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Survey Report on Overseas Business Operations by Japanese Manufacturing Companies
—Results of JBIC FY 2004 Survey: Outlook for Japanese Foreign Direct Investment (16th Annual Survey) —

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Survey Report on Overseas Business Operations by Japanese Manufacturing Companies

— Results of JBIC FY2004 Survey:
Outlook for Japanese Foreign Direct Investment (16th Annual Survey) —

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Abstract

■ Aggressive attitude toward business in Japan and as abroad

The current top priority issues for domestic and overseas business operations are “strengthen or expand overseas production,” followed by “strengthen or expand R&D functions,” “strengthen or expand customer base by company’s own efforts” and “active expansion into new business areas.” Compared to the results of FY2002 survey, “Strengthen or expand domestic production” rose substantially in the ranking, as companies take a more positive stance toward not only overseas but also domestic operations. Efforts to enhance their own business systems, such as “review domestic production systems from the viewpoint of total cost” declined relatively.

It appears that Japanese manufacturers are not aiming for a one-way shift toward overseas production, but rather they intend to strengthen R&D functions and domestic production at the same time in order to achieve high-added value production in Japan and establish an optimized global production system.

■ Continuing trend to positive stance for overseas business

Examining the medium-term outlook for overseas operations, 81.9% of companies in all industries

responded that they expect to “strengthen or expand,” demonstrating that last year’s enthusiasm for overseas operations has not abated.

■ A trend toward strengthening or expansion in domestic operations as well

When questioned on their stance on domestic business operation over the medium term, 47.2% of the companies in all industries said “maintain the present level,” and 45.2% said “strengthen or expand.” These two responses each account for nearly half of all respondents, with a mere 4.6% expecting to “Reduce” in scale.

■ Exports from the parent company in Japan grow with the strengthening or expansion of overseas business operations

Investigation into the relationship between strengthening or expansion in overseas business operations and parent company exports from Japan over the past three years revealed that 49.7% of companies in all industries said their “exports have increased,” while only 13.3% said “exports have decreased.” By major industrial classifications, a majority of companies in the areas of General machinery, Electrical equipment & electronics, and Automobiles stated that “exports have increased,” indicating a deep-rooted relationship between strengthening or expansion in overseas business operations and growth in the parent company’s exports from Japan.

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■ Strongly positive stance on China, Central and Eastern Europe and Russia

The regions for which a high portion of the respondent companies named as prospects for “strengthening or expansion of the scale of overseas business operations” are China (76.5%), Central and Eastern Europe (64.1%), Russia & other CIS (63.0%) and North America (53.9%). Compared to FY2003 survey, this year’s survey found that intentions to expand overseas business operations have grown stronger for almost all countries and regions.

■ Very active toward China, Thailand and the North America in all industries

Many companies in all categories intending to strengthen or expand their operations have cited Eastern and Southern China, Thailand and the North America as business destinations. However, the number of such companies citing Latin America, the Middle East and Africa are relatively small.

■ Evaluation of overseas business performance have improved in all regions, but profitability levels are still unsatisfactory

The evaluation of sales and profitability satisfaction in their overseas business operations shows a trend towards improvement in each region and country. Business evaluations for the NIEs, ASEAN4 and China show relatively high levels of satisfaction, and there has been some improvement in Central and Eastern Europe, Latin America and elsewhere, so the business evaluations for Europe and North America have also seen relative increases. However, this year’s survey found some issues that still need to be addressed for the improvement of profitability.

Evaluation of business in China rose in this year’s survey, as it did in last year’s, but the level of profitability is still unsatisfactory. Many companies are trying to strengthen or expand the production and marketing sides of their business in China. However, if they want to raise the profitability of that business, it is becoming increasingly important for them to make more efficient investments, well tailored to the market, as they open up and secure market positions.

■ Economic growth in China to continue until 2010

When companies are asked how long they anticipated economic (high) growth in China to continue, as they draw up their business plans, the most common

answer is “until 2010 (the Shanghai Expo)” (174 companies), followed by “until 2008 (the Beijing Olympics)” (150 companies). Among the major industries, “until 2008” is the most common response in Electrical equipment and electronics, while “until 2010” is the most common response in the Automobile industry. Thus, views of economic growth vary between industries.

■ “Economic recession and market contraction” is viewed as most serious risk

The risks that could have a grave impact on operations in China are investigated separately as “Risks faced now” and “Future risks.” The results show that the main risks seen as “Risks faced now” are “insufficient electrical power supply” (56.5%), “rising prices for energy and raw materials” (36.5%) and “infringement of intellectual property rights” (29.3%). As for “Future risks,” the most common response is “revaluation of the Yuan” (67.7%). The company interviewed said that, in addition to decreased export competitiveness due to a revalued Yuan, other concerns included economic slowdown due to a rising Yuan and increased economic uncertainty caused by exchange rate fluctuations.

Among the current and future risks faced in China, the ones viewed as the most serious are “economic recession and market contraction” (20.2%), “insufficient electrical power supply” (18.8%) and “revaluation of the Yuan” (17.0%). While the most common view is that China’s economic growth will continue until 2010, company interviews pointed to concerns such as an earlier-than-expected economic recession or slow growth beyond 2010.

■ India and Russia rise in ranking, but anticipations are ahead of business plans

In the countries and regions that companies view as promising for business development in the medium term, the top ten countries/regions remained unchanged in this year’s survey. However, India, which was ranked the fifth last year, rose to the third place, while the tenth-place Russia rose to the sixth. Vietnam gathered more votes than during the last survey. These results imply that Japanese companies’ interests in these countries are growing. However, the number of companies with no specific business plans for these countries exceeds the number of companies that actually have such plans. This is not the case for

China, Thailand and the U.S.. Therefore, the ranking is considered to be a reflection of anticipations for future potentials, rather than realistic investment possibilities. Among the countries and regions that fell in the ranking as compared to the last survey, Indonesia saw the largest drop in votes.

Foreword

This survey, done in the form of a questionnaire, on overseas business operations by Japanese manufacturing companies has been conducted annually by Japan Bank for International Cooperation. We are delighted to publish here the report on the survey for fiscal year 2004, the 16th of an annual series. The latest survey results are suggestive in many ways, but the important core facts may be summarized in the following three points.

1. Positive Attitude toward, and Intensified Coordination between, Domestic and Overseas Business Operations

Many Japanese manufacturers place importance on the strengthening or expansion of overseas production, and continue to keep their intention to do so. The present survey result has also indicated that they are taking positive action in respect of their domestic operations, including research and development as well as production. Japanese companies are not unilaterally shifting their domestic production bases abroad through strengthening or expansion of overseas business operations, but they are also trying to achieve their objective by converting domestic operations into those of a high value-added type and maintaining or utilizing such domestic operations effectively. The present survey has brought quite an interesting result in this connection, based on questions concerning the 'top-priority issues for domestic and overseas business operations,' the 'relationship between strengthening or expansion of overseas business operations and export,' and 'international allocation of production.'

In order to achieve global management, realization of the optimal allocation of management resources and its adjustment from the global point of view is an essential task. In such circumstances, our attention is again drawn to the fact that many Japanese companies are conducting their business while maintaining and intensifying linkage between domestic and overseas business operations instead of merely replacing domestic production with overseas production. We believe this may enable us in future to establish a proper business model founded on the real

strength of Japanese companies.

2. Chinese Operations and Risks

There are still many companies wanting to strengthen or expand operations in China.

However, this investment in China is not a short-lived boom. It is noteworthy that since the SARS outbreak in 2003, there has been a growing awareness among Japanese companies of possible risks involved in business operations in China. It is needless to say that, when making investments, an investor should presume possible risks and prepare countermeasures in advance. But, it can be pointed out that investing companies are now being required to formulate solid business strategies in order to maintain their own competitiveness in China in the face of prospective growth potential and the inherent risks surrounding their operations. Though many companies consider China as promising because of its growing market, only a few of them are successful in securing their own positions in that market as they expected. The present survey result indicates that while China is expected to keep its high economic growth for some time, scale-down of the market size and economic recession has been pointed out as the most serious risk. China is a unique country where market competition is becoming more and more serious while having a lot of problems in its investment environment. With regard to China, it is becoming all the more important to devise proper strategies with careful attention on both major business chances and relevant risks.

3. Interest in Viable Countries and Business Strategies

Companies show growing interest in BRICs (Brazil, Russia, India and China), and also in Vietnam as a production base in Southeast Asia. But, for those countries other than China, only a few companies among those who named these countries have concrete business plans, and it may take some time to incline the companies to prepare actual investment plans.

In BRICs, European and U.S. companies are

intending actively to implement their business operations for the reasons of the prospect of high economic growth potential and abundant natural resources. In these countries, Japanese companies, while competing with such European and U.S. companies, will be obliged to deal with various challenges such as the necessity to understand properly the local market, risk control, and establishing a proper management style including a way of coordination with remotely located headquarters.

Incidentally, this survey was originally undertaken for the purpose of “overseas investment,” but since 2000 it was changed to the “overseas business operations”². This change was made because we decided that the survey should make clear how managerial resources are allocated and utilized within the full scope of the value chain in accordance with the actual activities of a company. We consider it important to watch not only the outflow of investment from Japan, but also what operations in the value chain each company sets up in relevant regions/countries for the purpose of maintaining and increasing its competitiveness. This is why we attempt to make detailed analysis by industry or other classifications in this survey report, putting aside whether our trial is successful or not. We hope this report will be of use in viewing the global business operations of Japanese companies.

Finally, we, taking this opportunity, would like to express our heartfelt thanks to the companies, especially staffs who prepared the answers, which was great cooperation to us on this survey. The present survey has received responses from as many as 595 companies (response rate: 63.4%). In addition, we were afforded further cooperation through face-to-face interviews with 50 companies, and telephone interviews with over 100 companies. We do not want to overload the staff of the responding companies, but the number of questions that we, as researchers want to ask is ever on the increase.

The volume of queries contained in the present survey is already too many. We nevertheless much appreciate the cooperation many people have kindly

2 The “overseas business operations” used in this survey include production outsourcing and procurement, in addition to the ordinary activities of production, sales, and research and development at overseas bases.

provided. Quite a number of academic experts or professors have also given us precious advice, from the design of the questionnaire to analysis of responses, and JBIC's staffs outside the institute and experts from outside the bank have also been kind enough to help us in various ways. This survey is thus completed through the assistance and cooperation of many people. We want to thank them all by placing the foregoing on record. Needless to say, however, we, the JBIC research staff, are solely responsible for any errors in interpretation of the obtained data and any conclusions drawn there from.

Chapter 1: Survey Method and Overview of Responding Companies

1. Survey Method

This survey covered 939 Japanese manufacturing companies, each of which had, as a general rule, three or more overseas affiliates incorporated locally, including at least one production base, as of the end of November 2003. Responses were collected from July to September 2004, during which period effective responses were returned from 595 companies. The effective response rate was 63.4% (Table 1). We conducted follow-up telephone interviews (104 companies) in line with the collection of questionnaire responses between August and October and carried out face-to-face interviews (50 companies) by visiting companies.

2. Overview of Responding Companies

Responding companies possessed a total of 10,079 overseas affiliates, and almost half of these were production bases. In the geographical distribution of the production bases, the largest number of 1,346 affiliates was gathered in China; next was 1,190 affiliates in ASEAN4, followed by a further 759 affiliates in North America, 612 affiliates in NIEs, and 454 affiliates in EU15. The number of bases in China has shown a remarkable increase in this year's survey, for the first time outrunning that of ASEAN4, which had occupied the largest number of production bases by regional distribution since the FY1994 survey (Table 2 and Figure 1-2)³. The companies responding to this year's survey were classified according to size of capital; a total of 460 companies had capital of 1.0 billion yen or more (nonconsolidated basis), accounting for 77.3% of the total number of companies who responded to the questionnaire. The number of companies having 1,001 or more employees (nonconsolidated basis) is 291 companies occupying approximately half (48.9%) of the total number. More specifically, about 40% (37.0%) of the companies converge to the band of 1,001 employees or more to less than 5,000 employees. The breakdown by industrial classification shows shares of 10% to

3 Refer to Appended Table 1 for details.

Table 1 Survey Overview

(Unit : Companies, %)

Survey Year	93	94	95	96	97	98	99	00	01	02	03	04
Number of companies surveyed	652	700	718	722	743	749	786	791	792	812	932	939
Number of respondents	338	382	422	432	445	455	472	469	501	508	571	595
Response rate	51.8	54.6	58.8	59.8	59.9	60.7	60.1	59.3	63.3	62.6	61.3	63.4
Number of overseas affiliates	5,428	5,385	6,496	6,730	6,978	6,654	7,225	7,285	7,710	8,924	9,838	10,079

Table 2 Number of Overseas Affiliates by Type of Base and Region

(n = 595) (Unit: Companies)

	NIES	ASEAN 4	China	Other Asian Countries	North America	Latin America	EU15	Central and Eastern Europe	Other European Countries	Russia, other CIS	Southeast Asia Pacific	Middle East	Africa	Total
Production Bases	612	1,190	1,346	188	759	216	454	84	16	11	68	16	24	4,984
Sales Bases	830	383	463	52	637	177	969	101	70	32	141	53	38	3,946
R&D Bases	25	29	67	6	108	4	60	3	—	—	8	—	—	310
Others	107	89	122	15	244	53	161	5	8	3	26	3	3	839
Total	1,574	1,691	1,998	261	1,748	450	1,644	193	94	46	243	72	65	10,079

**"Others" includes service companies, financial subsidiaries, etc.

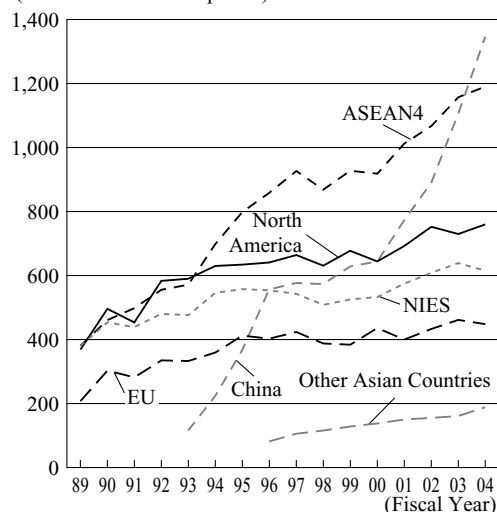
〈The Classification of Major Regions in This Survey〉

NIES (Korea, Taiwan, Singapore, Hong Kong)**ASEAN4** (Thailand, Indonesia, Malaysia, Philippines)**North America** (U.S., Canada)**EU15** (UK, Germany, France, Italy, Netherlands, Belgium, Greece, Luxembourg, Denmark, Spain, Portugal, Austria, Finland, Sweden, Ireland)**Central and Eastern Europe** (Poland, Hungary, Czech Republic, Slovak Republic, Bulgaria, Romania, Slovenia, Albania, Croatia, Serbia and Montenegro, Bosnia and Herzegovina, Former Yugoslav Republic of Macedonia)

〈The Classification of Provinces and Administrative Districts of China in This Survey〉

Northeastern China (Heilongjiang Province, Jilin Province, and Liaoning Province)**Northern China** (Beijing, Tientsin, Hebei Province, and Shandong Province)**Eastern China** (Shanghai, Jiangsu Province, Anhui Province, and Zhejiang Province)**Southern China** (Fujian Province, Guangdong Province, and Hainan Province)**Inland China** (Provinces other than those mentioned above and Autonomous regions)**Figure 1 Changes in Number of Overseas Production Bases**

(Unit: Number of companies)

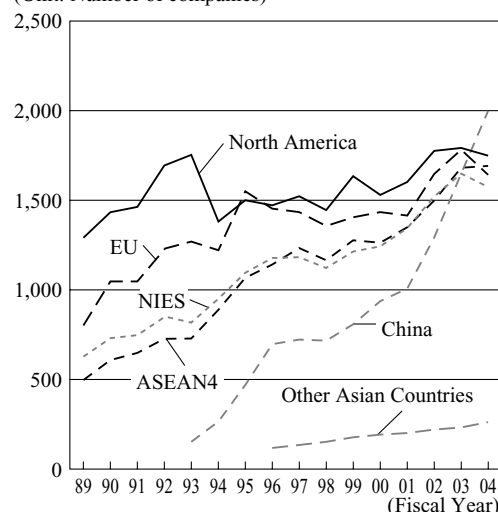


*Data for China starts from FY 1993. Data for Other Asian Countries starts from FY1996.

*In the graph above, the EU15 for this year's survey have been consolidated into the EU line.

Figure 2 Changes in Number of Overseas Affiliates

(Unit: Number of companies)



*Data for China starts from FY 1993 and for Other Asian Countries from FY1996.

*In the graph above, the EU15 for this year's survey have been consolidated into the EU line.

Table 3 Number of Responding Companies Based on Paid-in Capital (individual company base)

	Number of Companies	Shares (%)
Less than ¥100.0 million	42	7.1%
¥100.0 million~less than ¥500.0 million	63	10.6%
¥500.0 million~less than ¥1.0 billion	30	5.0%
¥1.0 billion~less than ¥5.0 billion	122	20.5%
¥5.0 billion~less than ¥10.0 billion	86	14.5%
¥10.0 billion or more	252	42.4%
Total	595	100.0%

Table 4 Number of Responding Companies by Gross Sales (consolidated base)

	Number of Companies	Shares (%)
Less than ¥50.0 billion	250	42.2%
¥50.0 billion~less than ¥100.0 billion	100	16.9%
¥100.0 billion~less than ¥200.0 billion	79	13.3%
¥200.0 billion~less than ¥300.0 billion	41	6.9%
¥300.0 billion~less than ¥500.0 billion	43	7.3%
¥500.0 billion~less than ¥1.0 trillion	36	6.1%
¥1.0 trillion or more	44	7.4%
Total	593	100.0%

*Two companies did not respond.

Table 6 Number of Responding Companies Based on Number of Employees (individual company base)

	Number of Companies	Shares (%)
300 employees or less	103	17.3%
301 to 500 employees	82	13.8%
501 to 1,000 employees	119	20.0%
1,001 to 5,000 employees	220	37.0%
5,001 to 10,000 employees	40	6.7%
10,001 or more employees	31	5.2%
Total	595	100.0%

20% in Electrical equipment and electronics (111 companies), Automobiles (94 companies), Chemicals (88 companies), and General machinery (64 companies), with these top four classifications taking a combined 60% share (Table 3-6).

Table 5 Number of Responding Companies Based on Industrial Classification

Industrial Classification	Number of Companies	Shares (%)
Foodstuffs	31	5.2%
Textiles	30	5.0%
Wood and wood products	5	0.8%
Paper and pulp	5	0.8%
Chemicals	88	14.8%
[Chemicals (excluding pharmaceuticals)]	[77]	[12.9%]
[Pharmaceuticals]	[11]	[1.8%]
Petroleum and rubber	12	2.0%
Ceramics, cement and glass	18	3.0%
Steel	14	2.4%
Nonferrous metals	19	3.2%
Metal products	22	3.7%
General machinery	64	10.8%
[Assembled products]	[49]	[8.2%]
[Components]	[15]	[2.5%]
Electrical equipment and electronics	111	18.7%
[Assembled products]	[40]	[6.7%]
[Components]	[71]	[11.9%]
Transportation (excluding automobiles)	11	1.8%
Automobiles	94	15.8%
[Assembled products]	[9]	[1.5%]
[Components]	[85]	[14.3%]
Precision machinery	33	5.5%
[Assembled products]	[21]	[3.5%]
[Components]	[12]	[2.0%]
Other	38	6.4%
Total	595	100.0%

Chapter 2: Current Top Priorities for Domestic and Overseas Business Operations

1. Current Top Priorities for Domestic and Overseas Business Operations

In this question regarding current top priorities for domestic and overseas business operations, the following items have attracted the largest votes from the 584 respondent companies. The largest vote has been given to “strengthen or expand the overseas production” (57.9%), followed by “strengthen or expand the R&D functions” (40.2%), “strengthen or expand the customer base by the company’s own efforts” (26.5%), and also “active expansion into new business areas” (22.4%) (Table 7). Compared with the results of FY2002 survey, as no similar question was made in FY2003, this year’s survey has produced a few interesting points: (i) “strengthen or expand the overseas production” (54.6% in FY2002→57.9% in this fiscal year) continues as the choice of the largest number of companies; (ii) “strengthen or expand

Table 7 Top-priority Issue for Domestic and Overseas Business Operations (FY2004)

(n=584)

Rank	Top Priority Issues for Domestic and Overseas Business Operations	Number of Companies	Response rate
1	Strengthen or expand the overseas production	338	57.9%
2	Strengthen or expand R&D functions	235	40.2%
○ 3	Strengthen or expand the customer base by the company's own efforts	155	26.5%
4	Active expansion into new business areas	131	22.4%
5	Reduce interest-bearing debt	126	21.6%
6	Review and improve efficiency of group companies' management	122	20.9%
7	Acquire business resources to strengthen principal business	115	19.7%
8	Strengthen or expand the domestic production	104	17.8%
9	Strengthen or expand service operations related to the company's products	96	16.4%
10	Introduce or establish a global supply chain management	92	15.8%
11	Review domestic production systems from the viewpoint of total cost	60	10.3%
12	Concentrate on environmental issues and environment-related business	49	8.4%
13	Review overseas production systems from the viewpoint of total cost	41	7.0%
14	Outsource the activities of production	20	3.4%
○ 15	Renewal of overage domestic plant	17	2.9%
○ 16	Securing energy, resources and materials for the company's own operations	13	2.2%

Note 1: An empty circle "○" indicates options newly added for the first time into this year's survey.

Note 2: 18 companies answered "Other" as a priority issue.

