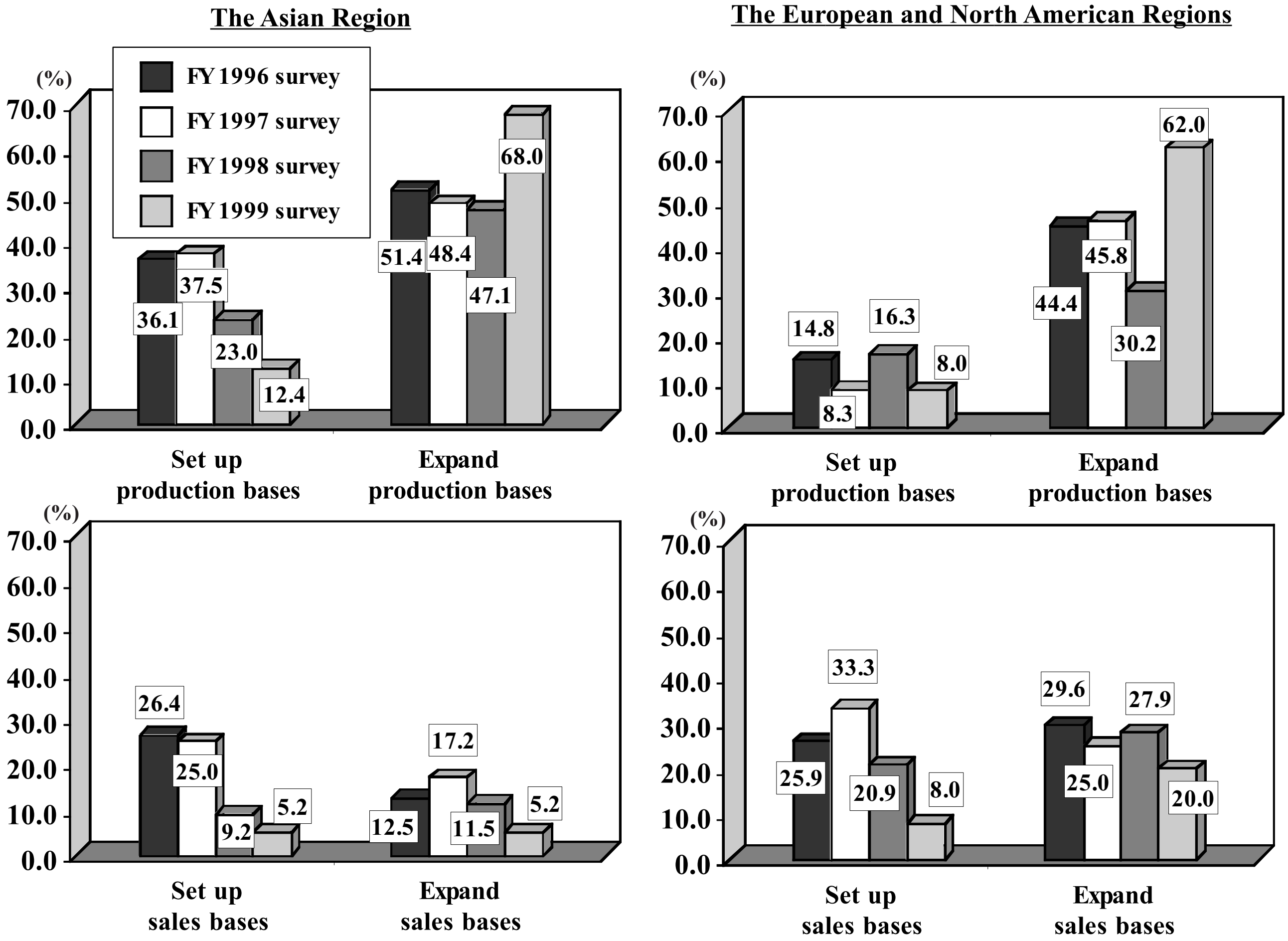
Among the SMEs responding that they have plans to decrease FDI over the medium term, the largest 36.0% cite that an adequate number of overseas operational bases have been set up for now. Similar findings are seen for companies with bases in ASEAN4 and China (Table A-III-1).