R&D functions" (a new query added this year), which imply that a positive attitude toward domestic operations appeared to be a high priority, and "strengthen or expand the domestic production" (8.6%→17.8%) showed sharply enlarged support; and (iii) "reduce interest-bearing debt" (23.5%→21.6%), "review and improve efficiency of group companies' management" (32.5%→20.9%), "review domestic production systems from the viewpoint of total cost" (25.4%→10.3%), "review overseas production systems from the viewpoint of total cost" (9.4%→7.0%), and such subjects relating to streamlining of operational systems across the board have reduced emphasis (Tables 7 and 8). These changes since the FY2002 survey may be considered to have taken place because the Japanese manufacturing companies have become more aggressive toward domestic and overseas business operations as they have made efforts in streamlining of business systems or reinforcement of corporate culture in recent years, and in response to improved business performance and a recent upswing of the economy. It can be seen that though overseas production takes first place among high priority

Table 8 (Reference) Survey Results in FY2002

(n=489)

Rank	Top Priorities for Domestic and Overseas Business Operations	Number of Companies	Response rate
1	Strengthen or expand the overseas production	267	54.6%
2	Strengthen or expand the customer base by the company's own efforts	185	37.8%
3	Review and improve efficiency of group companies' management	159	32.5%
4	Review domestic production systems from the viewpoint of total cost	124	25.4%
5	Strengthen or expand service operations related to the company's products	120	24.5%
6	Acquire business resources to strengthen principal business	117	23.9%
7	Reduce interest-bearing debt	115	23.5%
8	Active expansion into new business areas	87	17.8%
9	Introduce or establish a global supply chain management	81	16.6%
10	Concentrate on environmental issues and environment-related business	46	9.4%
10	Review overseas production systems from the viewpoint of total cost	46	9.4%
12	Strengthen or expand the domestic production	42	8.6%
13	Outsource the activities of production	22	4.5%
14	Develop technology by utilizing venture companies	9	1.8%
15	Expand transactions over the Internet	8	1.6%

Note: 17 companies answered "Other" as a priority issue.

issues, Japanese companies are at the same time trying to realize high value-added production in Japan or to build an optimized global production system by carrying out "strengthen or expand R&D functions" and "strengthen or expand the domestic production."

2. Top priorities by major industry

Top priority issues chosen by each of the four major industries have some special features as shown in the following (Table 9). In Chemicals, "strengthen or expand the overseas production" (46.0%) is surpassed by "strengthen or expand R&D functions" (51.7%). Also, "acquire business resources to strengthen principal business" (29.9%) holds a high share as compared with the all-industry average (19.7%). In the case of General machinery, its order of priority is almost the same as that of the all-industry total, but the share of "strengthen or expand service operations related to the company's products" (30.2%) is much higher than the all-industry average (16.4%). Electrical equipment and electronics also shows a tendency similar to that of the all-industry total, but the share of "strengthen or expand the customer base

Table 9 Top Priority Issues for Domestic and Overseas Business Operations (By Major Industries) (FY 2004)

<Chemicals>

Rank	Top Priorities for Domestic and Overseas Business Operations	Number of Companies (87 companies)	Response rate
1	Strengthen or expand R&D functions	45	51.7%
2	Strengthen or expand the overseas production	40	46.0%
3	Acquire business resources to strengthen principal business	26	29.9%
4	Active expansion into new business areas	25	28.7%
4	Review and improve efficiency of group companies' management	25	28.7%

<General Machinery>

Rank	Top Priorities for Domestic and Overseas Business Operations	Number of Companies (63 companies)	Response rate
1	Strengthen or expand the overseas production	34	54.0%
2	Strengthen or expand R&D functions	29	46.0%
3	Strengthen or expand service operations related to the company's products	19	30.2%
4	Strengthen or expand the customer base by the company's own efforts	18	28.6%
5	Reduce interest-bearing debt	15	23.8%

<Electrical Equipment and Electronics>

Rank	Top Priorities for Domestic and Overseas Business Operations	Number of Companies (108 companies)	Response rate
1	Strengthen or expand the overseas production	55	50.9%
2	Strengthen or expand R&D functions	49	45.4%
3	Strengthen or expand the customer base by the company's own efforts	39	36.1%
4	Active expansion into new business areas	27	25.0%
5	Acquire business resources to strengthen principal business	24	22.2%

<Automobiles>

Rank	Top Priorities for Domestic and Overseas Business Operations	Number of Companies (93 companies)	Response rate
1	Strengthen or expand the overseas production	78	83.9%
2	Strengthen or expand R&D functions	45	48.4%
3	Strengthen or expand the domestic production	23	24.7%
4	Introduce or establish a global supply chain management	21	22.6%
5	Reduce interest-bearing debt	17	18.3%

by the company's own efforts" (36.1%) is particularly high above the all-industry average. Regarding Automobiles, awareness of the need for "strengthen or expand the overseas production" has reached a high of 83.9%, and "strengthen or expand the domestic production" (24.7%) is also well above the all-industry average (17.8%). The automobile industry's strong stance on enlargement of production both at home and abroad is notable as compared with other industries.

Compared with the FY2002 survey, Chemicals gave the first priority to "strengthen or expand R&D functions," a subject newly added, while the "review and improve efficiency of group companies' management" has dropped in share (39.2%→28.7%) (Tables 9 and 10). In General machinery, there is not much change in the top rankings except that "strengthen or expand R&D functions" has risen to the second place. In Electrical equipment and

Table 10 (Reference) Results of FY2002 Survey (By Major Industries)

<Chemicals>

Rank	Top Priorities for Domestic and Overseas Business Operations	Number of Companies (79 companies)	Response rate
1	Strengthen or expand the overseas production	37	46.8%
2	Review and improve efficiency of group companies' management	31	39.2%
3	Acquire business resources to strengthen principal business	30	38.0%
4	Strengthen or expand the customer base by the company's own efforts	29	36.7%
5	Strengthen or expand service operations related to the company's products	19	24.1%

<General Machinery>

Rank	Top Priorities for Domestic and Overseas Business Operations	Number of Companies (51 companies)	Response rate
1	Strengthen or expand the overseas production	25	49.0%
2	Strengthen or expand service operations related to the company's products	21	41.2%
3	Strengthen or expand the customer base by the company's own efforts	18	35.3%
4	Acquire business resources to strengthen principal business	15	29.4%
5	Review and improve efficiency of group companies' management	14	27.5%

<Electrical Equipment and Electronics>

Rank	Top Priorities for Domestic and Overseas Business Operations	Number of Companies (97 companies)	Response rate
1	Strengthen or expand the overseas production	50	51.5%
2	Review domestic production systems from the viewpoint of total cost	35	36.1%
3	Review and improve efficiency of group companies' management	32	33.0%
4	Strengthen or expand the customer base by the company's own efforts	27	27.8%
5	Introduce or establish a global supply chain management	26	26.8%

<Automobiles>

Rank	Top Priorities for Domestic and Overseas Business Operations	Number of Companies (80 companies)	Response rate
1	Strengthen or expand the overseas production	60	75.0%
2	Strengthen or expand the customer base by the company's own efforts	41	51.3%
3	Review domestic production systems from the viewpoint of total cost	22	27.5%
4	Introduce or establish a global supply chain management	20	25.0%
5	Review and improve efficiency of group companies' management	16	20.0%

electronics, the "review domestic production systems from the viewpoint of total cost" (36.1%→10.2%) and the "review and improve efficiency of group companies' management" (33.0%→15.7%) have broadly reduced the share of priorities, while those issues that imply positive business operations have occupied the upper rankings in this year's survey. In the Automobiles, the "strengthen or expand the overseas production" (75.0%→83.9%) has further increased its share, and there has also been evidence of movement toward the "review domestic production systems" (27.5%→6.5%) and the "strengthen or expand the domestic production" (15.0%→24.7%). All of these represent a prominent tendency toward expansion of production at home and abroad.

The rankings of the top-priority issues in the industries mentioned above coincide more or less with those of the all-industry total, which indicate positive attitudes both at home and abroad. But we

can also observe different features by industries. In Automobiles, because of favorable car sales mostly in overseas markets, automotive manufacturers, particularly leading assembly makers, have a strong desire to expand production capacity within and outside the country. In the Electrical equipment and

electronics, companies, who in the fiscal year 2002 had focused on streamlining of business operations in order to increase their competitiveness, are now in a very positive position with a revived appetite for capital investment including R&D functions, etc.

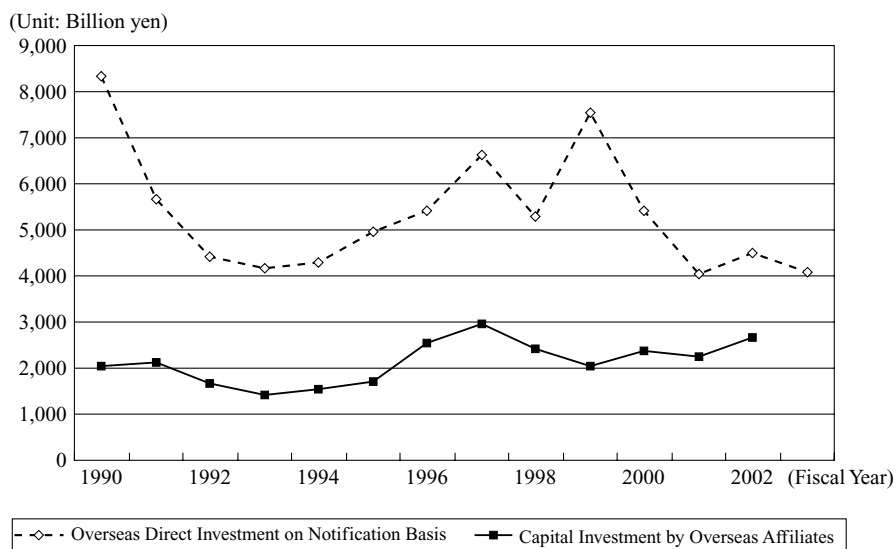
<Column 1> Capital Investment and Top Priorities for Domestic and Overseas Business Operations

This year's survey asked about top priorities for domestic and overseas business operations (multiple selection of three top subjects) after two years' absence since FY2002, and the results clarified that manufacturing companies are not only putting their efforts toward the "strengthen or expand the overseas production," but are also simultaneously pushing at home the "strengthen or expand R&D functions" and the "strengthen or expand the domestic production." And now, overseas investment between FY1990 and FY2002 seems to have the following trend⁴.

First stagnant period: After the peak time of 1990-91, overseas investment tended downward until 1993.

Recovery period: Overseas investment was on the increase from 1994 to 1997.

Column Figure 1 Amount of Overseas Investment (Manufacturing Sector)



Note 1) The above Overseas Direct Investment is cited from the Ministry of Finance's "Outward Direct Investment" (each fiscal year).

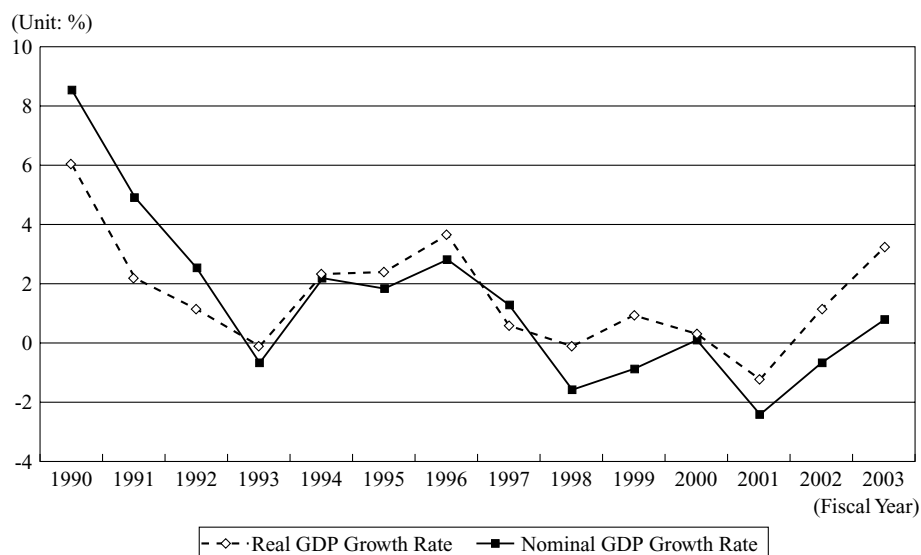
Note 2) The above Capital Investment by Overseas Affiliates is cited from the Ministry of Economy, Trade and Industry's "Basic Survey of Overseas Business Activities" (each fiscal year), provided that figures for FY2002 are an estimated amount.

4 The data used are from "Outward Direct Investment Results" contained in "Outward and Inward Direct Investment Trends" by the Ministry of Finance (website <http://www.mof.go.jp/1c008.htm>), and "Capital Investment by Overseas Affiliates in the Manufacturing Sector" contained in the "Basic Survey of Overseas Business Activities" by the Ministry of Economy, Trade and Industry ("Basic Survey of Japanese Companies' Overseas Business Activities" for each fiscal year by the Enterprises Statistics Office, Research and Statistics Dept., Economic and Industrial Policy Bureau, and Trade and Investment Facilitation Division, Trade and Economic Cooperation Bureau; both of the Ministry of Economy, Trade and Industry). The former data, which comprehensively cover outflow but do not include overseas reinvestment, are on a notification basis. On the other hand, the latter data are retrieved by means of questionnaires, enabling to cover the amount of capital investment made by overseas affiliates. Therefore, both of these data have been used to cover a wider scope of trends. The amount of the Capital Investment by Overseas Affiliates for FY2002 in the "Basic Survey of Overseas Business Activities" is an estimated one (from the FY2002 survey), but it is taken to be the same as an actual result.

Second stagnant period: After 1998⁵.

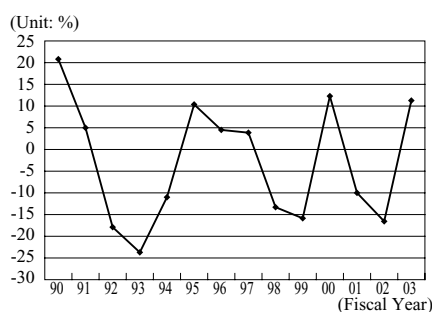
The above trend of overseas investment kept pace with the trend of the Japanese economy. After the collapse of the bubble economy in February 1991, Japanese economy went through an economic cycle⁶ including a trough of October 1993, a peak of May 1997, and a trough of January 1999, and duplicating this cycle, overseas investment generally dropped during the recession and recovered during the economic boom. After January 1999, the economy experienced a short economic cycle with a peak in November 2000 and a trough in January 2002. Given that the amount of overseas direct investment during 1999 was an outlier, no clear rising trend was observed for overseas direct investment for the

Column Figure 2 GDP Growth Rate



Source: Compiled by Japan Bank for International Cooperation based on the "1995 Calendar Year Based Timeline Table of GDE (GDP) by Demand Components (Fixed-based)," Cabinet Office⁷.

Column Figure 3 Year-to-Year Growth Rate of Domestic Capital Spending in the Manufacturing Sector



Source: Compiled by Japan Bank for International Cooperation based on "Survey on Planned Capital Spending" (each fiscal year) of the Development Bank of Japan

Column Table 1 (Reference) Results of FY2000 Survey Concerning Top Priority Issues for Domestic and Overseas Business Operations

Rank	Top Priority Issues for Domestic and Overseas Business Operations	Number of Companies (435 Companies)	Response Rate
1	Review and strengthen management methods	104	23.9%
2	Review and improve efficiency of group management	93	21.4%
3	Acquire business resources to strengthen principal business	66	15.2%
4	Expand and enhance the company's own customers	60	13.8%
5	Review overseas production systems from the viewpoint of total cost	42	9.7%
6	Strengthen service activities related to the Company's own manufactured products	20	4.6%
7	Introduce or establish a global supply chain	18	4.1%
8	Expand the percentage of overseas production	17	3.9%

Note 1) Alternatives less than 1% response have been omitted.

Note 2) 8 companies (1.8%) answered "Other" as a priority issue.

- The amount of the Overseas Direct Investment (Notification Basis) for 1999 came out very large because the amount toward Europe and North America sharply increased. Such a surge appears to have been caused mostly by the buy-out of a US tobacco maker's overseas business unit by a leading Japanese tobacco company, as well as some other large acquisition cases, and this move, therefore, should be considered as an exceptional case not in line with the general trend at that time.
- Peaks and troughs of economic cycles are in accordance with the "Determination of Business-Cycle Peak and Trough" by the Cabinet Office (<http://www.esri.cao.jp/jp/stat/di/041112hiduke.html>).
- "1995 Calendar Year Based Timeline Table of GDE (GDP) by Demand Components (Fixed-based)" by the Cabinet Office (Cabinet Office website: <http://www.esri.cao.go.jp/jp/sna/qc043-2/gdemenujb.html>).

period of 1999 to 2002.

On the other hand, let's see the domestic capital investment trend. The "Survey on Planned Capital Spending" (each fiscal year), which is a questionnaire style survey conducted by the Development Bank of Japan⁸, has a question on the amount of capital investment in the manufacturing sector along with the rate of year-to-year increase. The rate of year-to-year increase shows negative growth for the fiscal years 1992-1994, 1998-1999 and 2001-2002. Fiscal years 1993, 1998-1999, and 2001-2002 were years for which nominal GDP growth rate was negative, and this means that manufacturing sector's capital investment was also coincidentally on the decline.

In the case of the Overseas Direct Investment (Notification Basis), there is a time lag between notification and execution of investment. We tried to clarify the relationship in terms of year-to-year growth rate between the capital investment by overseas affiliate in the "Basic Survey of Overseas Business Activities" and the domestic capital investment in the "Survey on Planned Capital Spending," and it has been clarified that between the two there is a positive relationship with a correlation coefficient of 0.650 for the covered period of 1991 to 2002. During this period, FY2002 was a rather peculiar year. The estimated amount of capital investment by the foreign affiliates showed an increase by 18.2% over the previous year, while the domestic manufacturers' capital investment (actual result) showed a decrease of 16.2% below the previous year's level. Japan Bank for International Cooperation placed a question in their 2002 survey, as well as this year, asking companies to select their top-priorities for domestic and overseas business operations (multiple selection of three top subjects), and the results showed that "strengthen or expand the overseas production" took the first place with 54.6% of the total respondent companies, while the "review and improve efficiency of group companies' management" (32.5%) was the third and the "review domestic production systems from the viewpoint of total cost" (25.4%) was the fourth. This meant that companies wanted to strengthen or expand their overseas production, and at the same time, at home, they tackled the challenge to restructure their corporate strategies including production systems. Incidentally, the survey in FY2000 had in fifth place the issue of "review overseas production systems from the viewpoint of total cost" (ratio in response: 9.7%), surpassing the eighth-placed issue of the "expand percentage of overseas production" (3.9%), implying that at the time of the FY2000 survey, the restructuring of the production systems was also a priority for overseas business operations. Therefore, in connection with the restructuring of production systems, the companies, while paying proper attention to the world economy, nearly accomplished reviewing overseas production systems ahead of domestic production systems during the period of FY2000 to FY2002. This may well be considered to be one of the factors why no positive relationship was seen in FY2002.

So, how have the issues relating to the domestic business operations changed in the present survey? This has been one of the focus points in this question of the top priorities for domestic and overseas business operations. In the result, "review domestic production systems from the viewpoint of total cost" has remarkably reduced its importance, whereas such subjects as "strengthen or expand R&D functions," and "active expansion into new business areas," in addition to "strengthen or expand the overseas production," have jumped to higher positions. "Strengthen or expand the domestic production" also rose higher in the rankings. As an inclination toward expanding investment has been observed for both domestic and abroad in the present survey, and from the results of the above comparative survey, it is expected that a positive relationship can be seen between the trends of the domestic and overseas investment⁹.

8 "Report on the Survey of Planned Capital Spending" (each fiscal year) of the Development Bank of Japan, and "Statistics of the Survey of Planned Capital Spending (for 1990 onward)" in Survey ("Cho-sa") No. 50 of January 2003 of the Development Bank of Japan.

9 According to the prospects of planned capital spending in the manufacturing sector, released in December 2004 by the Development Bank of Japan ("Capital Spending Survey for FYs 2004 and 2005" (made in November 2004) (website: http://www.dbj.go.jp/japanese/download/plant_invest200411.html), capital spending in the manufacturing sector is expected to maintain its momentum of increase for the three consecutive years since 2003.

Chapter 3: Prospects for Domestic Business Operations over the Medium Term

1. Prospects for Domestic Business Operations

In this year’s survey, a question asks about the medium-term (next three years or so) prospects for domestic business operations (568 companies have responded). The results show that with reference to operation size, 47.2% of the respondent companies said they “will maintain the size of domestic business operations at the present level,” and 45.2% responded that they “will strengthen or expand domestic business operations,” both figures were nearly half of the total, while the respondent companies who “will reduce domestic business operations” remained at only 4.6% (Figure 3). For reference, a comparison of the above with the FY2002 survey results¹⁰ shows that the proportion of companies who responded that they “will strengthen or expand domestic business operations” increased by 2.3 points, and the proportion of those who “will reduce domestic business operations” decreased by 2.2 points.

Figure 4 Prospects for Domestic Business Operations over the Medium Term (By major industry)

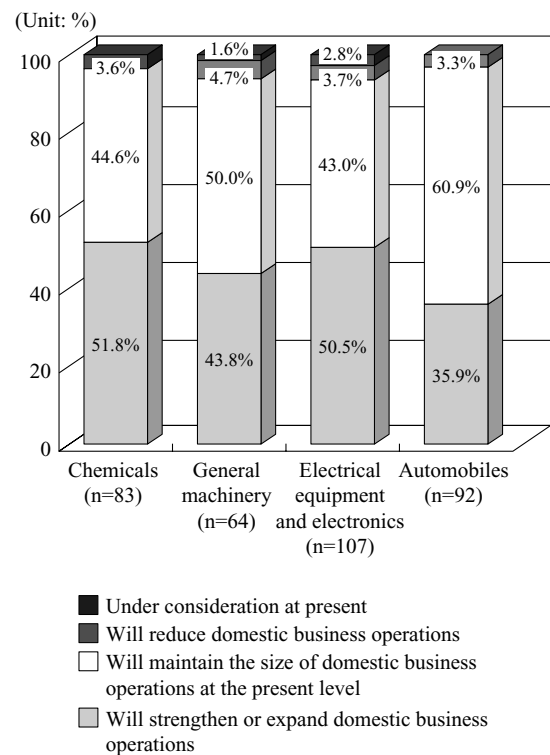
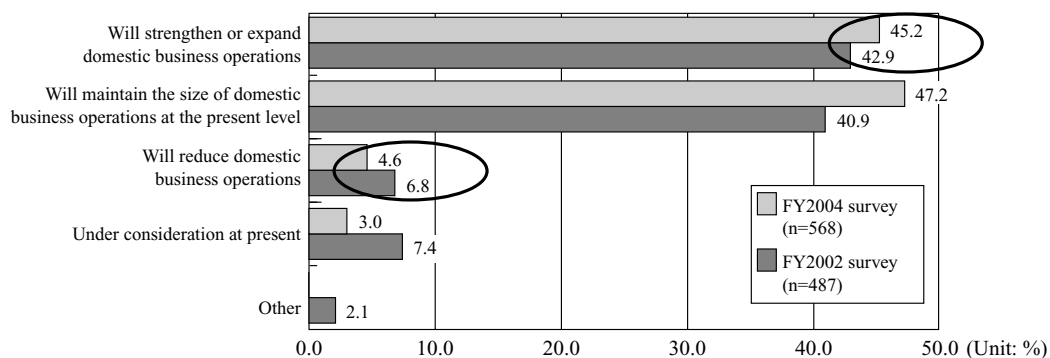


Figure 3 Prospects for Domestic Business Operations over the Medium Term



10 The available options in this survey differ from those in the FY2002 survey, so those that match this year’s options were collated and recalculated.

For reference, the options of the FY2002 survey and the corresponding share of responses are as follows:

1. Strengthen and expand domestic business operations by actively making capital investment as necessary (27.1%)
2. Strengthen domestic operations, including entering alliances with other companies (15.8%)
3. Maintain current status (10.7%)
4. Maintain the current scale of operations but realign/restructure domestic business operations (30.2%)
5. Reduce domestic business operations (6.8%)
6. Currently considering (7.4%)
7. Others (2.1%)

A review has been made of the survey results by major industry (Chemicals, General machinery, Electrical equipment and electronic, and Automobiles). In the General machinery and Automobiles industries, the respondent companies who “will maintain the size of domestic business operations at the present level” exceeded those who “will strengthen or expand domestic business operations,” but in Chemicals and Electrical equipment and electronics more than half of the companies responded they “will strengthen or expand domestic business operations,” indicating that in these industries the scale of domestic operations is on the increase for the medium term (Figure 4).

Interview from the companies about their prospects for domestic business operations has produced the following: “Products for the domestic market are produced at home. If the products produced in Chinese plants are brought into the Japanese market, we are not sure if domestic users are willing to purchase those products. They are inclined to buy high-quality goods even though priced higher” (Electrical equipment and electronics-Assembled products (“will strengthen or expand domestic business operations”)); “Basically we intend to maintain the present level of our domestic business operations. For that purpose, we find it necessary to create new domestic demand to match the portion shifted abroad, and we are having our domestic laboratory conduct basic technology development in this respect” (Chemicals (“will maintain the size of

domestic business operations at the present level”)); and “Domestic mass production is not economical costwise, and so our policy is to reduce it if possible. But, in Japan, assembly manufacturers have to operate their reinforced and expanded production facilities, and therefore we are obligated to increase and maintain our supply to these factories. Also, domestic customers’ quality requirements are too severe to be satisfied with overseas production. So, we have no other way but to use domestic production, though it is not advantageous costwise” (Precision machinery-Components (“will reduce domestic business operations”)). These comments express companies’ attitudes to put their efforts into domestic operations despite different environments surrounding the respective companies.

2. The Area Getting the Most Attention in Domestic Business Operations

To those companies which responded that they “strengthen or expand” domestic operations (response from 257 companies), “maintain the present level” (268 companies), or “reduce” (26 companies), we asked into what fields they are going to put their domestic effort to obtain the results. In every case, the highest proportion of answers came from companies who say that they will put effort into “R&D” (Figure 5). Some of the companies who responded that they “strengthen or expand” expressed their policy as follows: “As we have to link the needs of the domestic market to developmental actions, we

Figure 5 Fields of Focus in Future Domestic Operations (multiple responses)

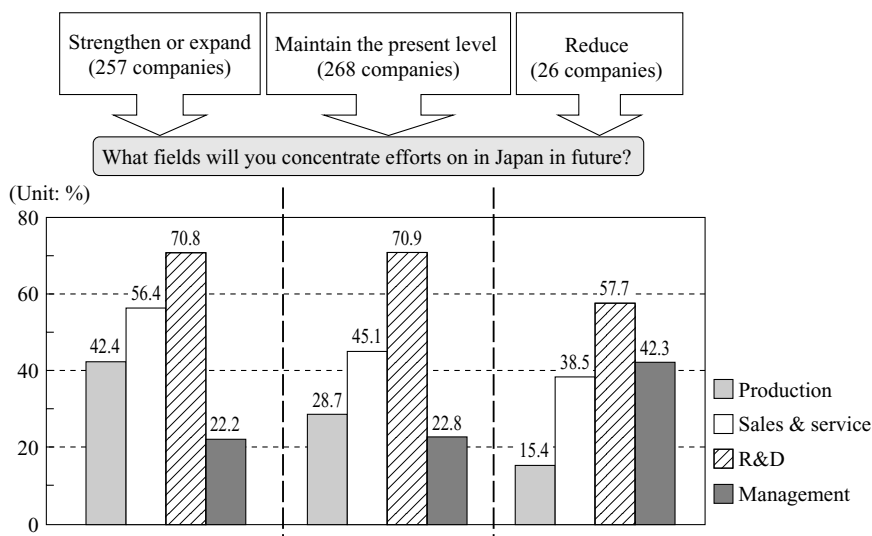
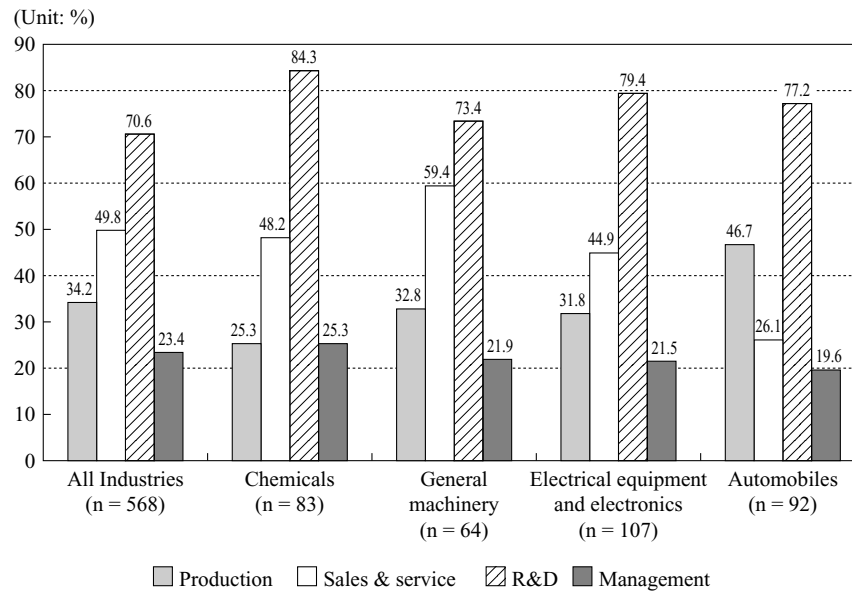


Figure 6 Fields to Focus on in Future Domestic Operations (By Major Industries) (multiple responses)



have no plans to shift the development base to China now or in the future. The production base is neither transferred partly nor entirely” (Precision machinery-Assembled products). Also, some of the companies who have responded they “maintain the present level” say: “We think we need to conduct technical development and production of our high-added value products domestically in future. Actually, we put emphasis on that, as it constitutes the basis for our technical guidance to be carried out at overseas base points” (Automobiles-Components), and “Our R&D process is centered in Japan, and we do little about it abroad. We cannot conceive of doing developmental work for core production technology anywhere else than in Japan” (Precision machinery-Assembled products). These comments suggest that many companies are desirous of keeping the R&D function, and thereby high-added value production, within Japan. Also, companies which have responded that they “strengthen or expand” are characterized by the fact that they provided a high proportion of responses relative to “production” and “sales & service,” indicating that those oriented toward “strengthening or expansion” are inclined to focus their efforts on both the facets of production and sales, against the background of the domestic trend of economic

recovery.

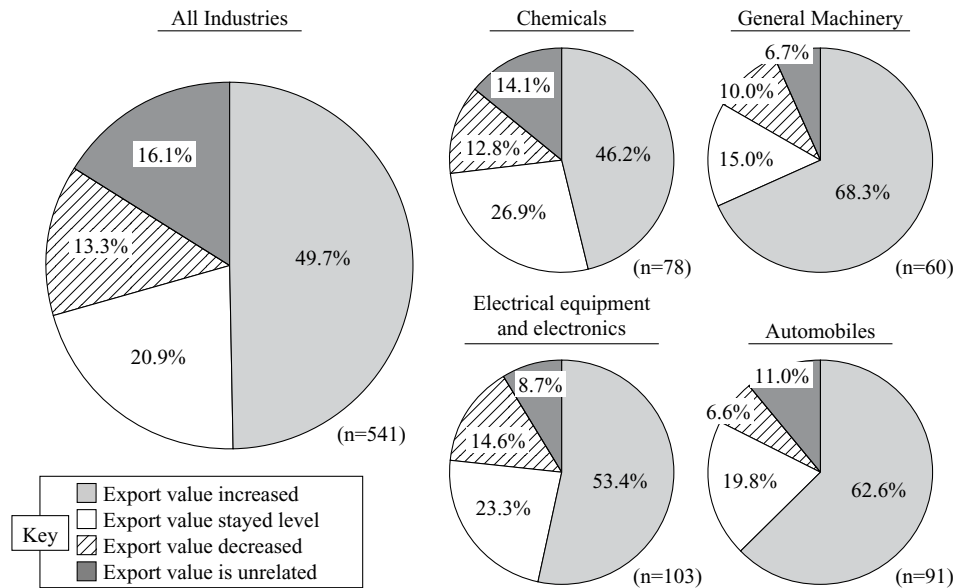
Counting of responses by focus areas according to major industrial classifications has been made irrespective of business destinations toward domestic operations, resulting in “R&D” occupying the highest share by industry total as well as by major industries. In General machinery, responses choosing “sales & service” have been high (59.4%), whereas in the Automobile industry responses choosing “production” have been high (46.7%), while selection of “sales & service” has been the lowest (26.1%) among the major industries (Figure 6).

3. Relationship between Strengthening or Expansion of Overseas Business Operations and Company’s Own Exports

Strengthening or expansion of overseas operations over the past three years¹¹ has been checked as to how it has affected each company’s own exports. The all-industry share of the companies who have responded “export value increased” has risen to 49.7%, but those who have answered “export value decreased” have stayed at 13.3% (Figure 7). By major industrial classifications, a majority of companies in the areas of General machinery, Electrical equipment and electronics, and Automobiles stated that “export value

¹¹ In this survey, overseas business operations are defined as production, sales, research and development activities in overseas bases, as well as outsourcing of manufacturing and procurement overseas.

Figure 7 Relationship between Strengthening or Expansion of Overseas Business Operations and Exports from Japan



Note: Companies which responded “We did not expand overseas business operations in the last three years” were excluded.

increased,” indicating a deep-rooted relationship between “strengthen or expand” overseas business operations and growth in the parent company’s exports from Japan. There are some cases here in which reinforcement of marketing overseas has contributed to increased exports from Japan, but there are also many cases of production expansion overseas leading to export growth.

Some comments given in our hearing by the respondent companies are as follows: “We are exporting material fiber to China, and we find the volume of our exports has increased owing to the strengthened or expanded operations in China” (Textiles), “Strengthening or expansion of our overseas operations required an increased supply of high-added value devices” (Electrical equipment and electronics-Assembled products), “Our export of parts has increased as a result of strengthening or expansion of our overseas production” (Electrical equipment and electronic-Components), “we already shifted most of our production functions to China and Southeast Asia, but we still keep R&D functions and mould fabrication at home. Needs are increasing for those high value-added products that are rather hard to be produced in other places than Japan” (Electrical equipment and electronics-Components). This last comment suggests that division of production functions between home and abroad is surely in

progress.

4. Stance on Domestic Business Operations among Companies that chose “Strengthen or Expand” Overseas Business Operations

In this survey, out of the companies who have responded they “will strengthen or expand overseas business operations” (Figure 15 appearing hereinafter), those who have responded they “strengthen or expand domestic business operations” in reference to the query about the prospects for domestic business operations, have accounted for the largest proportion of 46.7%, while those who “maintain the current size of domestic business operations” have been 45.6% and those who “reduce domestic business operations” remained at only 4.8% (Figure 8). On the other hand, out of the companies who have responded they “will maintain the size of overseas business operations at the present level,” those who have responded they “maintain the current size of domestic business operations” in reference to the query about the prospects for domestic business operations, have accounted for the largest proportion of 55.4%, exceeding 37.6% of “strengthening or expansion of domestic business operations” by a large margin (Figure 9). From these analyses, it is understood that those companies who will strengthen or expand overseas business operations are also

inclined strongly to “strengthen or expand” domestic

business operations, too¹².

Figure 8 Stance on Domestic Business Operations among Companies that Chose “Strengthen or expand” Overseas Business Operations (Medium-term Outlook)

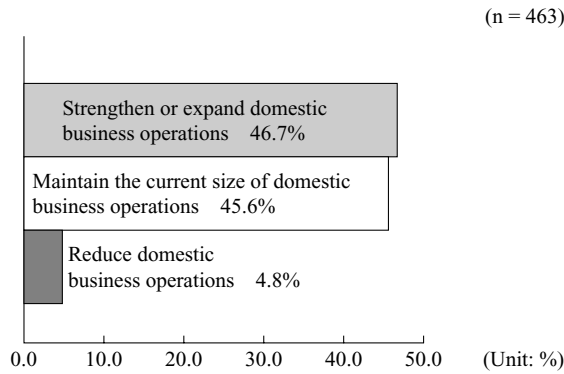
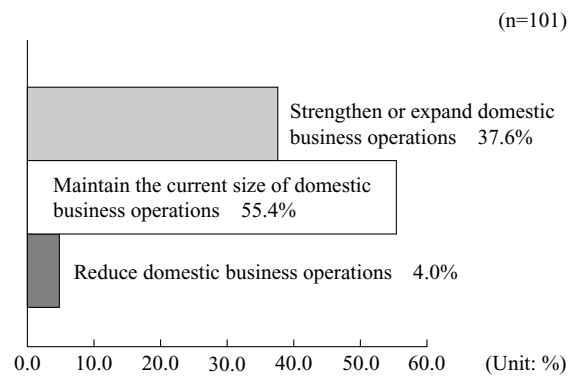


Figure 9 Stance on Domestic Business Operations among Companies that Chose “Maintain the Present Level” of Overseas Business Operations (Medium-term outlook)



Note: Overseas business operations are defined as production, sales, R&D activities in overseas bases, as well as outsourcing of manufacturing and procurement overseas.

<Column 2> Prospects for Domestic Business Operations - Trend in the Electrical Equipment and Electronics Industry

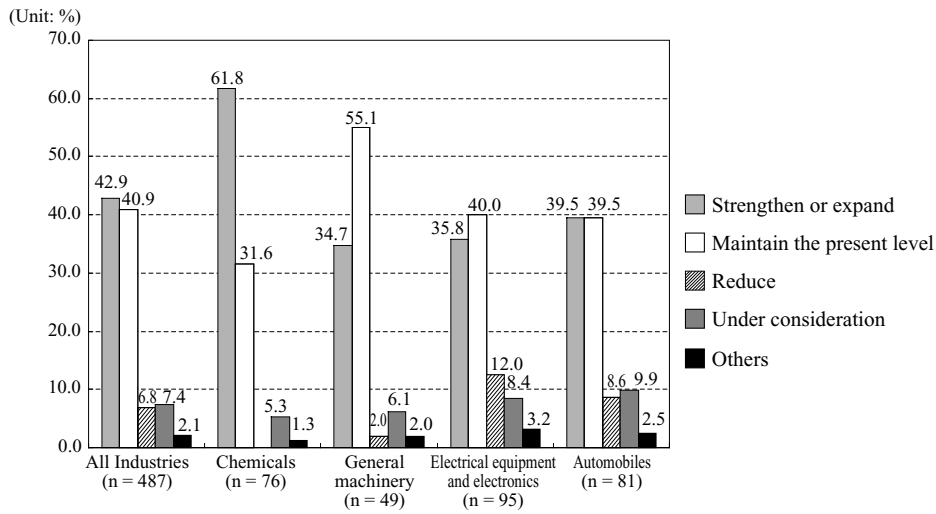
In reference to Electrical equipment and electronics industry, an investigation has been made about the business destinations for driving domestic business operations and the areas to which the companies will put their best efforts. First, comparison with the FY2002 survey results on the point of the business destinations for driving domestic business operations has been made to find a particular feature that the responses of “strengthen or expand” have increased from 35.8% to 50.5%, while the responses of “reduce” have decreased from 12.6% to 3.7%. This indicates that in this industry the business destinations for driving domestic business operations have turned toward the tendency of “strengthening or expansion”(Column Figure 4).

Second, the business destinations for driving domestic operations have been compared by assembly manufacturers or parts makers. Assembly manufacturers have the highest proportion of 64.1% for “strengthen or expand,” but parts makers have a 48.5% proportion for “maintain the present level,” which is well over their proportion of 42.6% for “strengthen or expand”(Column Figure 5). As to the fields to focus, “R&D” occupies the first place for both assembly manufacturer and parts makers. However, “production” acquired relatively high proportion for parts makers, while “sales & service” shows clearly high proportions rather than “production” for assembly manufactures (Column Figure 6). As for parts makers, they also keep almost as high a proportion for production as for R&D and sales, and therefore, it can be assumed that while reinforcing the functions of R&D, they also intend to strengthen or expand domestic production of high value-added products. They seem to deepen the tendency of supplying high value-added parts to assembly manufactures both at home and abroad. In

12 Relationship between Outward Direct Investment and Inward Capital Investment

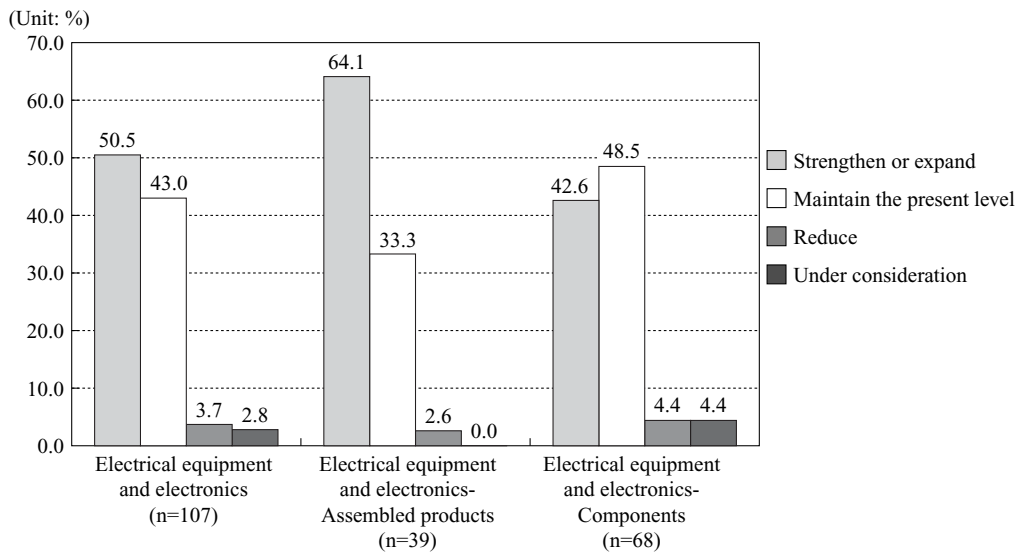
The “Annual Report on the Japanese Economy and Public Finance 2001-2002”(Cabinet Office) carries an account regarding the relationship between outward direct investment and domestic capital investment. The Report explains, “The trend of Japan’s outward direct investment has an inclination to get linked to the developments in domestic and overseas economies, as well as the exchange rate. (snip) Domestic business investment and outward direct investment increase or decrease almost simultaneously, and as such, we can see that outward direct investment and domestic business investment are not necessarily in a ‘zero-sum’ relationship.” This year’s survey has also proved the same result as represented by the foregoing view.

Column Figure 4 Prospects for Domestic Business Operations over the Medium-term in FY2002 Survey (By Major Industry)

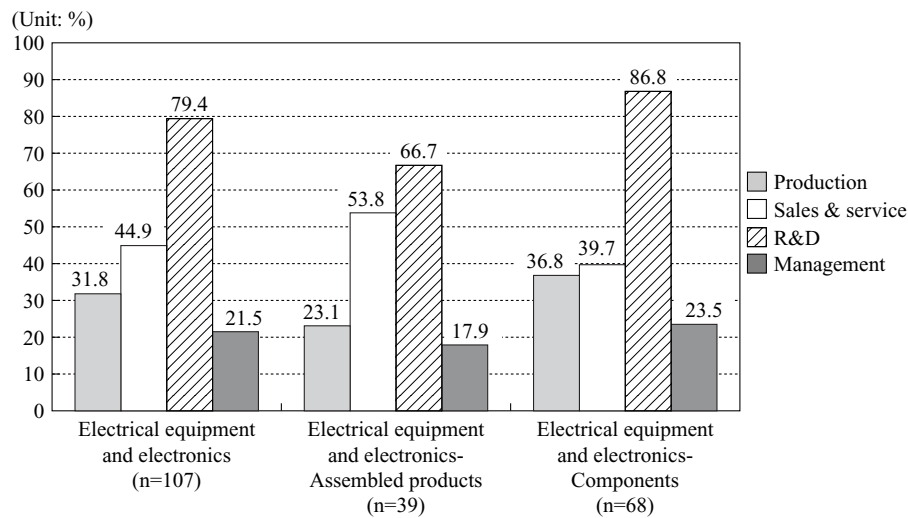


fact, the domestic production system is being reinforced for liquid crystal displays and other high-value added devices for the possible purposes of (1) creating a black box like situation to prevent leaks of confidential technical information abroad and (2) through enhancement of yield rate.

Column Figure 5 Prospects for Domestic Business Operations over the Medium-term by Electrical Equipment and Electronics - Assembled Products/Components



Column Figure 6 Fields of Focus in Future Domestic Operations by Electrical Equipment and Electronics-Assembled Products/Components (multiple responses)



Chapter 4: International Allocation of Production

Our survey for this year has included the subject of division of production functions between domestic and overseas bases. The survey method is to ask where, out of Japan, China, ASEAN, and Others, the respondent company currently produces, or in future expects to produce, “general-purpose products,” “high-value added products” or “products embodying the newest technologies,” and/or “where they intend destinations for future mass production of products embodying the newest technologies,” on the basis of choosing all that apply (multiple responses).

1. Results of Responses by Product

First, simple counting of responses has clarified that general-purpose products are produced in every region of Japan, China, and ASEAN (Figure 10). So far as high-value added products are concerned, about 90% of the respondent companies do their production in Japan, proving that the production of high-value added products is centered on Japanese domestic bases (Figure 11). Secondly, the largest number of the respondent companies prefer Japan as their destinations of production, and also of mass production of products embodying the newest

technologies (Figure 12 and 13). Some of their comments obtained through our interviews are as follows: “To avoid leaks of technique and expertise, we intend to mass produce in Japan those items that may involve high levels of technical expertise” (Textiles), “High value-added devices can be produced only in Japan, and we don’t intend to have them handled otherwise” (Electrical equipment and electronics-Assembled products). As illustrated by these comments, some companies will do their mass production in Japan not simply because the technical level available is low or high, but in order to avoid the risk of having the related technology and expertise leaked.