In the FY1998 survey, the impact of the Asian economic crisis was felt in the large shares of those respondents with bases in the ASEAN4 countries that cited “the local market shrank due to the recession in that country “(55.6%) and “uncertainty over the local currency “(44.4%). In this year, however, these reasons decline in

FigureA-III-1 Efforts to Undertake FDI Over Medium Term, Changing Pattern Over Time

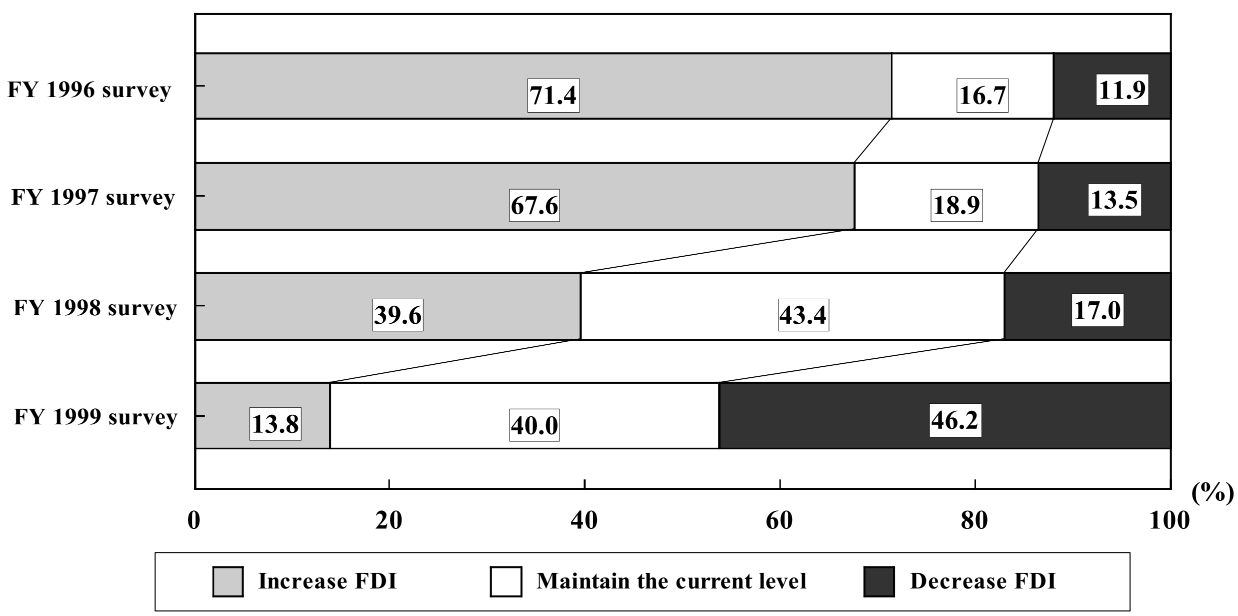


FigureA-III-2 Types of FDI Over the Medium Term (by Region), Changing Pattern Over Time (multiple response)



* Asian Region: NIES, ASEAN4, China and Other Asian Countries
European and North American Regions: EU, US-Canada

Figure A-III-3 Changes in the Amount of FDI Over the Medium Term, Changing Pattern Over Time



share to 8.3% and 16.7% respectively.

On the other hand, there is an increase in share of the companies that cited: “so far not achieved the expected results from operating overseas “(28.0%); “given economic downturn in the recipient country, a focus is on strengthening domestic bases “(24.0%); and “restructuring of existence production bases “(22.0%). These figures are higher than those for the entire companies, suggesting that the SMEs are facing a more difficult business environment in overseas operations than the companies as a whole.

5. OVERSEAS PRODUCTION RATIO: TREND AND FUTURE PLANS

The overseas production ratio is higher in this group than for the entire companies surveyed. Future plans also indicate that this ratio would increase gradually. The actual production ratio is 28.1% in FY1998, and the plan for FY2002 is 33.4% (Figure A-III-4).