General-purpose products of Electrical equipment and electronics industries are being produced in China (77.3%), ASEAN (60.0%), and Japan (42.7%). “Production of ordinary class products has been completely transferred to China” (Electrical equipment and electronics-Components), “Of the entire manufacturing process of semi-conductor, the wafer process, which is a high added-value process, is carried out within Japan but the labor-intensive assembly and testing process is undertaken overseas” (Electrical equipment and electronics-Components). As these comments show, this industry seems to be more advanced than others in adopting the divided

Figure 10 Current Production of General-purpose Products (multiple responses)

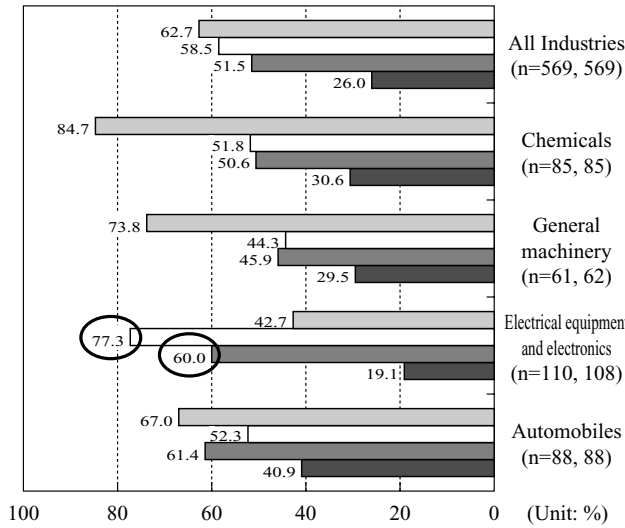
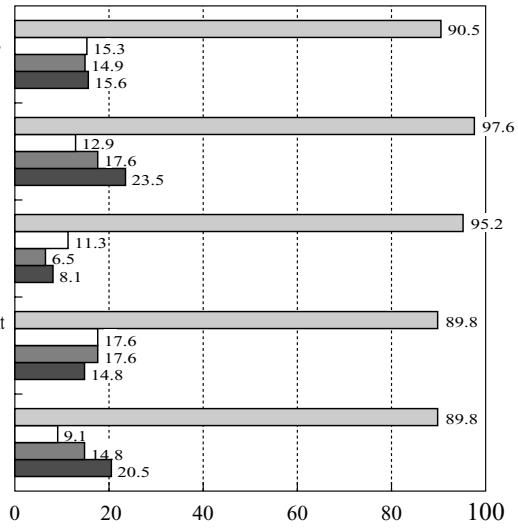


Figure 11 Current Production of High Value-added Products (multiple responses)



Legend: Japan (light gray), China (white), ASEAN (medium gray), Other Region (dark gray)

Note: In this question, “ASEAN” means the six countries of Thailand, Malaysia, the Philippines, Indonesia, Singapore and Vietnam.

Figure 12 Current Production for Products Embodying the Newest Technologies (multiple responses)

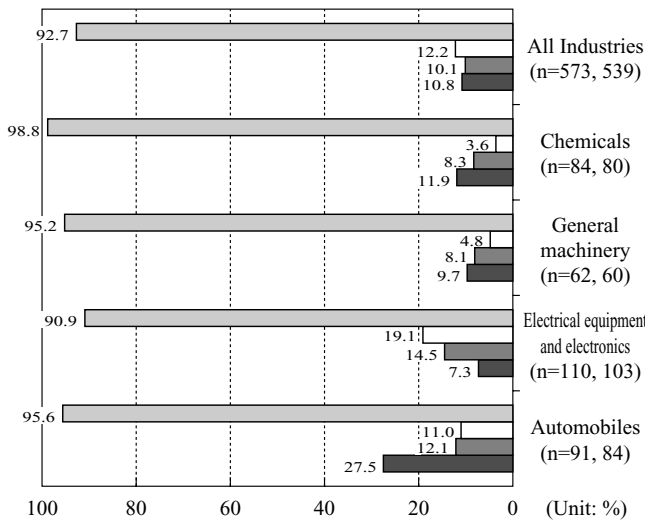
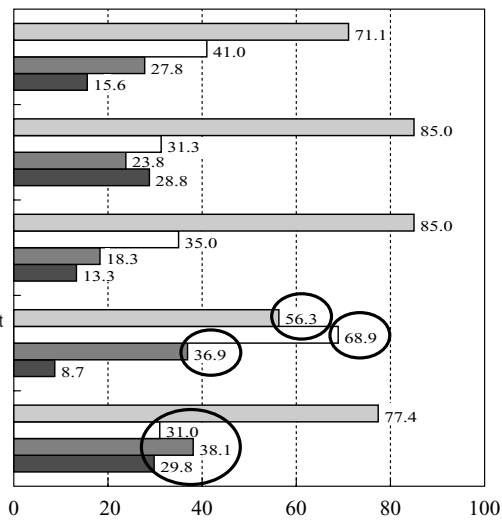


Figure 13 Destinations* for the Future Mass Production of Products Embodying the Newest Technologies (multiple responses)



*Note: Local production to shift to mass production in the next three years or so.

production system in which the production of general-purpose products and labor-intensive products is made in China or ASEAN taking advantage of lower costs there, and the production of high-added value products requiring high technical capabilities is performed within Japan. The destination for the future mass production of products embodying the newest technologies, China has been

the largest choice (68.9%), followed by Japan (56.3%) and ASEAN (36.9%).

“In production capacity within our company group, ASEAN bases surpass Chinese bases, though China’s capacity is fast expanding”(Electrical equipment and electronics-Assembled products). This comment suggests that the Electrical equipment and electronics industry is much more likely to prefer

China to ASEAN as an overseas destination for mass production. Other comments include the following: “In recent years, production tends to be concentrated in China, and we now perceive that the rise in dependency on China should be taken as a risk from the viewpoint of risk diversification” (Electrical equipment and electronics-Components), “Our strategy for the Asian region is to ‘keep a watchful eye on China and the rest of Asia.’ We will build one solid base in China, but we also have to have at least one more base elsewhere in Asia to avoid unforeseen risks such as SARS” (Electrical equipment and electronics-Assembled). These comments are suggestive of the necessity to prepare for the risk of over-concentration in China. As a destination for the future mass production of Automobile manufacturers, ASEAN is slightly above China.

Unlike other industries, many Automobile companies still choose ASEAN rather than China as the destination for production of high-added value products. Comments regarding this were as follows: “As to the matter of production, including types and production sites, we make an integrated judgment from the viewpoint of optimal global production” (Automobiles-Components), “We have constructed an optimal supply chain system for local car assemblers, so we don’t practice division of production functions by product types” (Same), “We make it our basic rule to do production where there is demand” (Automobiles-Assembled products), “In supplying

our parts to each foreign automobile assembly manufacturers, we first examine logistics and local production, taking the characters of the parts into consideration, and then we determine whether and where we should establish production bases, if at all” (Automobiles-Components). The Automobile industry’s overseas business operation is more likely to be based on local conditions than is that of other industries. Also, the industry has an industrial cluster in ASEAN centered in Thailand, and it is not long since Japanese automakers began to enter the China market. Probably these are the reasons why ASEAN is currently regarded as preferable to China.

2. Pattern of Regions of Production

In this survey, we have enumerated each different combination of responses specifying “Japan,” “China,” and/or “ASEAN” as production destinations. The purpose of this is to make a deeper analysis of the division of production among the aforesaid three countries and regions¹³. The characteristics thus obtained are as follows:

(1) General-purpose Products

In the category of general-purpose products, the most common responses by all industries was “Japan/China/ASEAN” (20.7%), followed by “Japan/China” (20.0%), “Japan” (19.3%), and “China/ASEAN” (15.0%) (Table 11). By major industrial classifications, the respondent companies

Table 11 Current Production for General-purpose Products (By major industry)

(Unit: [Left Row] Number of respondent companies; [Right Row] %)

Current Production for General-purpose Products	All Industries		Chemicals		General machinery		Electrical equipment and electronics		Automobiles	
	Number	%	Number	%	Number	%	Number	%	Number	%
Japan	108	19.3%	20	23.8%	19	31.7%	6	5.5%	16	18.6%
China	48	8.6%	2	2.4%	1	1.7%	18	16.5%	2	2.3%
ASEAN	45	8.0%	4	4.8%	9	15.0%	8	7.3%	8	9.3%
Japan · China	112	20.0%	19	22.6%	12	20.0%	19	17.4%	14	16.3%
Japan · ASEAN	48	8.6%	12	14.3%	5	8.3%	6	5.5%	11	12.8%
China · ASEAN	84	15.0%	2	2.4%	5	8.3%	32	29.4%	12	14.0%
Japan · China · ASEAN	116	20.7%	25	29.8%	9	15.0%	20	18.3%	23	26.7%
Total	561	100.0%	84	100.0%	60	100.0%	109	100.0%	86	100.0%

¹³ We checked in which region or combination of region each respondent company is conducting production. In this survey, we provided four options, viz., “Japan,” “China,” “ASEAN,” and “Other region” on a mark all that apply basis and established the following rules for processing in order to look into the state of division of production among the three poles of Japan, China, and ASEAN; any responses specifying “Other region” only are to be excluded; a combination of any one or more of “Japan,” “China,” and “ASEAN” with “Other region” chosen in the response (e.g. “Japan/Other region,” “Japan/China/Other region,” etc.) is to be counted as a part of “Japan,” “China,” “ASEAN,” or a combination of these regions (e.g. “Japan/Other region” → “Japan; Japan/China/Other region” → “Japan/China”).

Table 12 Current Production for General-purpose Products (Electrical equipment and electronics-Assembled products/Components)

(Unit: [Left Row] Number of respondent companies; [Right Row] %)

Current Production for General-purpose Products	Electrical equipment and electronics		Electrical equipment and electronics-Assembled products		Electrical equipment and electronics-Components	
	Number of companies	%	Number of companies	%	Number of companies	%
Japan	6	5.5%	4	10.3%	2	2.9%
China	18	16.5%	4	10.3%	14	20.0%
ASEAN	8	7.3%	2	5.1%	6	8.6%
Japan · China	19	17.4%	8	20.5%	11	15.7%
Japan · ASEAN	6	5.5%	3	7.7%	3	4.3%
China · ASEAN	32	29.4%	12	30.8%	20	28.6%
Japan · China · ASEAN	20	18.3%	6	15.4%	14	20.0%
Total	109	100.0%	39	100.0%	70	100.0%

in Chemicals and Automobiles industries gave most frequently responses to “Japan/China/ASEAN,” followed by “Japan,” in General machinery; “Japan” obtained the largest vote, followed by “Japan/China.” In Electrical equipment and electronics industry, the combination of “China/ASEAN” (29.4%) obtained the largest vote; then come the combinations of “Japan/China/ASEAN” (18.3%), “Japan/China” (17.4%), and “China” (16.5%), the three being at about the same level; and the vote for “Japan” (5.5%) is by far smaller as compared to other industries. In the same industry, the data have been counted separately for assembly and components manufacturers, with the result that the parts makers’ choice of “China” (20.0%) has surpassed that of assemblers by a large margin, while the components manufacturers’ choice of “Japan” stayed as low as 2.9% (Table 12). “What we produce in Japan and in China are roughly the same things. We produce orders for short delivery and small lots in Japan” (Electrical equipment and electronics-Components), “Items produced in Japan and Indonesia are basically the same, but mass production items are produced in Indonesia. We adopt a cell production system for the products we produce in Japan, since these products

are for special orders and are each different in detailed specifications, complying with customers’ individual requirements” (Electrical equipment and electronics-Assembled). As shown above, the production of general-purpose products is not always made overseas. If the product concerned needs to be customized for each user or it has to be delivered within a short time, there can be a plan of production division, in which some part of production is still conducted in Japan.

(2) High-added Value Products

Generally in this category, “Japan” has an overwhelmingly high share of the responses. In Chemicals, the combination of “Japan/China/ASEAN” is in second place, while in the three industries other than Chemicals, the combination of “Japan/China” is in second place (Table 13).

(3) Current Production for Products Embodying the Newest Technologies and Destinations for the Future Mass Production

As with high-added value products, “Japan” has received an overwhelmingly large share in the responses as a region suitable for production of

Table 13 Current Production for High-added Value Products

(Unit: [Left Row] Number of respondent companies; [Right Row] %)

Current Production for High added value Products	All Industries		Chemicals		General machinery		Electrical equipment and electronics		Automobiles	
	Number of companies	%	Number of companies	%	Number of companies	%	Number of companies	%	Number of companies	%
Japan	414	73.0%	67	78.8%	52	83.9%	76	70.4%	64	73.6%
China	12	2.1%	—	—	1	1.6%	2	1.9%	—	—
ASEAN	11	1.9%	—	—	2	3.2%	5	4.6%	—	—
Japan · China	56	9.9%	3	3.5%	5	8.1%	11	10.2%	10	11.5%
Japan · ASEAN	29	5.1%	5	5.9%	1	1.6%	4	3.7%	8	9.2%
China · ASEAN	3	0.5%	—	—	—	—	—	—	1	1.1%
Japan · China · ASEAN	42	7.4%	10	11.8%	1	1.6%	10	9.3%	4	4.6%
Total	567	100.0%	85	100.0%	62	100.0%	108	100.0%	87	100.0%

products using the newest technologies.

By major industries, Chemicals are characterized in that there has been no response without including “Japan” In Electrical equipment and electronics, Japan has a low share, but the combination of “Japan/China” is higher in comparison with other industries (Table 14).

As a destination for future mass production, the all industries total has chosen “Japan,” “China,” and “Japan/China” in that order. Electrical equipment and electronics manufacturers have chosen “China,” “Japan,” and “Japan/China” in descending order of preference, showing a strong tendency to produce in China in future. Automobiles have put “Japan/China/ASEAN” in second place and “Japan/ASEAN” in third place, indicating a

characteristic tendency to lay emphasis on ASEAN (Table 15). The results for Electrical equipment and electronics assembly or components manufacturers show that the first preference is “Japan” (28.2%) for assembly and “China” (26.6%) for components (Table 16). Electrical equipment and electronics have a short product cycle, and therefore, a product using the newest technologies may transform itself into a commodity type product quite rapidly. Thus, the timing of production transfer abroad is likely to come sooner than previously. This survey has made it evident that upon such production transfer, not ASEAN but China is more likely to be a major candidate for a mass production destination.

With reference to “production at an optimum location and division of production,” some comments

Table 14 Current Production for Products Embodying the Newest Technologies

(Unit: [Left Row] Number of respondent companies; [Right Row] %)

Current Production for Products Embodying the Newest Technologies	All Industries		Chemicals		General machinery		Electrical equipment and electronics		Automobiles	
	Number of companies	%	Number of companies	%	Number of companies	%	Number of companies	%	Number of companies	%
Japan	455	81.8%	74	89.2%	55	90.2%	79	73.8%	76	86.4%
China	11	2.0%	—	—	—	—	2	1.9%	—	—
ASEAN	10	1.8%	—	—	1	1.6%	4	3.7%	—	—
Japan · China	32	5.8%	2	2.4%	1	1.6%	10	9.3%	1	1.1%
Japan · ASEAN	21	3.8%	6	7.2%	2	3.3%	3	2.8%	2	2.3%
China · ASEAN	4	0.7%	—	—	1	1.6%	1	0.9%	1	1.1%
Japan · China · ASEAN	23	4.1%	1	1.2%	1	1.6%	8	7.5%	8	9.1%
Total	556	100.0%	83	100.0%	61	100.0%	107	100.0%	88	100.0%

Table 15 Destinations for the Future Mass Production of Products Embodying the Newest Technologies

(Unit: [Left Row] Number of respondent companies; [Right Row] %)

Destinations for the Future Mass Production of Products Embodying the Newest Technologies	All Industries		Chemicals		General machinery		Electrical equipment and electronics		Automobiles	
	Number of companies	%	Number of companies	%	Number of companies	%	Number of companies	%	Number of companies	%
Japan	248	46.8%	44	55.7%	34	56.7%	23	22.3%	40	50.0%
China	71	13.4%	5	6.3%	5	8.3%	24	23.3%	2	2.5%
ASEAN	34	6.4%	5	6.3%	2	3.3%	6	5.8%	6	7.5%
Japan · China	61	11.5%	11	13.9%	10	16.7%	18	17.5%	6	7.5%
Japan · ASEAN	27	5.1%	5	6.3%	3	5.0%	3	2.9%	8	10.0%
China · ASEAN	42	7.9%	1	1.3%	2	3.3%	15	14.6%	7	8.8%
Japan · China · ASEAN	47	8.9%	8	10.1%	4	6.7%	14	13.6%	11	13.8%
Total	530	100.0%	79	100.0%	60	100.0%	103	100.0%	80	100.0%

Table 16 Destinations for the Future Mass Production of Products Embodying the Newest Technologies (Electrical equipment and electronics -Assembled products/Components)

(Unit: [Left Row] Number of respondent companies; [Right Row] %)

Destinations for the Future Mass Production of Products Embodying the Newest Technologies	Electrical equipment and electronics		Electrical equipment and electronics-Assembled products		Electrical equipment and electronics-Components	
	Number of companies	%	Number of companies	%	Number of companies	%
Japan	23	22.3%	11	28.2%	12	18.8%
China	24	23.3%	7	17.9%	17	26.6%
ASEAN	6	5.8%	3	7.7%	3	4.7%
Japan · China	18	17.5%	5	12.8%	13	20.3%
Japan · ASEAN	3	2.9%	—	—	3	4.7%
China · ASEAN	15	14.6%	6	15.4%	9	14.1%
Japan · China · ASEAN	14	13.6%	7	17.9%	7	10.9%
Total	103	100.0%	39	100.0%	64	100.0%

were received from the respondent companies; “As compared with Japan, China has merit only in its lower cost of labor, but its total cost of production is the least economical as parts, electricity, and so forth are not so cheap there. If a yield rate of 100% can be achieved in Japan, it will be possible to cut production costs dramatically, bringing down domestic production costs to a level equal with that of China” (Electrical equipment and electronics-Components), “We will go to wherever our customer assembler is in operation. In relation to international allocation of production in Asia, we are of the opinion that it is more efficient to concentrate plant facilities in a certain place than to spread multiple plants throughout various countries and regions” (Automobiles-Components). As commented, actual execution is left to the determination of respective companies in consideration of production cost, investment climate, marketing strategy, and all other circumstances and factors. From the results of this

survey, it can be said that Japanese manufacturing companies are using the production at their bases in Japan as their mainstay and carrying out well-balanced division of production for general-purpose products in China and ASEAN, though some variance is observed by type of industry.

As shown by this comment; “We develop technology in Japan and manufacture in China as our own way of division of labor” (Precision machinery-Assembled), Japanese companies put efforts into the production of high added-value products and products embodying the newest technologies through reinforcement of R&D functions within Japan, and at the mass production stage, they transfer part of their production to China or ASEAN, thus establishing the cycle of division of production among Japan, China, and ASEAN. This true picture of Japanese manufacturers can be seen from the results of this survey.

<Column 3> Division of Production among Japan, China, and ASEAN

How are Japanese companies executing division of production in relation to general-purpose products and high value-added products, and products using the newest technologies and the destination for mass production of them? Using the data available from this survey, we have further analyzed the way companies are performing division of production in relation to Japan, China, and ASEAN. First, we checked distribution of combinations of regions and kinds of products, in other words, which regions general-purpose products and high-added value products are being produced. The result shows that the combination of “general-purpose products (Japan) + high value-added products (Japan)” has the highest share at 17.6% in the total of responses (Column Table 2), “Japan/China + Japan” (13.8%), and “Japan / China / ASEAN + Japan” (12.7%).

Similar analysis has been made in relation to the combination of “products using the newest technologies” and “destination for the future mass production of products embodying the newest technologies,” showing that the combination of “Japan + Japan” has the highest share (46.0%) (Column Table 3). The other combinations, in descending order of preference, are as follows: “Japan +

Column Table 2 Production for Combination of General-purpose Products and High-Added Value Products (Unit: [Left Row] Number of respondent companies; [Right Row] %)

All Industries		Production of high-added value Products															
		Japan		China		ASEAN		Japan · China		Japan · ASEAN		China · ASEAN		Japan · China · ASEAN		Total	
Production of General-purpose Products	Japan	98	17.6%	1	0.2%	—	—	2	0.4%	3	0.5%	1	0.2%	3	0.5%	108	19.4%
	China	34	6.1%	7	1.3%	3	0.5%	1	0.2%	1	0.2%	—	—	1	0.2%	47	8.4%
	ASEAN	31	5.6%	1	0.2%	6	1.1%	4	0.7%	1	0.2%	—	—	1	0.2%	44	7.9%
	Japan · China	77	13.8%	—	—	—	—	28	5.0%	—	—	—	—	6	1.1%	111	19.9%
	Japan · ASEAN	34	6.1%	1	0.2%	1	0.2%	4	0.7%	6	1.1%	—	—	1	0.2%	47	8.4%
	China · ASEAN	62	11.1%	1	0.2%	—	—	6	1.1%	5	0.9%	2	0.4%	8	1.4%	84	15.1%
	Japan · China · ASEAN	71	12.7%	—	—	1	0.2%	10	1.8%	13	2.3%	—	—	21	3.8%	116	20.8%
	Total	407	73.1%	11	2.0%	11	2.0%	55	9.9%	29	5.2%	3	0.5%	41	7.4%	557	100.0%

Japan/China”(9.2%), “Japan + China” (7.9%), etc. By all industries, nearly half of the respondent companies specify Japan as the mass production site for their high-tech products. The combinations of mass production sites on the all-industry basis are as follows: “Japan”(46.8%), “China”(13.4%), and “Japan/China”(11.5%). From this, we know that many companies intend to establish mass production in China rather than ASEAN.

In the Electrical equipment and electronics industry, for which particularly characteristic data have become available as compared to other industries, the combination of “general-purpose products/Japan + high-added value products/Japan” has the highest share at 22.4% (Column Table 4). The other combinations, in descending order of preference, are as follows: “Japan/China + Japan” (12.1%), “China + Japan”(11.2%). It is apparent that China rather than ASEAN is the main so far as the production of general-purpose products is concerned.

A further similar analysis has been made for the combination of “products embodying the newest technologies” and “destinations for the future mass production of products embodying the newest technologies.” The combination of “Japan + Japan” has proved to be the most popular with a share of 21.4% (Column Table 5). The other combinations, in descending order of preference, are as follows: “Japan + China”(14.6%), “Japan + Japan/China”(13.6%). In the Electrical equipment and electronics industry, it is obvious that China rather than ASEAN is considered more desirable as a mass production destination for products using the newest technologies.