6. EFFECT OF FDI ON DOMESTIC PRODUCTIVE CAPACITY

(1) Overall Effect

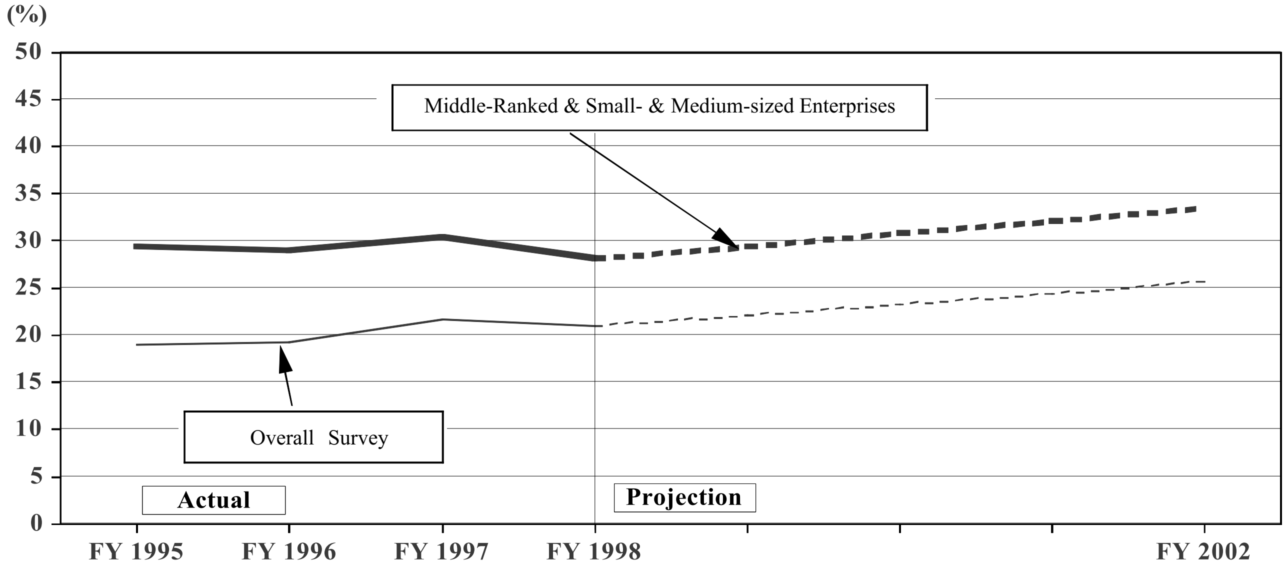
When asked about the effects of FDI on production facilities in Japan, the highest 58.5% respond that “since FDI is conducted to maintain and expand overseas market shares,domestic production facilities will remain intact,” followed by “though the production of domestically manufactured commodity products will be shifted overseas,domestic production facilities will focus on the

TableA-III-1 Reasons for Decrease in FDI over the Medium Term (multiple response)

(Unit: %)

	All regions		ASEAN4	
	FY1998 survey	FY1999 survey	FY1998 survey	FY1999 survey
So far not achieved the expected results from operating overseas	7.7	28.0	11.1	33.3
An adequate number of overseas bases have been set up for now	42.3	36.0	33.3	33.3
The local market shrank due to the recession of the recipient country’s economy in that country	30.8	10.0	55.6	8.3
Uncertainty over the local currency	23.1	6.0	44.4	16.7
Uncertainty over the local political and social situation	11.5	6.0	22.2	16.7
Restructuring of existence production bases	3.8	22.0	0.0	16.7
Given economic downturn in the recipient country, a focus is on strengthening domestic bases	3.8	24.0	11.1	33.3

Figure A-III-4 Changing Overseas Production Ratio and Future Plans



manufacturing of higher quality products" (24.5%) (Figure A-III-5).

On the other hand, a low 13.8% replies, "domestic production facilities will be downsized because of replacement by overseas production". These responses indicate that, overseas production as a whole would affect domestic production facilities in Japan in a minor way.