Column Table 3 Combination of Production and Mass production of Products Embodying the Newest Technologies

(Unit: [Left Row] Number of respondent companies; [Right Row] %)

All Industries		Mass production of products embodying the newest technologies															
		Japan		China		ASEAN		Japan · China		Japan · ASEAN		China · ASEAN		Japan · China · ASEAN		Total	
Production of products embodying the newest technologies	Japan	244	46.0%	42	7.9%	24	4.5%	49	9.2%	20	3.8%	32	6.0%	21	4.0%	432	81.5%
	China	—	—	11	2.1%	—	—	—	—	—	—	—	—	—	—	11	2.1%
	ASEAN	1	0.2%	2	0.4%	5	0.9%	—	—	—	—	2	0.4%	—	—	10	1.9%
	Japan · China	—	—	15	2.8%	1	0.2%	12	2.3%	—	—	1	0.2%	2	0.4%	31	5.8%
	Japan · ASEAN	1	0.2%	1	0.2%	4	0.8%	—	—	7	1.3%	1	0.2%	7	1.3%	21	4.0%
	China · ASEAN	—	—	—	—	—	—	—	—	—	—	3	0.6%	—	—	3	0.6%
	Japan · China · ASEAN	2	0.4%	—	—	—	—	—	—	—	—	3	0.6%	17	3.2%	22	4.2%
	Total	248	46.8%	71	13.4%	34	6.4%	61	11.5%	27	5.1%	42	7.9%	47	8.9%	530	100.0%

Column Table 4 Production for Combination of General-purpose Products and High-added Value Products (Electrical equipment and electronics)

(Unit: [Left Row] Number of respondent companies; [Right Row] %)

Electrical equipment and electronics		Production of high value-added products															
		Japan		China		ASEAN		Japan · China		Japan · ASEAN		China · ASEAN		Japan · China · ASEAN		Total	
Production of general-purpose products	Japan	6	5.6%	—	—	—	—	—	—	—	—	—	—	—	—	6	5.6%
	China	12	11.2%	1	0.9%	2	1.9%	1	0.9%	1	—	—	—	—	—	17	15.9%
	ASEAN	5	4.7%	—	—	2	1.9%	1	0.9%	—	—	—	—	—	—	8	7.5%
	Japan · China	13	12.1%	—	—	—	—	5	4.7%	—	—	—	—	—	—	18	16.8%
	Japan · ASEAN	5	4.7%	—	—	1	0.9%	—	—	—	—	—	—	—	—	6	5.6%
	China · ASEAN	24	22.4%	1	0.9%	—	—	3	2.8%	—	—	—	—	4	3.7%	32	29.9%
	Japan · China · ASEAN	11	10.3%	—	—	—	—	1	0.9%	3	2.8%	—	—	5	4.7%	20	18.7%
	Total	76	71.0%	2	1.9%	5	4.7%	11	10.3%	4	3.7%	—	—	9	8.4%	107	100.0%

Column Table 5 Combination of Production and Mass production of Products Embodying the Newest Technologies (Electrical equipment and electronics)

(Unit: [Left Row] Number of respondent companies; [Right Row] %)

Electrical equipment and electronics		Mass production of products embodying the newest technologies															
		Japan		China		ASEAN		Japan·China		Japan·ASEAN		China·ASEAN		Japan·China·ASEAN		Total	
Production of products embodying the newest technologies	Japan	22	21.4%	15	14.6%	5	4.9%	14	13.6%	2	1.9%	12	11.7%	6	5.8%	76	73.8%
	China	—	—	2	1.9%	—	—	—	—	—	—	—	—	—	—	2	1.9%
	ASEAN	1	1.0%	1	1.0%	1	1.0%	—	—	—	—	1	1.0%	—	—	4	3.9%
	Japan·China	—	—	6	5.8%	—	—	4	3.9%	—	—	—	—	—	—	10	9.7%
	Japan·ASEAN	—	—	—	—	—	—	—	—	1	1.0%	—	—	2	1.9%	3	2.9%
	China·ASEAN	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
	Japan·China·ASEAN	—	—	—	—	—	—	—	—	—	—	2	1.9%	6	5.8%	8	7.8%
	Total	23	22.3%	24	23.3%	6	5.8%	18	17.5%	3	2.9%	15	14.6%	14	13.6%	103	100.0%

Chapter 5: Overseas Production Ratio

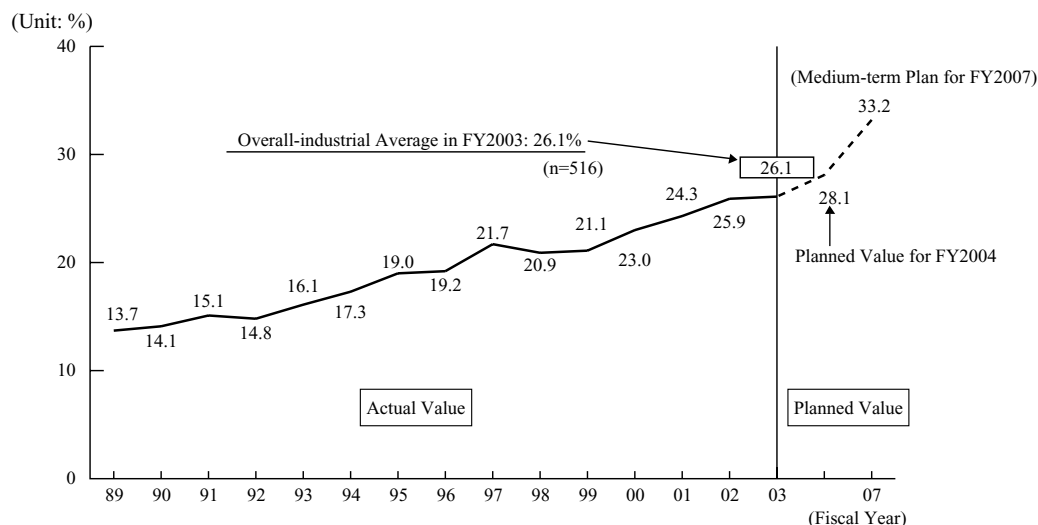
The overseas production ratio of the 516 respondent companies was 26.1%, an actual value for FY2003, rising year on year for five consecutive years (Figure 14). The FY2004 estimated value and FY2007 planned value are respectively 28.1% and 33.2%, suggesting that many companies are thought to be planning expansion of overseas production. By major industries, the actual value of overseas production ratio in FY2003 is 38.8% (the highest of all) for Electrical equipment and electronics followed by Automobiles (26.8%), General machinery (18.4%), and Chemicals (16.9%) (Table 17). For all of these four industrial classifications, prospects are bright enough to foresee an increased overseas production ratio with reference to both FY2004 actual value and

FY2007 mid-term planned value.

Table 17 Overseas Production Ratio (By Major Industries)

	Number of Respondent Companies	Actual Value in FY 2003	Planned Value for FY 2004	Mid-term Planned Value for FY 2007
All Industries	516	26.1%	28.1%	33.2%
Chemicals	75	16.9%	18.3%	24.1%
General Machinery	53	18.4%	19.9%	25.8%
Electrical Equipment and Electronics	99	38.8%	41.1%	45.5%
Automobiles	76	26.8%	28.7%	35.5%

Figure 14 Trend of Overseas Production Ratio (All-industry Average)



Chapter 6: Prospects for Overseas Business Operations over the Medium Term

1 Summary

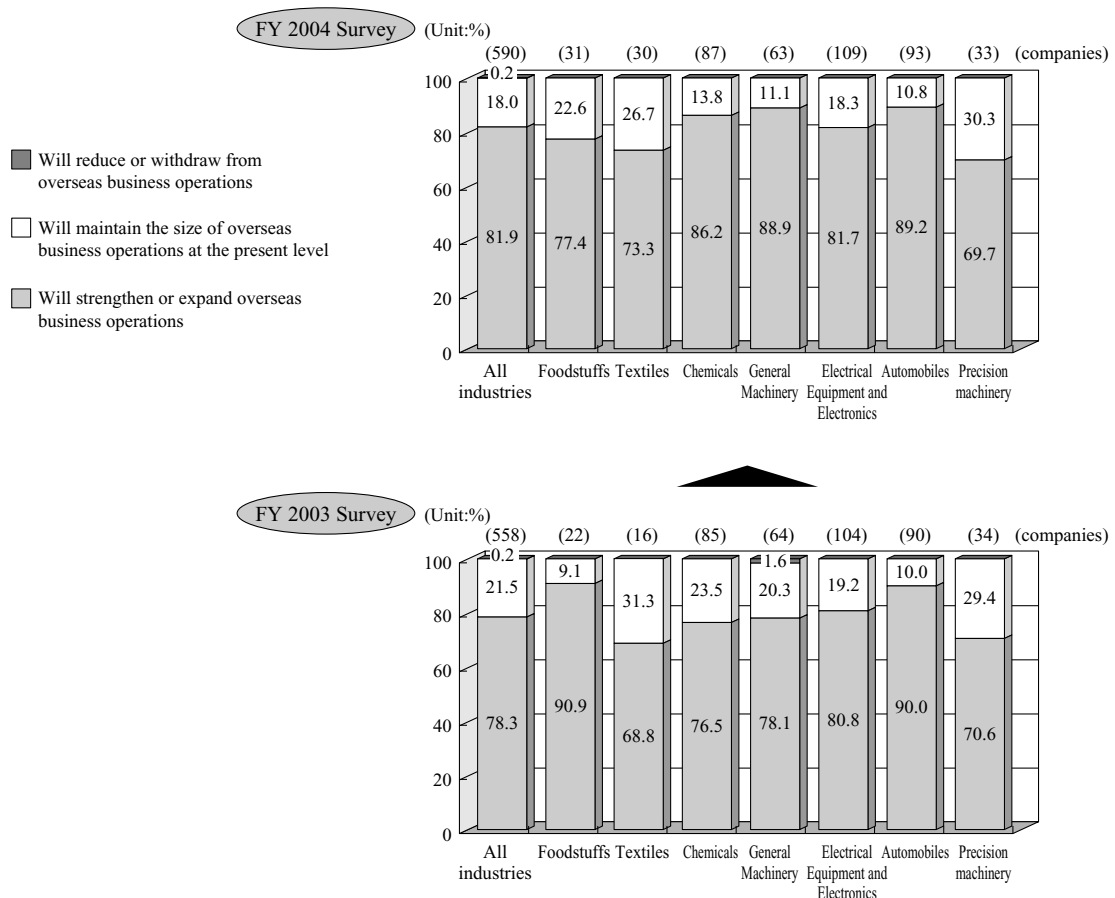
When asked for the medium-term (next three years or so) prospects for overseas business operations¹⁴, 81.9% of the 590 respondent companies answered, “will strengthen or expand overseas business operations,” 18.0% “will maintain the size of overseas business operations at the present level,” and 0.2% “will reduce or withdraw from overseas business operations” (Figure 15). Compared with the FY2003 survey results, the proportion of companies who responded that they “will strengthen or expand” has risen by 3.6 points, exemplifying the

continued positive attitude toward overseas business operations.

By industries, the keenest to strengthen or expand overseas business operations has been Automobiles (89.2%), followed by General machinery (88.9%), and Chemicals (86.2%) (Figure 15). Compared with the FY2003 survey result, both Chemicals (76.5% in FY2003) and General machinery (78.1% in FY2003) have increased by about 10 points the proportion of companies who responded that they “will strengthen or expand overseas business operations,” showing that in the above industries an increased number of companies are positive attitude toward overseas business operations¹⁴.

Looking at the regional variation on stance to overseas business operations over the medium term (next

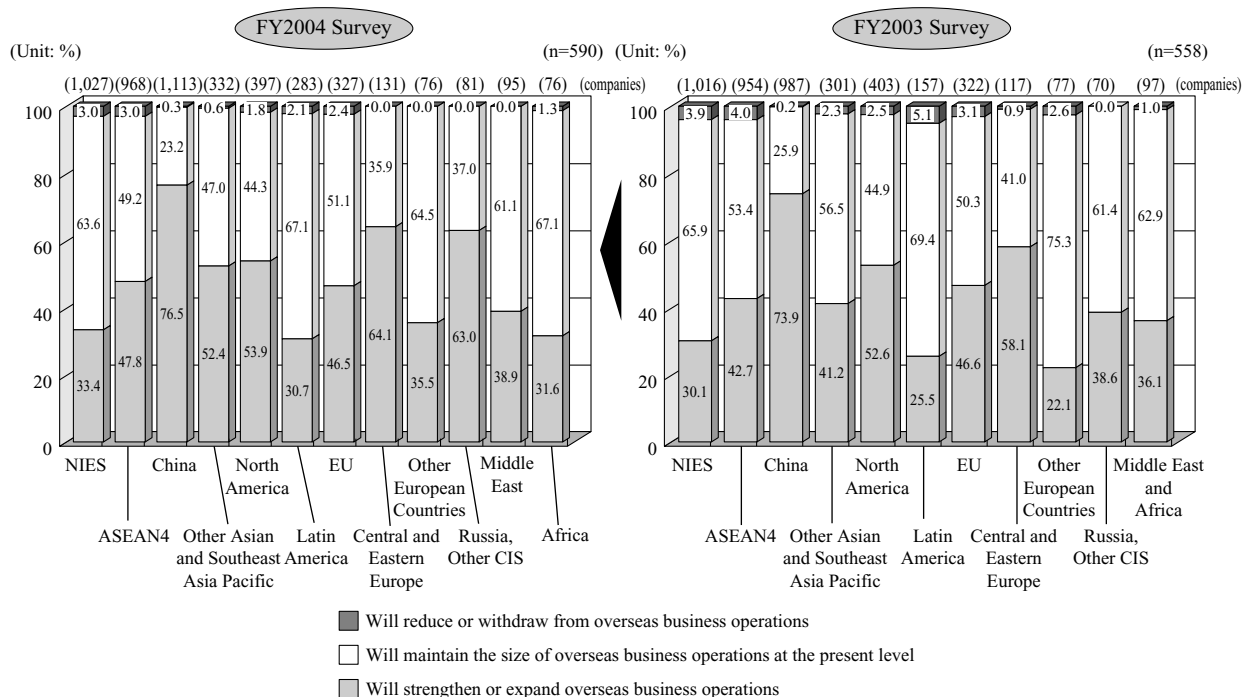
Figure 15: Prospects for Overseas Business Operations over the Medium term (next 3 years orso) (By major industry)



Note: The term “overseas business operations” used in this survey is defined as production, sales, research and development activities in overseas bases, as well as outsourcing of manufacturing and procurement overseas.

14 The term “overseas business operations” used in this survey is defined as production, sales, research and development activities in overseas bases, as well as outsourcing of manufacturing and procurement overseas.

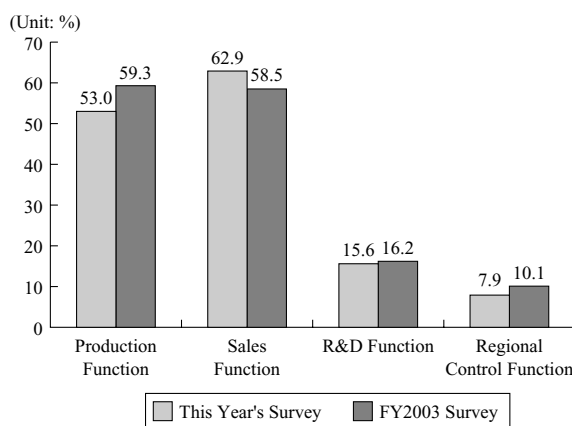
Figure 16 Prospects for Overseas Business Operations over the Medium term (next 3 years or so) (All regions)



Note: Individual questions about the NIES, ASEAN4, China and other Asian countries, and Southeast Asia Pacific have been included before the FY2003 survey, and questions about Latin America were added for the first time in the FY2004 survey. Shares of total values for each country and area in such regions in Figure 16 have been calculated.

three years or so)¹⁵, the regions/countries for which the highest proportion of companies said that they would “strengthen or expand the size of overseas business operations” are China (76.5%), followed by Central and Eastern Europe Countries (64.1%), and Russia, other CIS (63.0%) (Figure 16). In comparison with the FY2003 survey results, this year’s survey has proven that the companies’ stance on strengthening or expansion of their overseas business operations has strengthened in nearly all countries/regions. Particularly, the proportion of companies planning to strengthen or expand their business operations in Russia, other CIS has risen by about 24 points (51 companies out of 81) as compared to FY2003 survey results (27 companies out of 70, or 38.6%), the increase being the largest among the target countries/regions in the present survey. The above results indicate that the number of companies making positive attitudes toward business operations in the said region is on the increase, probably due mainly to the number of companies in the two industrial classifications of General

Figure 17 Strengthening or Expansion Stance by Fields



machinery (19 companies this year and 6 in FY2003) and Electrical equipment and electronics (18 companies this year and 8 in FY2003) who responded that they will strengthen or expand their business operations in that region. Both industries formed the top two in responding to this year’s survey and that of FY2003.

Further, the prospects for overseas business

15 Individual questions about the NIES, ASEAN4, China and other Asian countries, Southeast Asia Pacific have been included before the FY2003 survey, and questions about Latin America were added for the first time in the FY2004 survey. Shares of total values for each country and area in such regions in Figure 16 have been calculated. In the FY2004 survey, the category of “Middle East & Africa” was divided into “Middle East” and “Africa.” This year’s survey has also renamed the “EU” to “EU15.” The figures shown in parentheses are the total number of responses for each region.

operations over the medium-term (next three years or so) can be classified by activity fields as follows. Among the target fields of activity to be strengthened and expanded, sales function (62.9%) shows the highest proportion, followed by production function (53.0%), R&D function (15.6%), and regional control function (7.9%)¹⁶ (Figure 17). The results of this year's survey are characterized, in comparison with those of FY2003, by the fact that the strengthening or expansion of sales function (58.5% in FY2003) has overtaken production function (59.3% in FY2003). The fields to be strengthened and expanded vary by regions. In NIEs and EU15, the tendency to strengthen or expand the sales function is stronger than that of the production function, and in China and North America, the proportion of companies who will strengthen or expand the production function rather than the sales function is still generally high, although the number who put weight on the sales function is increasing.

2. Countries/Regions for Strengthening or Expansion (all regions)

In the preceding section, we reviewed the stance for overseas business operations by each country/region in the medium term (next three years or so). Taking North America in Figure 16 as the example, you will see that out of 397 companies doing business operations in that region, 53.9% are intending to strengthen or expand the size of business operations in the same region over the medium-term basis (next three years or so). In short, we have shown the companies' stance for their business operations in each country/region.

In this section, we will use an analytical viewpoint different from what has been used in the preceding section in order to check companies' attitude for their overseas business operations covering all countries/regions in the medium term (next three years or so). To be more precise, for each country/region, the number of companies who have said that they will strengthen or expand their business operations in that country/region is totaled, and that

figure is divided by the aggregate number of companies (refer to Figure 15) who responded that they will strengthen or expand their overseas business operations for the medium term (next three years or so), thus showing ratios.

In Figure 18, the North America, for example, indicates that 44.3% of companies in all industries (214 companies out of 483) have an intention of strengthening or expansion of their business operations in that region. Also, Figure 23 clarifies that 41.6% of Electrical equipment and electronics manufacturers (37 companies out of 89) have an intention of strengthening or expansion of their business operations in Thailand. In other words, the analysis in this section shows which countries/regions throughout the world interest companies as sites for their overseas business operations for the medium term (next three years or so).

The analysis further makes it clear that quite a large number of companies from the all industries (total number of respondent companies is 483) are intending to strengthen or expand their business operations in Eastern China (68.9%), Southern China (47.6%), Thailand (47.8%), and North America (44.3%) (Figure 18). On the other hand, in Latin America (Mexico: 7.0%; Brazil: 8.3%), the Middle East (7.7%), and Africa (5.0%), the number of companies intending to strengthen or expand their business operations is relatively small. From the foregoing, it can be seen that of the countries/regions where overseas business operations are to be strengthened or expanded, company interest is mostly concentrated on China, Thailand, and North America, with a particular tendency to put a very positive stance on Eastern China.

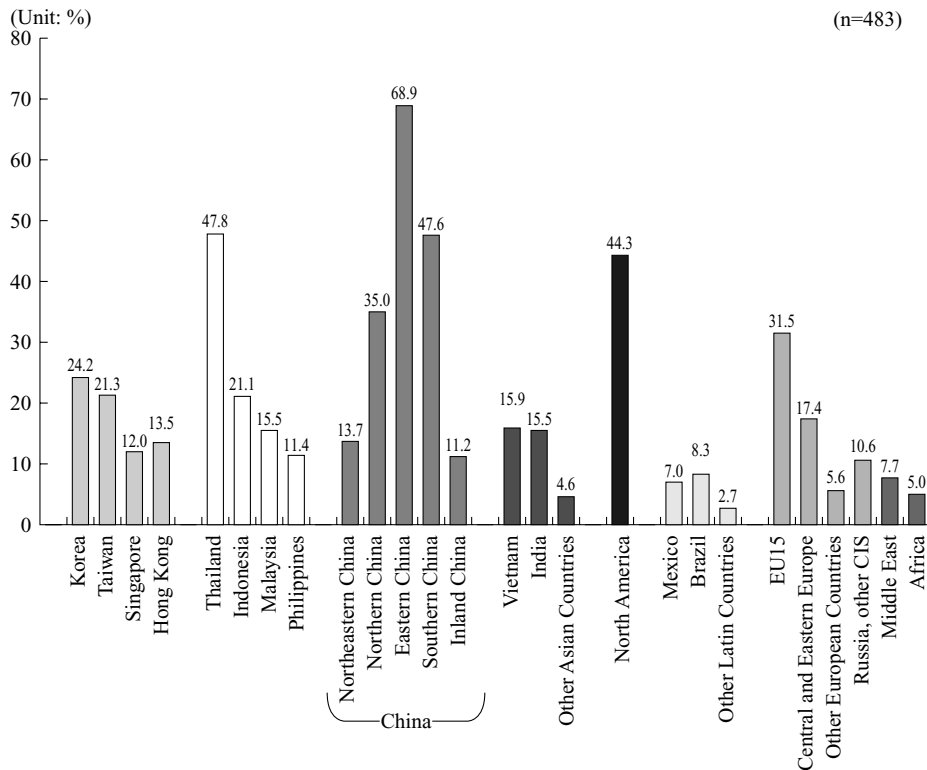
Likewise, the stance for strengthening or expansion may be analyzed in regard to the four major industries and by number of respondent companies as well as functions, as follows:

(1) Chemicals

The stance of Chemicals manufacturers (number of respondents: 75) toward strengthening or expansion of overseas business operations can be examined as

¹⁶ The figures shown in parentheses are the number of respondent companies for each country/region. Companies which responded that they would "strengthen or expand" were asked in which functions they intended to do so, from production, sales, R&D and regional control functions. Multiple options are presented within each field and any company that selected at least one option was counted as one company in the corresponding field.