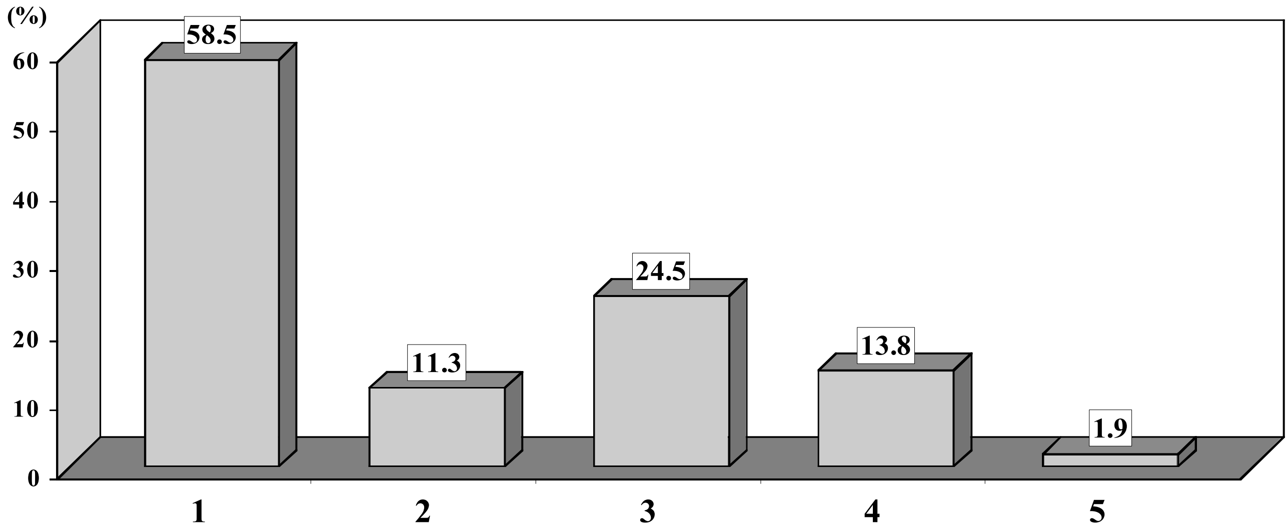
(2) Effect by FDI Destination

Table A-III-2 shows that companies with operational bases in ASEAN4 and China reply "domestic production facilities will be scaled down in significant percentage," 25.6% and 21.4% respectively. However, since "maintain/expand sales in the local market" accounts for the highest shares for both ASEAN4 and China, FDI does not seem to have a significant effect on their continued production activities in Japan.

7. PROMISING FDI DESTINATIONS OVER THE MEDIUM TERM

China continued to rank the first among the SMEs as a promising FDI destination over the medium term (next three years) (Table A-III-3).

Figure A-III-5 The Effect of FDI on Domestic Production Facilities (multiple response)



1. Since FDI is conducted to maintain/expand overseas market shares, domestic production facilities will remain intact.
2. Since the contents of overseas manufactured products are different from those of domestically manufactured products, our domestic production facilities will remain intact.
3. Though the production of domestically manufactured commodity products will be shifted overseas, domestic production facilities will focus on the manufacturing of higher quality products.
4. Domestic production facilities will be downsized because of replacement by overseas production
5. Others

Table A-III-2 The Effect of FDI on Domestic Production Facilities by Region (multiple response)

(Unit: %)

	NIES	ASEAN	China	US-Canada	EU
1. FDI is conducted to maintain/expand overseas market shares.	75.0	48.7	46.4	67.7	68.4
2. The contents of overseas manufactured products are different from that of domestically manufactured products.	10.0	17.9	7.1	3.2	10.5
3. Domestic production facilities will focus on the manufacturing of higher quality products.	25.0	23.1	32.1	25.8	21.1
4. Domestic production facilities will be downsized.	5.0	25.6	21.4	6.5	5.3
5. Others	5.0	0.0	3.6	0.0	0.0

Table A-III-3 Promising FDI Destinations over the Medium Term (multiple response)

Rank	Promising Destinations for Investment on Medium Term (next three years)								
	FY 1999 Survey	Respondents 48	Share (%) 100	FY 1998 Survey	Respondents 47	Share (%) 100	FY 1997 Survey	Respondents 55	Share (%) 100
1	China	28	58	China	26	55	China	30	55
2	U.S.A	12	25	U.S.A	14	30	Vietnam	15	27
3	Thailand	9	19	Philippines	10	21	U.S.A	11	20
4	Philippines	8	17	Malaysia	9	19	Philippines	9	16
5	India	6	13	Indonesia	9	19	Malaysia	9	16
6	Mexico	6	13	Vietnam	9	19	Indonesia	9	16
7	Indonesia	5	10	Thailand	8	17	Hongkong	8	15
8	Malaysia	5	10	Brazil	6	13	India	7	13
9	Vietnam	4	8	India	4	9	Mexico	6	11
10	England	4	8	Mexico	4	9	Thailand	6	11
							England	6	11