Figure 18 Number of Companies for Strengthening or Expansion (ratio) (All industries)



follows (Figure 19). As with the all industry basis, a positive, strong stance is shown toward Eastern China (80.0%), Thailand (46.7%), and North America (46.7%).

As to functions that companies will strengthen or expand (Figure 20), the ratio of production function is high for Eastern China and for Thailand, but the ratio of sales function is high for Northern China, North America, and EU15. Comparison with

the FY2003 survey results also reveals that the ratio of sales function has been rising generally and has overtaken that of production function for Southern China. As a definitive means to strengthen the sales function, many companies have suggested “strengthening sales through the utilization of dealers and agents,” but in Eastern China “expanding existing bases” was the most popular answer suggested by the respondent companies. As a means to strengthen the

Figure 19 Number of Companies for Strengthening or Expansion (ratio) (Chemicals)

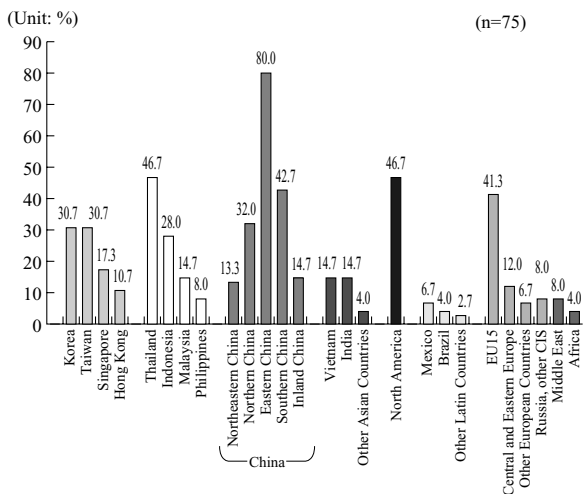


Figure 20 Strengthening or Expansion Stance by Fields (Chemicals)

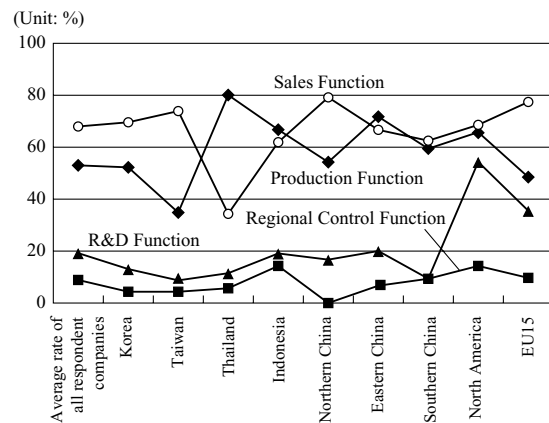
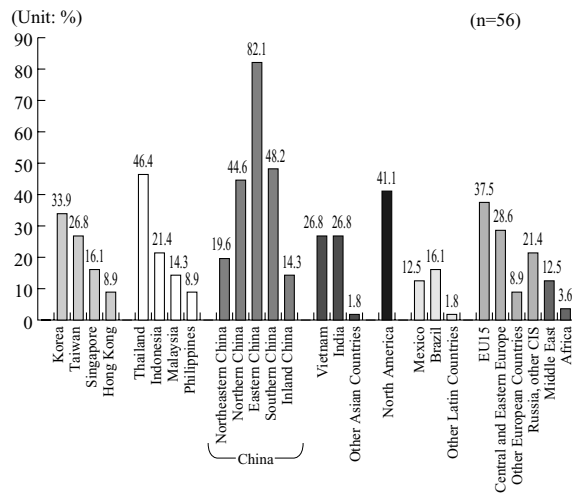


Figure 21 Number of Companies for Strengthening or Expansion (ratio) (General machinery)



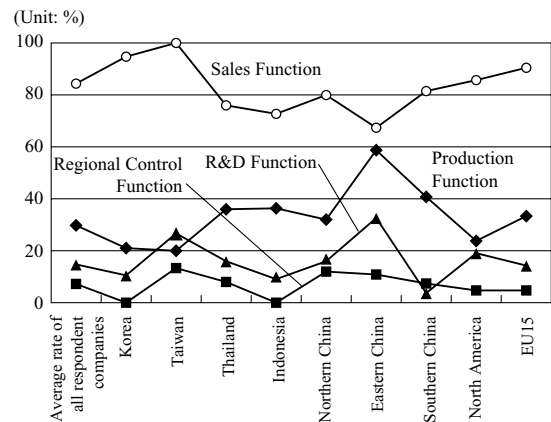
production function, the most popular answers were such plans as “establishing new bases” (46.5%) in Eastern China, “expanding existing production line” (64.3%) in Thailand, “improving operation rates of existing production lines” (47.8%) in North America. From these results, it can be seen that in Eastern China a positive movement has developed toward improvement of production bases, and that in the same region company efforts are being made to develop the market by enhancing existing marketing capabilities.

North America is characterized by the necessity of strengthening or expansion of the R&D function (54.3%) being cited by the largest number of respondent companies in any country/region, and also that, as a means to achieve that “applied research: developing new products, improving existing products” (68.4%) are highlighted by many respondent companies.

(2) General machinery

A look at the stance of General machinery manufacturers (number of respondents: 56) for strengthening or expansion of overseas business operations (Figure 21) shows their strong attitudes toward Eastern China (82.1%), Southern China (48.2%), Northern China (44.6%), and Thailand (46.4%). Characteristics of General machinery manufacturers may be described as: (i) their stance for strengthening or expansion toward Northern China is particularly high as compared with that other

Figure 22 Strengthening or Expansion Stance by Fields (General machinery)



industries; (ii) their positive attitude toward Vietnam (26.8%), India (26.8%), and Russia, other CIS (21.4%) is strong as compared with other industries.

Viewing by function shows that strengthening or expansion of the sales function is expected in Korea, Thailand, China (Northern China, Eastern China, and Southern China), North America, and EU15, with a remarkably increased ratio in comparison with the FY2003 survey results (Figure 22). As a means to achieve strengthening or expansion of the function, “strengthening sales through the utilization of dealers and agents” is cited by an overwhelming majority of the companies concerned.

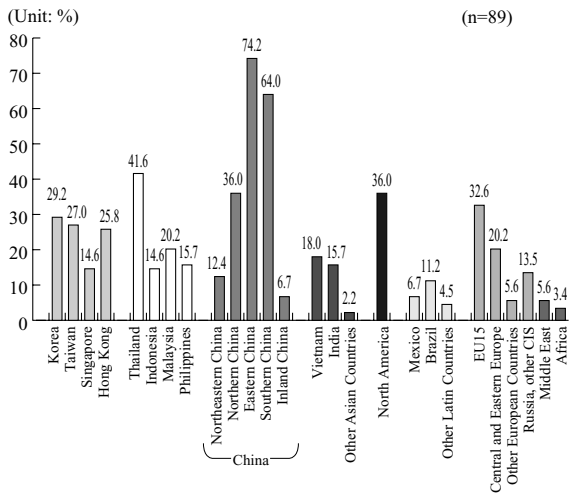
The proportion for “production function” is generally low, but it is exceptionally high for Eastern China (58.7%).

(3) Electrical equipment and electronics

The stance of Electrical equipment and electronics manufacturers (number of respondents: 89) toward strengthening or expansion of overseas business operations was examined (Figure 23) and it was found that a positive, strong stance is shown toward Eastern China (74.2%), and Southern China (64.0%), the former outweighing the latter. Also, within ASEAN4, their stances for strengthening or expansion of business operations are strongest toward Thailand (41.6%) and weakest toward Indonesia (14.6%).

Function-wise, in Eastern China, the stance for strengthening or expansion is aimed at the production

Figure 23 Number of Companies for Strengthening or Expansion (ratio) (Electrical equipment and electronics)



function and regional control function, the production function in Southern China and Thailand, and the sales function in North America, EU15, Korea, and Taiwan (Figure 24).

As a means to strengthen the production function, repeatedly sought for Eastern China and Thailand, companies cite “improving operation rates of existing production line” and “expanding existing production lines,” reflecting the stance toward reinforcing production activities in the said regions on the basis of existing facilities.

A comparison with the FY2003 survey results shows that the ratio of sales function has risen

Figure 25 Number of Companies for Strengthening or Expansion (ratio) (Automobiles)

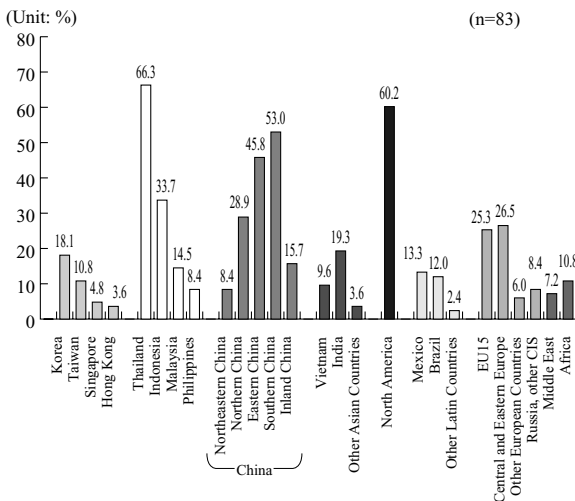
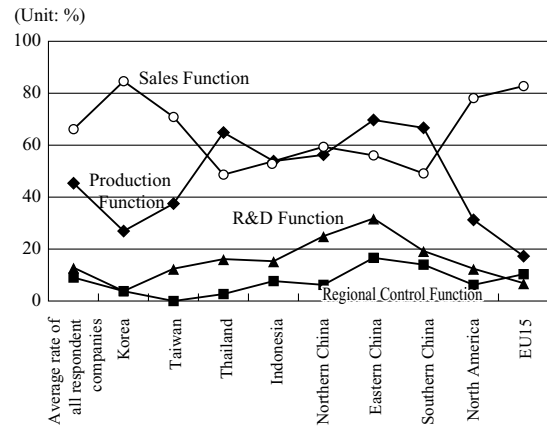
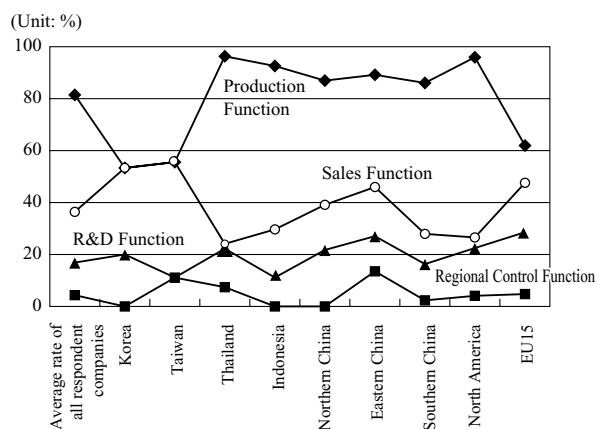


Figure 24 Strengthening or Expansion Stance by Fields (Electrical equipment and electronics)



generally, the rise being particularly remarkable in China where, in the Northern China, sales function has overtaken production function in importance (sales function: 59.4%; production function: 56.3%). From these results, it is observed that the Electrical equipment and electronics manufacturers are intensifying their efforts toward China market, as symbolized by the comment: “For expansion of our world market, it is important for us to bolster our activities in the global market China” (Electrical equipment and electronics - Assembled products).

Figure 26 Strengthening or Expansion Stance by Fields (Automobiles)



(4) Automobiles

The stance of Automobile manufacturers (number of respondents: 83) toward strengthening or expansion of overseas business operations is examined as follows (Figure 25). Their attitude is very positive toward Thailand (66.3%), North America (60.2%), Southern China (45.8%), and Eastern China (53.0%). Particularly, Thailand (66.3%) shows the highest favor, outweighing North America (60.2%). One company commented: "Thailand has a cluster of the automotive industry, and in order to counter the rapid development of China, we have to strengthen our activities in Thailand" (Automobiles-Assembled products). Companies seem to be determined to fortify their advantageous position in Thailand, in order to win future severe competition in the Asian market.

Within China, attention is being drawn to the formation of industrial cluster due to the expanding business operations of the Japanese automobile industries. The present survey has revealed that the number of companies intending to strengthen or expand business operations in Southern China (53.0%) is more than that for Eastern China (45.8%). In ASEAN4, Indonesia (33.7%) is strongest next to Thailand. One company mentioned "Indonesia serves as a driver of active demand in Asian market. Upswing may well be expected in this term's turnover" (Automobiles). Voices similar to this comment appreciating active demand are heard.

A check by functions suggests that strengthening or expansion of the production function is being sought in many countries/regions in consequence of automakers' positive moves toward expanding production (Figure 26). Regarding the sales function, the proportion intending to activate this in Eastern China (45.9%) is much higher than that in North America or Southern China.

As a means to strengthen the production function, many manufacturers who put weight on Thailand and Eastern China will expand their existing facilities such as "expanding existing production

lines" and "establishing a production line for new products," while many other manufacturers concerned with Southern China are characterized by planning to "establish new bases." When Eastern China and Southern China are compared by the changes in numbers of production bases since last year, Southern China shows a greater rate of increase than Eastern China¹⁷. This suggests that increasing numbers of automobile makers are moving into Southern China.

3. Stance for overseas business operations (major Asian regions)

On looking at the details of the main areas of the Asian region, it is observed that there are differences in the stances toward strengthening or expansion of overseas business operations between regions and within regions. Each area is now further studied and compared with the FY2003 survey results.

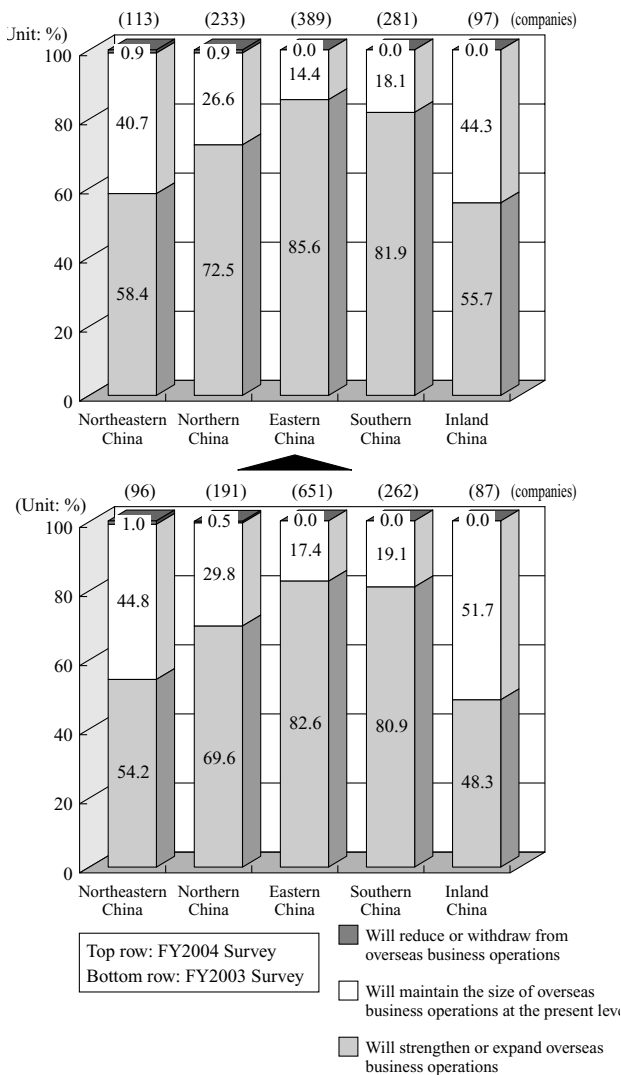
(1) Stance for Strengthening or Expansion in China

A regional breakdown of the stances for strengthening or expansion in China shows that it continues to be strongest toward Eastern China (85.6%) as was the case in FY2003, followed by Southern China (81.9%), and Northern China (72.5%) (Figure 27). The proportion of respondent companies for strengthening or expansion in Northeastern China (58.4%) and Inland China (55.7%) has increased over the FY2003 survey results, but these two regions are still quite far behind the Eastern and Southern China.

Examining the stance for strengthening or expansion by individual functions, it is a general tendency in China that stances for strengthening or expanding the production function and sales function are strongly favored (Figure 28). However, comparison with the FY2003 survey results has shown that, this year, the proportion of strengthening or expanding production function has become slightly lower, while that of sales function has risen,

¹⁷ Because respondent companies are different every year, there is some difficulty in accurate comparison. However, this year's survey has shown that automobile makers currently have 57 production bases in Southern China, the said figure being more than twice that of the FY2003 survey (an increase of 32 bases over the 25 bases in FY2003). In Eastern China, the number of production bases is 59 in this year's survey, an increase of 22 bases over the FY2003 figure of 37.

Figure 27 Prospects for Overseas Business Operations (Details by Region: China)

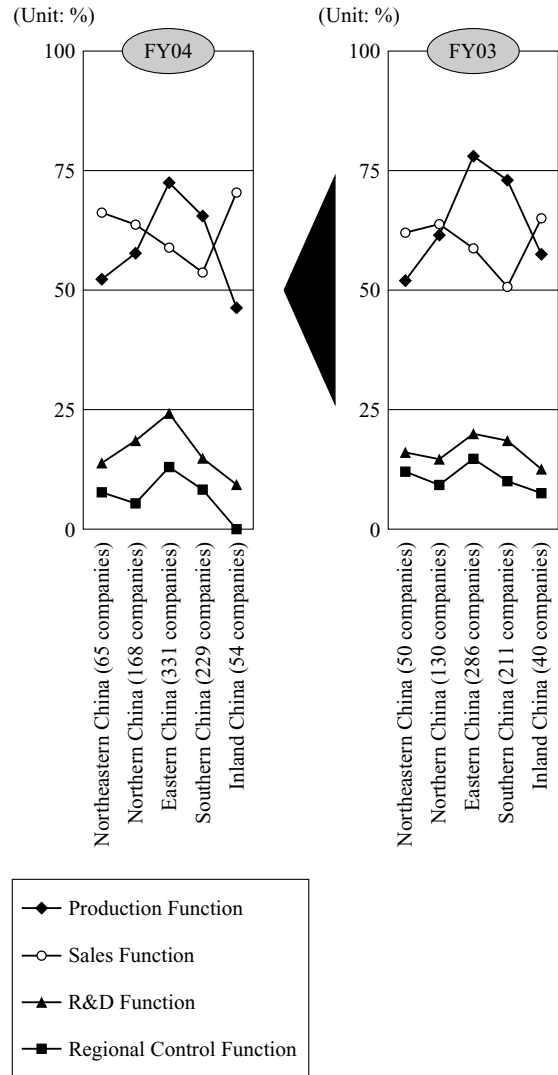


Note: The term “overseas business operations” used in this survey is defined as production, sales, research and development activities in overseas bases, as well as outsourcing of manufacturing and procurement overseas.

indicating that companies endeavoring to strengthen or expand the market are on the increase.

A closer look at these results shows that as a means to strengthen or expand the production function, the “expanding existing production line” is cited most by respondent companies in Northern, Eastern, and Southern China at the proportions of 39.2% (38 companies out of 97), 42.9% (103 companies out of 240), and 41.3% (62 companies out of 150) respectively (Appended Table 2). On the other hand, as compared to the FY2003 survey results, the proportion answering that they will “establish new bases” has reduced in Northern,

Figure 28 Functions for Strengthening or Expansion (China)



Note: Figures in parenthesis for countries and regions in the above figures are numbers of respondent companies. Companies which responded that they would “strengthen or expand” were asked in which functions they intended to do so, from production, sales, R&D and regional control functions. Multiple options were presented within each function, and a company which selected any one of them was counted as one company in the corresponding function.

Eastern, and Southern China. Particularly in Eastern China, a decrease of 9 points has been observed (41.3% in the FY2003 survey and 32.5% in this year’s survey). This seems to mean that the tendency has moved from the setting-up of new bases to the expansion of existing bases.

As a means to strengthen or expand the sales function, in the four regions excluding Eastern China, the proportion of respondent companies who cite “strengthening sales through the utilization of dealers

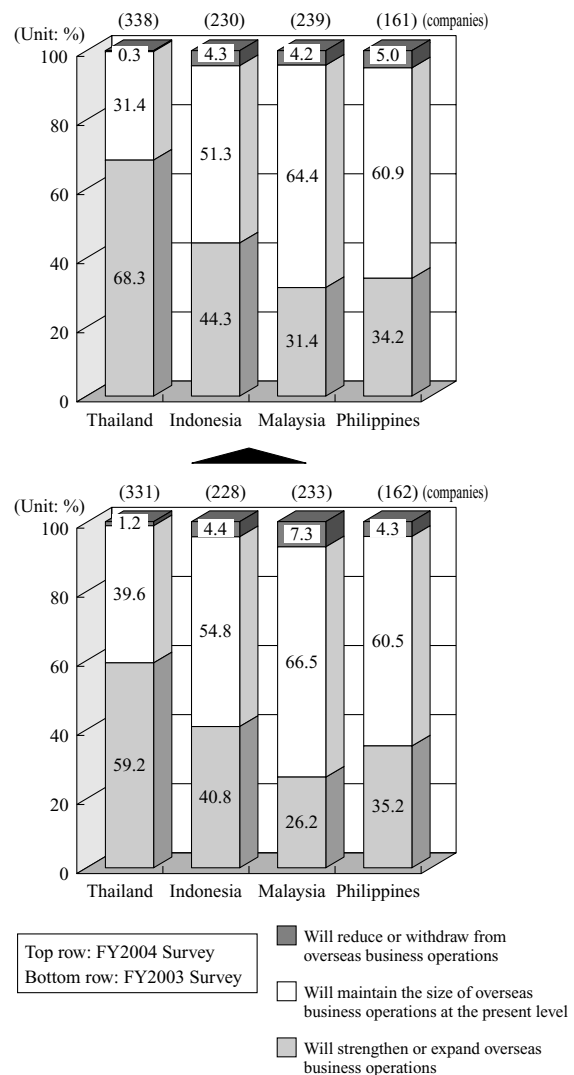
and agents” is the highest (68.8% in Northeastern China; 52.3% in Northern China; 48.0% in Southern China; and 65.8% in Inland China). In Eastern China, “expanding existing bases” has been most favored (47.7%) (Appended Table 2). As compared with the FY2003 survey results, the proportion of companies who cite “expanding existing bases” has leveled off or has slightly decreased across all regions of China. In contrast to the foregoing, the proportion of respondent companies who cite “strengthening sales through the utilization of dealers and agents” keeps increasing widely across all regions, and thus the proportion favoring the sales function has increased in relation to the overall strengthening or expansion drive¹⁸. This suggests that the prevailing tendency in the reinforcement of sales activity in China is to use dealers and agents rather than the companies’ own business networks.

The proportion favoring research and development function (“R&D function”) as the field to be strengthened and expanded in China is relatively higher than in other countries/regions, particularly in Eastern China where it is highest at 24.2% (80 companies out of 331) (Appended Table 2). The detailed ideas for strengthening or expanding the selected field, cited in every region by many companies, are firstly “securing skilled personnel,” followed by “applied research: developing new products, improving existing products.” From the foregoing, it can be seen that many companies intend to hire local personnel and develop products suitable for market needs within China, with particularly close attention being paid to Eastern China.

(2) Stance for Strengthening or Expansion in ASEAN4

The stance for strengthening or expansion in the individual countries of the ASEAN4 may be examined by countries as follows. Thailand (68.3%) is the most favored, followed by Indonesia (44.3%),

Figure 29 Prospects for Overseas Business Operations (Details by Region: ASEAN4)

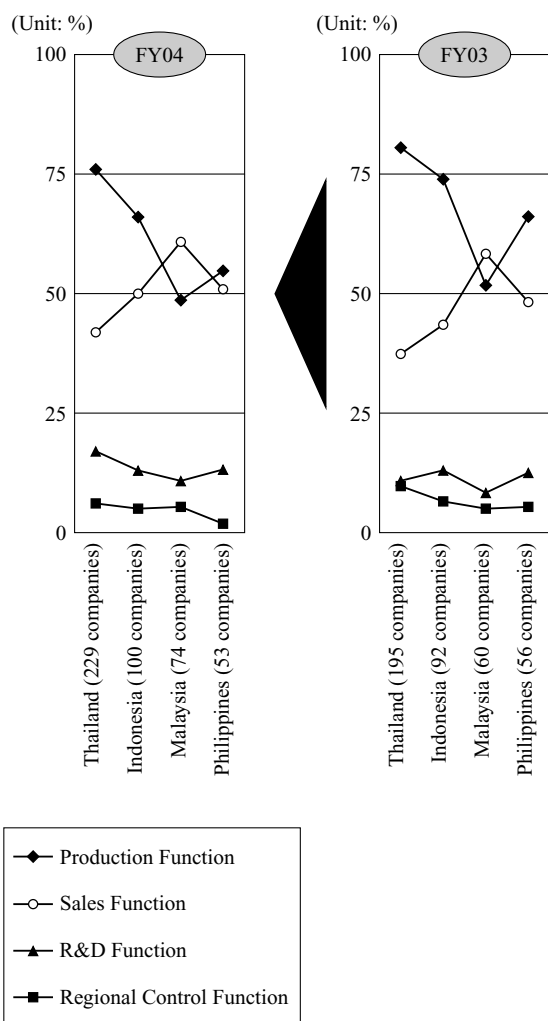


Note: The term “overseas business operations” used in this survey is defined as production, sales, research and development activities in overseas bases, as well as outsourcing of manufacturing and procurement overseas.

the Philippines (34.2%), and Malaysia (31.4%) (Figure 29). Particularly, the degree of strengthening or expansion in Thailand has advanced by 10 points from the FY2003 survey results (59.2% in FY2003), the new level being the highest among NIEs and ASEAN4 and high enough to prompt many

18 Changes since FY2003 in the number of respondent companies who chose “expanding existing bases” in their responses are as follows. (“▲” means decrease, and “△” means increase). Northeastern China: 23.3% (35.5% in FY2003; ▲12.2%), Northern China: 39.3% (39.8%; ▲0.5%), Eastern China: 47.7% (47.6%; △0.1%), Southern China: 38.2% (42.1%; ▲3.9%), Inland China 23.7% (57.7%; ▲34.0%). Also, changes since FY2003 in the number of companies who cited “strengthening sales through the utilization of dealers and agents” in their responses are as follows. Northeastern Region: 68.8% (48.4% in FY2003; △20.4%), Northern China: 52.3% (41.1%; △11.2%), Eastern China: 40.0% (35.1%; △4.9%), Southern China: 48.0% (39.3%; △8.7%), Inland China: 65.8% (38.4%; △27.4%).

Figure 30 Functions for Strengthening or Expansion (ASEAN4)



Note: Figures in parenthesis for countries and regions in the above figures are numbers of respondent companies. Companies which responded that they would “strengthen or expand” were asked in which functions they intended to do so, from production, sales, R&D and regional control functions. Multiple options were presented within each function, and a company which selected any one of them was counted as one company in the corresponding function.

companies to put more effort into strengthening their business operations in Thailand in the Asian region.

The strengthening or expanding attitude toward each country and by activity functions can be reviewed as follows. In Thailand, Indonesia, and the Philippines, the proportion of strengthening or expansion of the “production function” is high, surpassing that of the “sales function” (Figure 30). The difference between the two functions, however, has been narrowed when compared to the FY2003

survey results. By contrast, in Malaysia the proportion of strengthening or expansion of the “sales function” (60.8%, 45 companies out of 74) has exceeded that of the “production function” (48.6%, 36 companies out of 74), making the tendency, which appeared in the FY2003 survey results, more evident in this year’s survey.

A close look at these results shows that the proportion of companies who responded that they will strengthen or expand the “production function” was 76.0% (174 companies out of 229) in Thailand, followed by Indonesia (66.0%, 66 companies out of 100), and the Philippines (54.7%, 29 companies out of 53) (Appended Table 2). Also, in this year’s survey there has been a small increase in the number of companies who responded that they will strengthen or expand the “sales function” in ASEAN4 countries, but in Malaysia the number of companies aiming to strengthen or expanding sales was 60.8%, the largest ever for that country. The tendency in Malaysia that was seen in the FY2003 survey results (production function, 51.7%; sales function, 58.3%) has intensified in this year’s survey. From this result, it appears that the role of Malaysian affiliates for Japanese companies has been shifting gradually from that of production base to sales base.

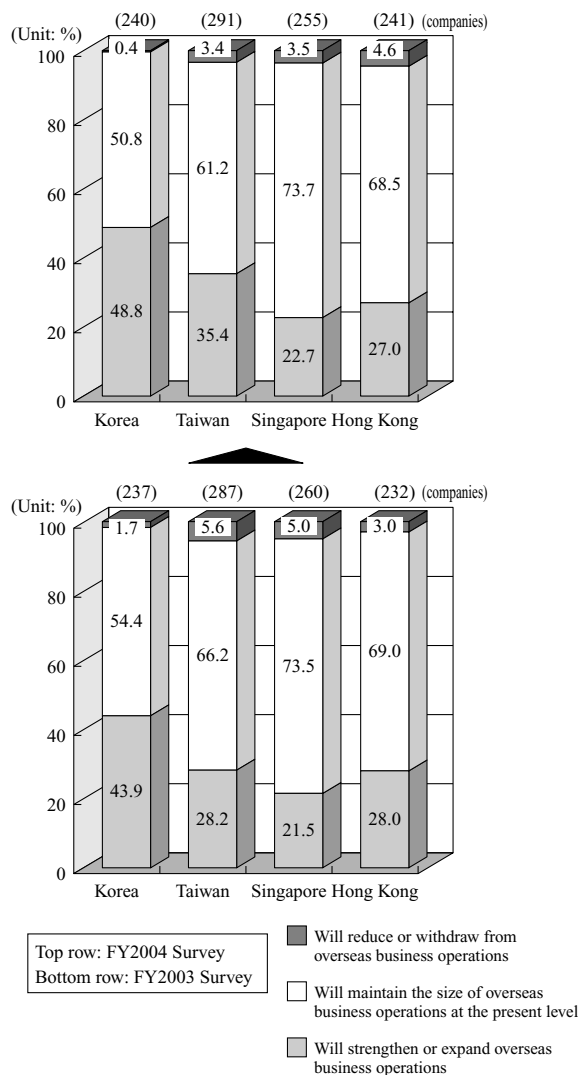
As the favored means to strengthen or expand the “production function,” the majority of companies have cited for all countries the “expanding existing production lines” (48.9% for Thailand, 54.5% for Indonesia, 48.3% for the Philippines, and 44.4% for Malaysia) (Appended Table 2). On the other hand, the proportion of companies who have cited the “establishing new bases” is low for all four countries, suggesting that, for ASEAN4, companies are likely to develop their business operations by expanding the production capacity of the existing bases.

(3) Stance for Strengthening or Expansion in the NIEs

The stance for strengthening or expansion by country and region in the NIEs may be examined by countries as follows. South Korea (48.8%) is the most favored, followed by Taiwan (35.4%), Hong Kong (27.0%), and Singapore (22.7%) (Figure 31).

The strengthening or expanding attitudes to each country/region by activity functions can be reviewed

Figure 31 Prospects for Overseas Business Operations (Details by Region: NIEs)

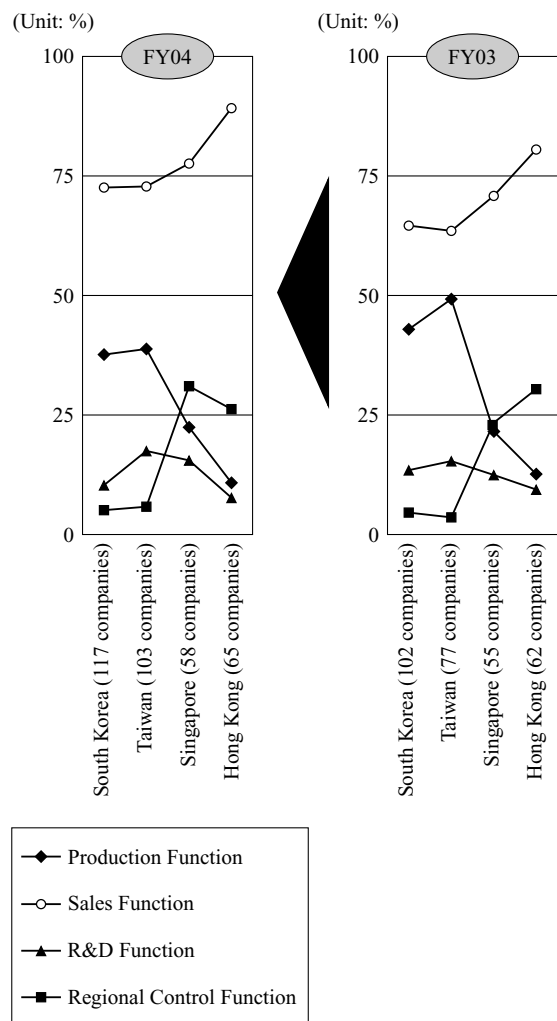


Note: The term “overseas business operations” used in this survey is defined as production, sales, research and development activities in overseas bases, as well as outsourcing of manufacturing and procurement overseas.

as follows. The proportion of companies who chose the “sales function” as the function of activity to be strengthened and expanded is high, surpassing that of “production function” by a large margin, and this tendency has continued to grow stronger since the FY2003 survey (Figure 32).

A closer look at these results by country/ region shows that for South Korea and Taiwan, the strengthening or expansion of “production function” is high, with South Korea standing at 37.6% (44

Figure 32 Functions for Strengthening or Expansion (NIEs)



Note: Figures in parenthesis for countries and regions in the above figures are numbers of respondent companies. Companies which responded that they would “strengthen or expand” were asked in which functions they intended to do so, from production, sales, R&D and regional control functions. Multiple options were presented within each function, and a company which selected any one of them was counted as one company in the corresponding function.

companies out of 117) and Taiwan at 38.8% (40 companies out of 103) (Appended Table 2). As a means to strengthen or expand the “production function,” many companies have cited the “expanding existing production lines” for both South Korea and Taiwan (47.8% for South Korea and 40.0% for Taiwan)¹⁹.

19 This year’s survey revealed that Taiwan now has 64 production bases of Electrical equipment and electronics manufacturers, an increase of 16 from the FY2003 survey result (48 bases). The proportion of the same manufacturers who would strengthen or expand their business operations in Taiwan was as high as 27.0% (Figure 23).

On the other hand, for Singapore and Hong Kong the proportion of companies who responded that they will strengthen or expand the “regional control function” is higher than elsewhere in the Asian region, with Singapore standing at 31.0% (18 companies out of 58) and Hong Kong at 26.2% (17 companies out of 65) (Appended Table 2). As to the specific area for the regional control function to be strengthened and expanded, many companies chose the “strengthening of sales departments” (77.8%, 14 companies out of 18) for Singapore and the “strengthening of purchasing departments” (47.1%, 8 companies out of 17) and the “strengthening of sales departments” (41.2%, 7 companies out of 17) for Hong Kong.

Comparison of the number of respondent companies highlighting the “sales departments” for Singapore in the FY2003 survey results shows that the number has increased from the FY2003 result of 9 companies (out of 13) to 14 companies (out of 18). In this connection, there are some manufacturers’ comments obtained by interview. “We use the Singapore affiliates as purchasing base; in future we are planning to utilize Singapore as a base for research and development and also as a logistics point for Southeast Asia” (Precision machinery-Assembled products), “We control our sales activity in India from the Singapore base” (Electrical equipment and electronics-Components). As illustrated by these comments, quite a few companies appreciate the convenience of Singapore as a sales or logistics base. Additionally, some companies are utilizing Singapore as an interface for India, the promised high-growth market.

(4) Stance for Strengthening or Expansion in Vietnam and India

The strengthening or expanding attitudes in Vietnam and India may be examined as follows. Strengthening or expansion of business operations in Vietnam and India have become more favored as compared to the FY2003 survey results (“Vietnam” 58.3% in FY2004, 49.6% in FY2003; “India” 61.0% in FY2004, 45.8%

in FY2003) (Figure 33). As to India in particular, though the number of respondent companies it has collected is fewer than the other Asian countries/regions, the proportion of the respondent companies who have responded they “will strengthen and expand” their business operations has increased by 15 points, indicating a high level of interest that Japanese companies keep on holding in this country.

In terms of functions, the functions to strengthen or expand may be examined as follows. For both Vietnam and India, the strengthening or expansion of the “production function” outweighed that of the “sales function” in the FY2003 survey result. However, this year’s survey has shown that the positions of the two functions have been reversed with the proportion in favor of strengthening or expanding the “sales function” now surpassing that of the “production function” (Figure 34).

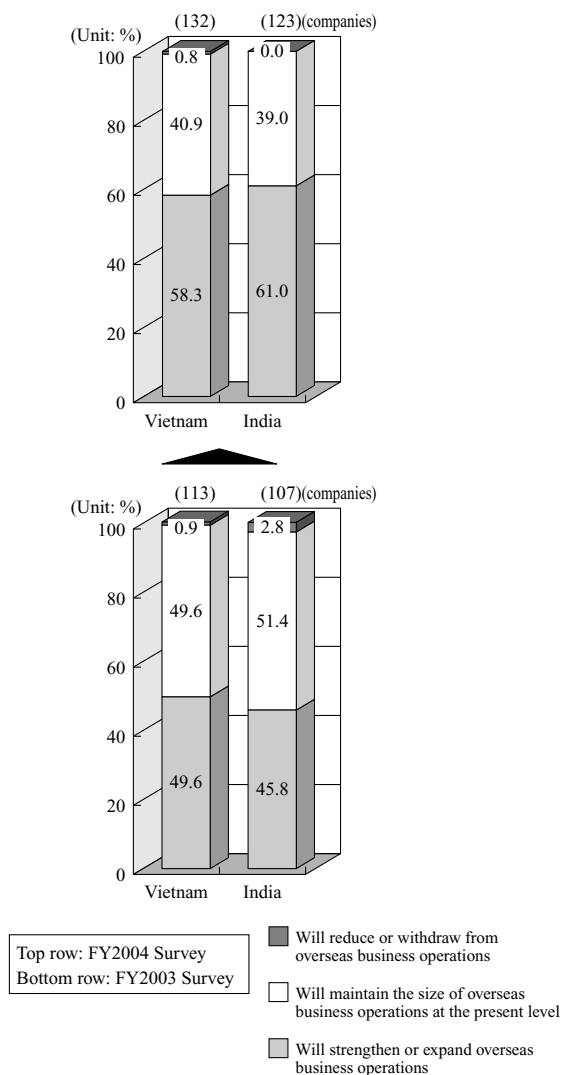
To be more precise, as compared to the FY2003 survey result, the number of companies who said they will “strengthen or expand” their business operations in Vietnam has increased by 21 companies, from 55 to 76. The number of respondent companies who highlighted the “sales function” has also increased by almost the same number, that is, 19 companies, from 27 companies to 46 (Appended Table 2)²⁰. The number of companies who responded that they “will strengthen or expand” their business operations in India has increased by 27 companies from 48 to 75, while the number of respondent companies who have highlighted the “sales function” has also increased by almost the same amount (increase of 25 companies from 27 in FY2003 to 52 in FY2004)²¹. From the foregoing, it is established that the number of companies who responded they “will strengthen or expand” their business operations in Vietnam and India has increased substantially since the FY2003 survey, and the increase is chiefly due to the increase in the number of companies desirous of strengthening or expanding the “sales function.”

Breaking down the stances for strengthening or expansion in both Vietnam and India, the largest number of respondent companies favor the

20 The number of companies who highlighted the “production function” in Vietnam has increased by 7 companies from 34 (FY2003) to 41 (this year).

21 The number of companies who highlighted the “production function” in India has increased by 4 companies from 32 (FY2003) to 36 (this year).

Figure 33 Prospects for Overseas Business Operations (Details by Region: Vietnam and India)

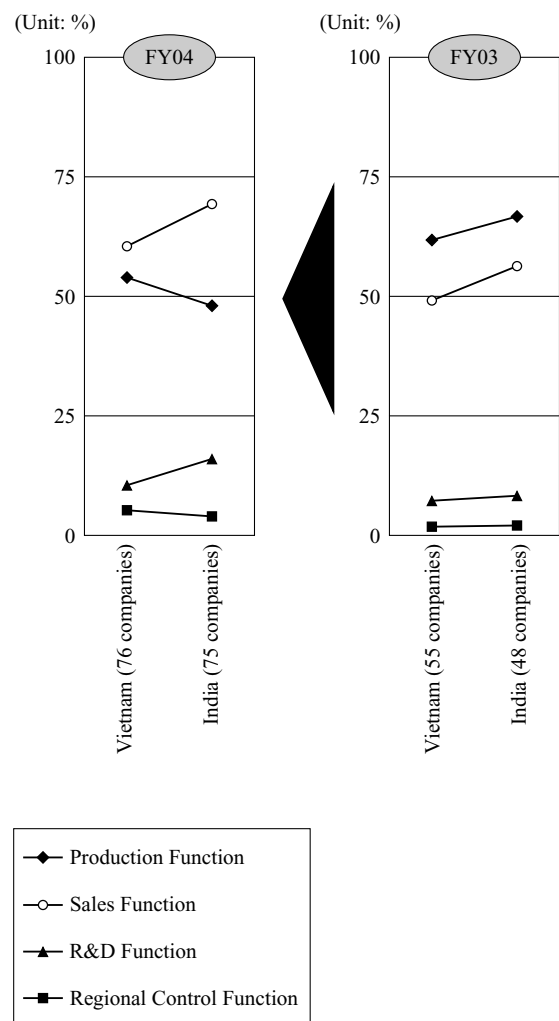


Note: The term “overseas business operations” used in this survey is defined as production, sales, research and development activities in overseas bases, as well as outsourcing of manufacturing and procurement overseas.

“strengthening sales through the utilization of dealers and agents,” with the proportions reaching 65.2% for Vietnam (30 companies out of 46) and 63.5% for India (33 companies out of 52) (Appended Table 2). The number of respondent companies who highlighted this activity function has increased substantially since the FY2003 survey, and this increase is characterized by the large increase of General machinery manufacturers (“Vietnam,” 10 companies out of 30; increase of 8; “India,” 9 companies out of 33; increase 6).

From these analyses, the manufacturers’ function in Vietnam and India appears to be based upon

Figure 34 Functions for Strengthening or Expansion (Vietnam and India)



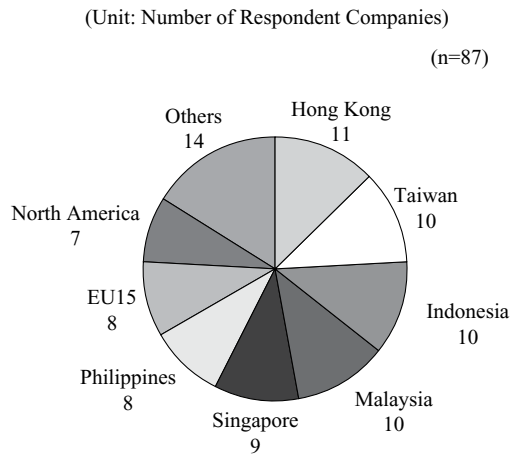
Note: Figures in parenthesis for countries and regions in the above figures are numbers of respondent companies. Companies which responded that they “strengthen or expand” were asked in which functions they intended to do so, from production, sales, R&D and regional control functions. Multiple options were presented within each function, and a company which selected any one of them was counted as one company in the corresponding function.

developing expected growth of the local market by using dealers and agents.

4. Reduction, withdrawal and relocation to third countries

In this year’s survey, 87 companies have said they “will reduce or withdraw from their overseas business operations.” By countries/regions, companies who responded that they “will reduce or withdraw from

Figure 35 Reduced or Withdrawn Countries and Regions



business operations” in Hong Kong are the most numerous (11 companies), followed by Taiwan, Indonesia, and Malaysia (10 companies each) (Figure 35). On the other hand, those who are considering reduction in or withdrawal from China are just three companies, leaving the majority among those who are considering reduction in or withdrawal from the NIEs, ASEAN4, etc. By functions, the sales function in Hong Kong and production function in Taiwan, Indonesia, and Malaysia are the main functions from which the companies are considering reduction or withdrawal.

Companies who have responded that they will “reduce or withdraw” may be classified by industries as follows. Of 87 bases for which “reduction or withdrawal” is indicated, 21 or about a fourth of the total are concerned with Electrical equipment and electronics manufacturers, followed by Automobiles (16), General machinery (14), and Chemicals (12) (Figure 36). In relation to Electrical equipment and electronics manufacturers, 5 companies are considering “reduction or withdrawal” from Indonesia, and it is noteworthy that the above number is relatively large in comparison with other countries/regions.