IV. OVERSEAS BUSINESS ACTIVITIES AFTER THE ASIAN ECONOMIC CRISIS (ASEAN4 AND KOREA)

1. THE OUTLOOK OF SALES AND PROFITS OVER THE MEDIUM AND LONG TERM (AVERAGING ACROSS 5 COUNTRIES)

This section looks at the prospect of business recovery for Japanese affiliates in the 5 crisis-affected countries (ASEAN4 and Korea). The companies forecast that their sales and profits would bounce back to the pre-crisis level within FY1999. This pace of recovery is faster than the aggregate forecast. Many of these SMEs are small and light-footed, making metal products and various electric and automobile components. Thus ,they are able to act flexibly and make full use of their characteristic by shifting to exports, including exports to Japan. Compared with the entire companies surveyed, they forecast a brighter prospect for business recovery (Figure A-IV-1).

2. FUTURE FDI STRATEGIES IN THE ASIAN REGION

In response to the survey on future FDI strategy, over half of these companies respond that they would "strengthen the overseas bases "(62.2%), which is followed by "maintain overseas bases" (37.8%). None of them intend to "decrease the number of the overseas bases or have a shift in focus of investment to other countries or regions." The percentage of companies that cited strengthen the overseas bases is higher than the figure for the entire companies, indicating their positive investment strategy for Asia.

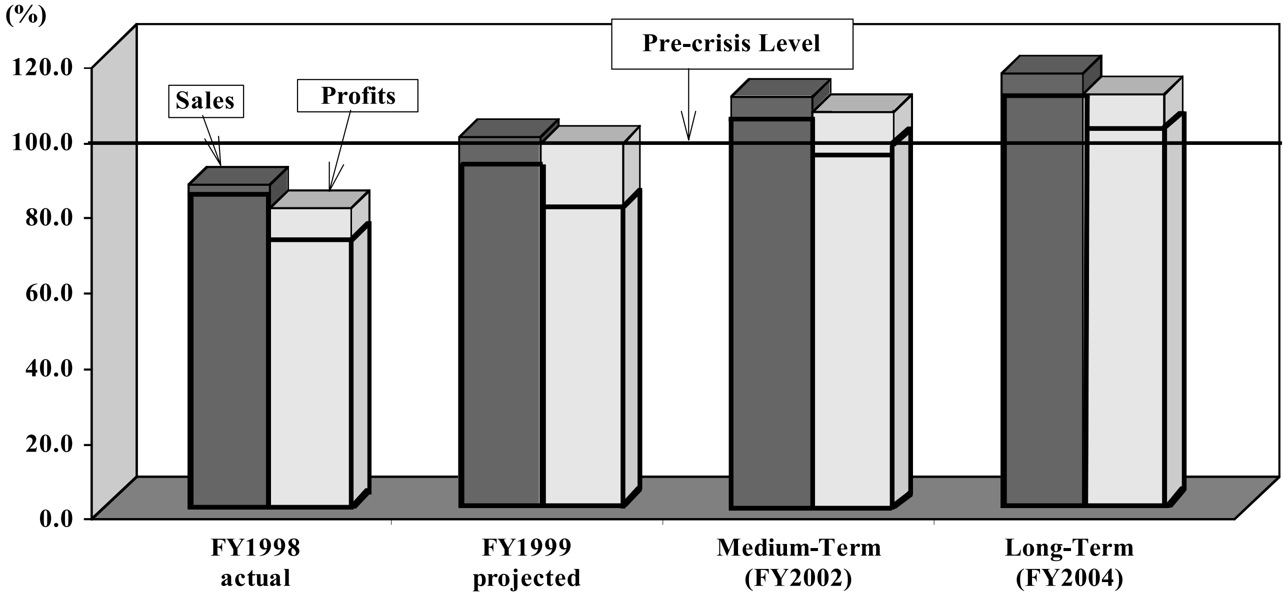
Of the companies responded "strengthen the overseas bases," specifically those intended to "expand the existing facilities" account for the highest 59.4% share, whereas those replied to "establish new production bases" have the lowest 5.8% share. Also, a number of companies respond that they would "diversify product lines" and "strengthen sales bases," accounting for 52.2% and 43.5% respectively. This indicates that after the Asian economic crisis, an investment strategy focuses more on maintaining and expanding the client base of their sales (Figure A-IV-2).

3. EFFECT OF U.S. AND EUROPEAN COMPANIES MOVING INTO ASIA

Of the SMEs citing that "advancement by US and European companies into Asia effects on the market activity," breakdown by country indicates that the greatest effect is felt in the Philippines at 36.4% and Korea at 25.0%. (Figure A-IV-3)

By industry, a high percentage of the SMEs in chemicals (excluding pharmaceuticals) and automobile parts industries in the Philippines, as well as, chemicals (excluding pharmaceuticals) and precision machinery assembly industries in Korea respond "advancement by US and European companies into Asia effects on the market activity".

Figure A-IV-1 The Outlook of Sales and Profits over the Medium-and Long-Term (averaging across 5 countries)



* 5 countries: Thailand, Indonesia, Malaysia, Philippines, and Korea

* ▭ : Overall survey

Figure A-IV-2 Future FDI Strategies in the Asian Region

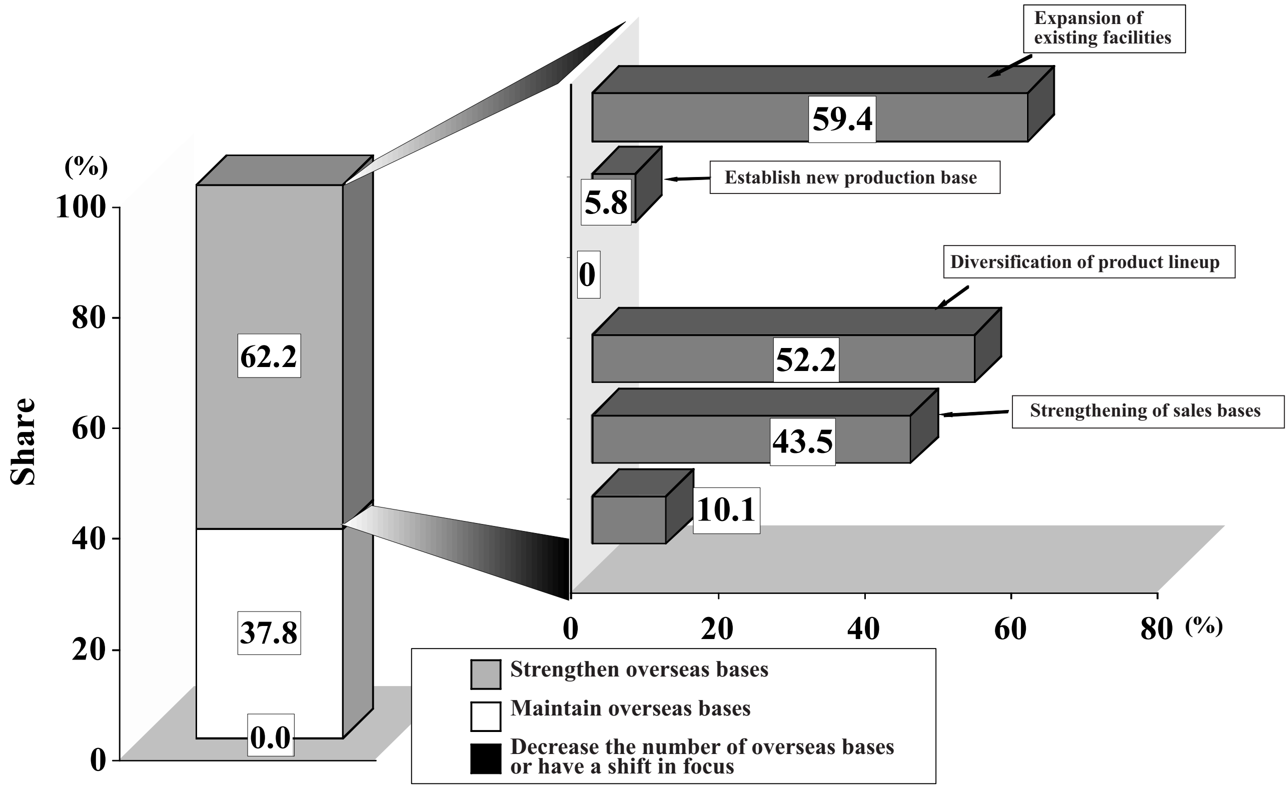


Figure A-IV-3 The Effect of U.S. and European Companies' Advancement into Asia