To the 87 companies who responded that they will “reduce or withdraw,” a further question was put as to why they have reached that decision. 38 companies gave their reason as “reduction or withdrawal from the business concerned.” Thirty-seven companies said “relocation or division to a third country,” and ten companies cited “to return to Japan”

Figure 36 Reduced or Withdrawn Manufacturers (By major industry)

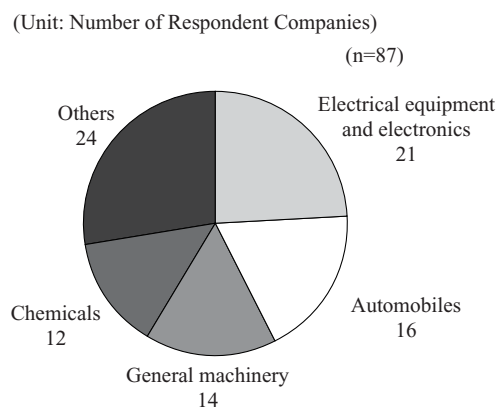
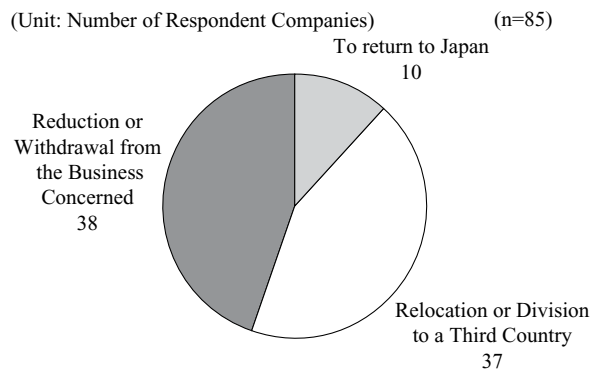


Figure 37 Reasons for Reduction or Withdrawal



Note: Two companies did not respond.

Table 18 Reduced or Withdrawn Countries and Regions from the Business Concerned (n=38)

Country and Region	Function	Number of Bases
Taiwan	Production	2
Taiwan	Sales	2
Singapore	Production	1
Singapore	Sales	2
Hong Kong	Sales	4
Indonesia	Production	4
Malaysia	Production	5
Philippines	Production	5
Northeastern China	Production	1
Northern China	Sales	1
Vietnam	Sales	1
Other Asian Countries	Production	1
North America	Production	1
North America	Sales	3
Brazil	Production	2
Brazil	Sales	1
EU15	Sales	1
Africa	Production	1

(Figure 37)²².

Regarding the 38 companies who answered “reduction or withdrawal from the business concerned,” a further survey was made as to which function is to be reduced in or withdrawn from which country and region. Their answers were as follows. The countries/regions where the number of reduced or withdrawn bases is the highest are Malaysia (5) and the Philippines (5), followed by Taiwan, Hong Kong, Indonesia, and North America (4 each) (Table 18). The reduced or withdrawn functions have a feature in that in Malaysia, the Philippines, and Indonesia all the bases indicated are “production function” and in Hong Kong all bases are of the “sales function.” Of the 10 companies who said they would “reduce or withdraw to return to Japan,” 3 bases are in EU15 and 2 in Indonesia (Table 19). When the 37 companies that chose “relocation or division to a third country” are investigated further to find which functions they are moving, and to where. The most common relocation origins are Hong Kong (6), Taiwan (5), Singapore (5) and the EU15 (5). Of those, the movement of production is more common from Taiwan and the EU15, while relocation of sales functions is the most common from Singapore and Hong Kong (Table 20 and Figure 38). The most common destinations are China (24 bases) followed by Malaysia (5) and Thailand (4). The most common

areas relocating to China are “sales functions” from Hong Kong (6 bases) and “production functions” from Taiwan (4). Looking at the relocation of bases by industry, in the Electrical equipment and electronics industry, there are as many as relocations of the “production function” from Indonesia to China (3 bases), and in the Automobiles industry there are also “production functions” for relocation from Taiwan to China (3).

The results of this survey show there is a trend for bases to relocate to China from Asia and from Europe and North America, but there are also examples of relocation (reorganization) within ASEAN.

Table 19 Countries and Regions Where Operations are to be returned to Japan (n=10)

Country and Region	Function	Number of Bases
Taiwan	Production	1
Singapore	Sales	1
Hong Kong	Sales	1
Indonesia	Production	2
Malaysia	Production	1
North America	Production	1
EU15	Production	1
EU15	Sales	2

Table 20 Table of Origins and Destinations for Relocation

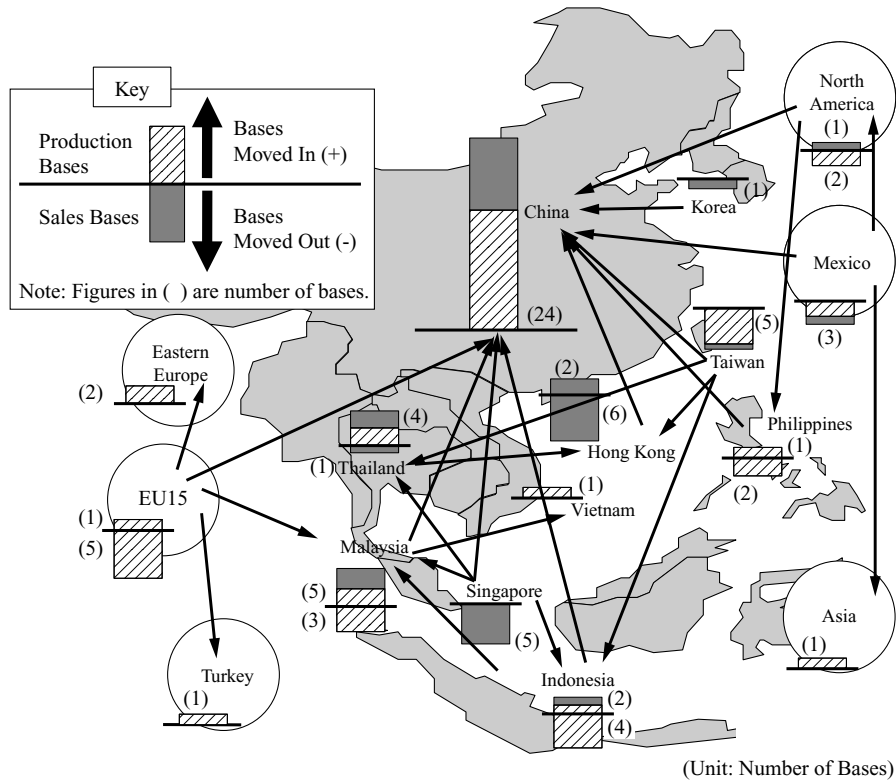
From	Function	To
Korea	Sales	China
Taiwan	Production	China
Taiwan	Production	China / Indonesia
Taiwan	Production	China / Thailand
Taiwan	Production	China / Thailand
Taiwan	Sales	China / Hong Kong
Singapore	Sales	Thailand
Singapore	Sales	Malaysia
Singapore	Sales	Malaysia / Thailand
Singapore	Sales	Malaysia / Indonesia
Singapore	Sales	China
Hong Kong	Sales	China
Hong Kong	Sales	China
Hong Kong	Sales	China
Hong Kong	Sales	China
Hong Kong	Sales	China
Hong Kong	Sales	China
Thailand	Sales	Hong Kong

From	Function	To
Indonesia	Production	Malaysia
Indonesia	Production	China
Indonesia	Production	China
Indonesia	Production	China
Malaysia	Production	Vietnam
Malaysia	Production	China
Malaysia	Production	China
Philippines	Production	China
Philippines	Production	China
North America	Production	Philippines
North America	Production	China
Mexico	Production	Asia
Mexico	Production	China
Mexico	Sales	United States
EU15 (Italy)	Production	EU15 (the Netherlands)
EU15	Production	Malaysia
EU15	Production	China
EU15	Production	Eastern Europe
EU15	Production	Eastern Europe / Turkey / China

(37 respondent Companies, some of which had multiple relocation destinations, so 45 bases are relocated)

22 Two companies did not respond.

Figure 38 Relocated Countries and Regions and Functions

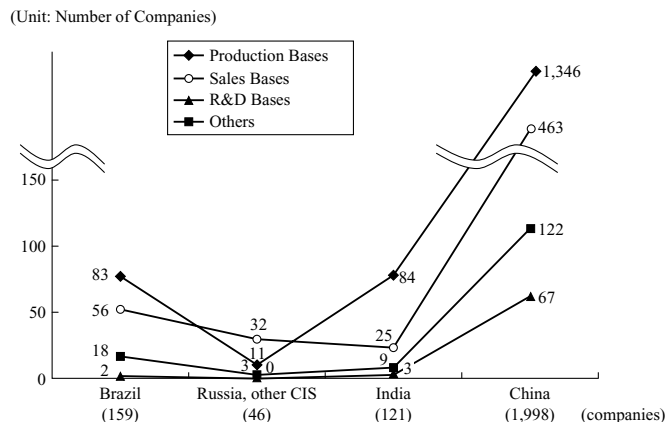


<Column 4> BRICs

In this column, by gathering data from this survey on the BRICs (Brazil, Russia, India, and China), which have been the recent focus of interest from the world’s investors, we examine the characteristics of business operations in the BRICs for Japanese manufacturers.

The current numbers of overseas affiliates in each country show that there are 1,998 in China, an overwhelming share. For production bases in particular, China has the largest share at 1,346 affiliates, while Russia’s share is very low at 11 affiliates (Column Figure 7). As for the sales bases, China has the largest share at 463 affiliates, while in India where the number of respondent companies who have

Column Figure 7 Number of Overseas Affiliates (BRICs)



Note: See Table 2.

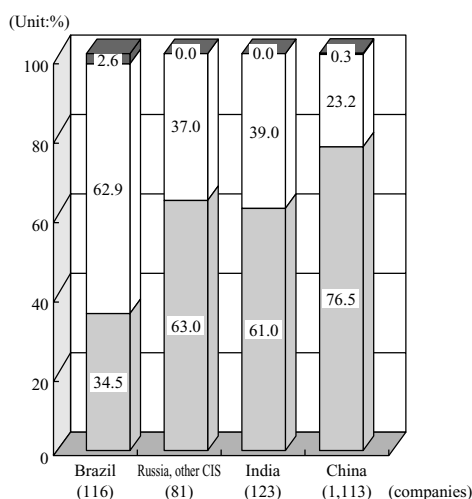
answered in this survey that they will strengthen or expand the sales function has greatly increased, it has a small share at 25 affiliates. As for the companies' medium-term (next three years or so) outlooks for business operations, stances on China are remarkably positive (76.5%), exemplifying the very positive attitude toward business operations in China (Column Figure 8). On the other hand, stances on Russia are 63.0% and on India are 61.0%, showing the companies' relatively strong attitudes toward these two countries. The ratio for Brazil, however, is 34.5%, with companies inclined to maintain the current level.

Of the fields for strengthening or expansion, sales functions hold high shares in each country but the production functions are slightly higher in China (Column Figure 9). In Brazil and India, approximately half of companies intend to expand production functions but the proportion for Russia is very low. Breaking down the sales function, most companies cited the "strengthening sales through the utilization of dealers and agents" as a means to strengthen or expand the sales function in each country (Appended Table 2). However, companies citing the "establishing new bases," which has to be accompanied by an inflow of foreign direct investment, remain scarce among the three countries other than China²³. As it appears, few companies are yet ready to spend equity capital in order to strengthen sales activity in a local market.

The BRICs are countries seen as having large growth potential, and they are the subject of growing expectations from Japanese manufacturers, as future destinations for business development. Examples include "We expect much from the BRICs, particularly for their growth potential as a market" (Electrical equipment and electronics-Assembled products). This is just one of the many comments received during interviews, expressing the expectations of the high growth potential of the BRICs countries. However, investment to exploit the large population and abundant resources etc, for both production and sales in these four countries would have to be enormous.

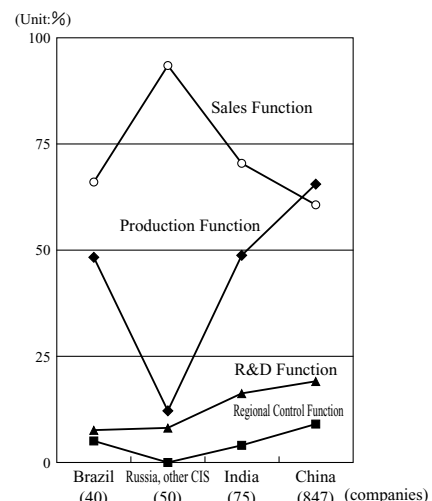
If Japanese manufacturers, which already have many production bases in regions such as China and ASEAN, aim to expand their production functions in the BRICs in future, they would have to assign priorities or limit the scale of their investments. Investments in distribution can be relatively small in

Column Figure 8 Prospects for Overseas Business Operations (Details by Region: BRICs)



Note: See Figure 16.

Column Figure 9 Functions for Strengthening or Expansion (BRICs)

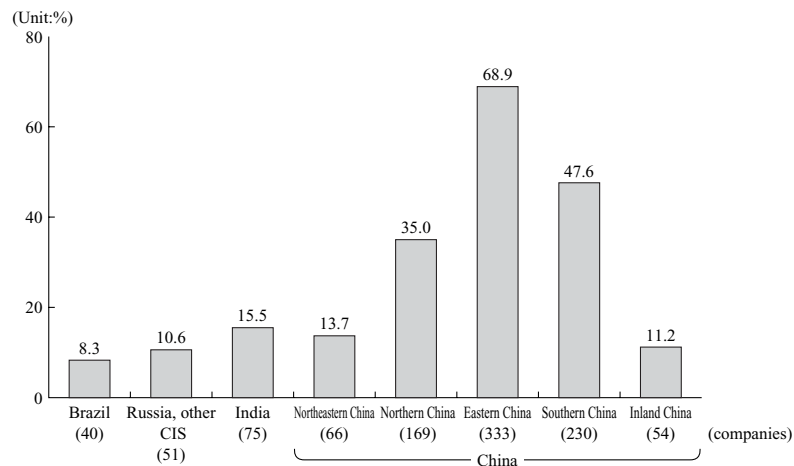


Note: See Figure 28 and 34.

23 The number of companies who chose the "establishing new bases," by countries: Brazil (2 companies), Russia (11 companies), India (8 companies), China (122 companies) (Appended Table 2).

scale, but distribution is an area where competing Western companies are also strong²⁴. The current efforts of Japanese manufacturers differ greatly between the four countries (Column Figure 10), but the investment strategies they adopt in future, faced by the enormous potential of the BRICs, will be closely watched.

Column Figure 10 Number of Companies for Strengthening or Expansion (ratio) (BRICs)



Note: See Figure 18.

<Column 5> Position of Hong Kong

In this survey, the number of companies who responded that they will strengthen or expand the sales department in Hong Kong is down by half from the FY2003 survey results. Also, there are many companies who intend to relocate their sales base in Hong Kong to China.

From these results, it is assumed that the number of companies shifting the function of sales for China's domestic market from the Hong Kong base to a base within China has increased. This seems to have resulted from the fact that establishment and development of sales bases within China has been much eased by streamlining of the legal infrastructure following China's accession to the WTO in December 2001, and also because entry restrictions and various other restrictions relating to domestic sales have been deregulated as promised upon accession to the WTO²⁵. This tendency is expected to become firmer as the opening of China market makes further progress.

However, some companies who highly appreciate the position of Hong Kong intend to continue their sales activities in Chinese market from their base in Hong Kong. During interviews it was commented: "We use an agent in Hong Kong to cover sales within China. This way, in Hong Kong we can cope with any problem that might occur on China mainland" (Precision machinery-Components). As this comment indicates, a not inconsiderable number of companies still believe that to cover China's domestic sales from Hong Kong can be expedient, particularly if the assumable effect of so-called China risks and the convenience for sales to Chinese elsewhere in Asia are taken into consideration.

Moreover, companies' interest for Hong Kong as a base for procurement and logistics is still high.

²⁴ With reference to this matter, it is pointed out in the survey done by A.T. Kearney on the investment potential relating to retail sales of 30 emerging countries, that "in China, the Western companies are moving ahead of Japanese retailers in terms of chain-store operation and merchandise procurement capability" (Nihon Keizai Shinbun, June 22, 2004).

²⁵ Upon accession to the WTO, the government of China made a commitment to deregulate restrictions on the entry of foreign capital into the distribution business. As of mid-December 2004, China's foreign trade and domestic sales are fully liberalized for a holding company established by a foreign company (Nihon Keizai Shinbun, December 1, 2004).

In fact, in this year's survey, the proportion of companies who responded that they will strengthen or expand the purchasing department has increased from the FY2003 survey results. The interviews also elicited the following comment: "Our products produced in China are once brought together in Hong Kong and sent out from there to worldwide destinations, with the portion for China's domestic sales being dispatched to Beijing" (Electrical equipment and electronics - Components). As exemplified by this comment, there are companies who make it a practice to consolidate the finished goods produced in China into Hong Kong and then export them worldwide, including to China, utilizing Hong Kong's transportation infrastructure effectively. As reviewed above, this year's survey has revealed the trend of sales bases in Hong Kong moving to China, and there may seem to be doubts over Hong Kong's future as the sales control base. However, in order to avoid the effect of China risks in future, there is merit in handling domestic sales within China from the sales base in Hong Kong. Besides, now that CEPA (Closer Economic Partnership Agreement) is validated, foreign-affiliated companies qualified as Hong Kong-based companies can benefit from the slackening of various restraints to market entry in China, and also can take advantage of the convenience of the logistical function of Hong Kong. These should be beneficial for a company if it intends to develop business operations in China while maintaining a base in Hong Kong. Therefore, if the real advantages that Hong Kong has are recognized clearly, there may be a swing-back from China to Hong Kong.

Chapter 7: Evaluation of Overseas Business Performance

1. Overview

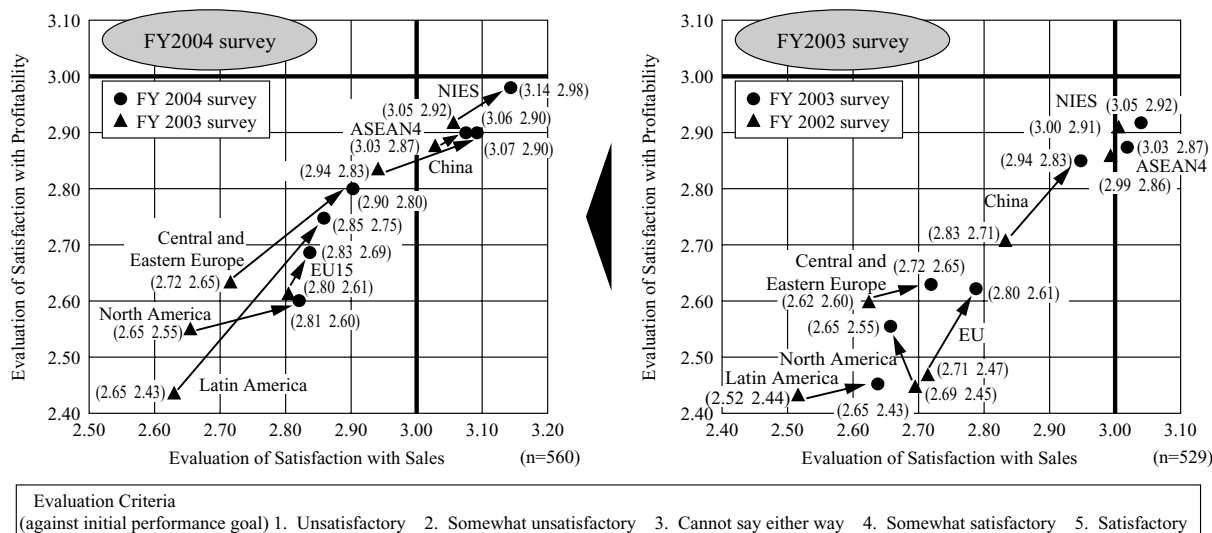
The evaluation of sales and profitability satisfaction of the respondent companies' overseas business operations²⁶ showed some tendency to improvement in each country/region in the FY2003 survey, and in the present survey has shown further advancement (Figure 39). It is characterized by the business evaluations being at a comparatively high satisfaction level for NIEs, ASEAN4, and China, and also at a relatively higher level for Europe and North America owing to the improvements in Central and Eastern Europe, and in Latin America. Improvement has been particularly remarkable in Latin America and in Central and Eastern Europe. Detailed reasons for the improvements are hard to cite from the present survey results, but the following is a comparison of responses regarding the evaluation of satisfaction with profitability between the FY2003 survey and this year's survey (Figure 40). In Latin America, "unsatisfactory" has decreased in number of responses (25.0% → 11.7%), and "cannot say either

way" has increased (36.8% → 46.9%). In Central and Eastern Europe, "unsatisfactory" has decreased (21.1% → 13.2%), and "somewhat satisfactory" has increased (7.9% → 15.4%). These factors have pushed up the evaluation results.

In this year's survey, however, throughout all countries or regions the profitability satisfaction level is below the middle point "3," remaining at an unsatisfactory level; the business evaluations in North America, a large market which was once the source of high profit, stays lowest; in China and North America, the breadth of increase for sales satisfaction is rather smaller than that for profitability satisfaction; these problems still remain in the way of improved profitability.

With reference to the profitability of each country/region, the major reasons why respondent companies evaluate it as "somewhat satisfactory" can be examined for the last five years as follows (Figure 41). Companies who cited "successful sales activities in the country or region concerned" were the most in number for all the four regions. On the other hand, as the reason why the "somewhat unsatisfactory" evaluation was given (Figure 42), companies who

Figure 39 Evaluation of Overseas Business Performance (All industries)



Note: Evaluation of satisfaction with sales means an evaluation of the portion of the business performances excluding sales to the parent company. Evaluation of satisfaction with profitability means an evaluation of the returns on investment. Further, these evaluations are of the head office's satisfaction with business in each country. They do not express simple falls or rises in sales volume or profitability.

26 Regarding overseas business operations in each country/region, each respondent company is asked to evaluate satisfaction levels on the sales and profitability of such operations using the following five-stage criteria: "Satisfactory" (5 marks), "Somewhat satisfactory" (4 marks), "Cannot say either way" (3 marks), "Somewhat unsatisfactory" (2 marks), and "Unsatisfactory" (1 mark). All marks are totaled up, from which an average is calculated for each country/region.

Figure 40 Distribution of Respondent Companies on Satisfaction with Profitability (All industries)

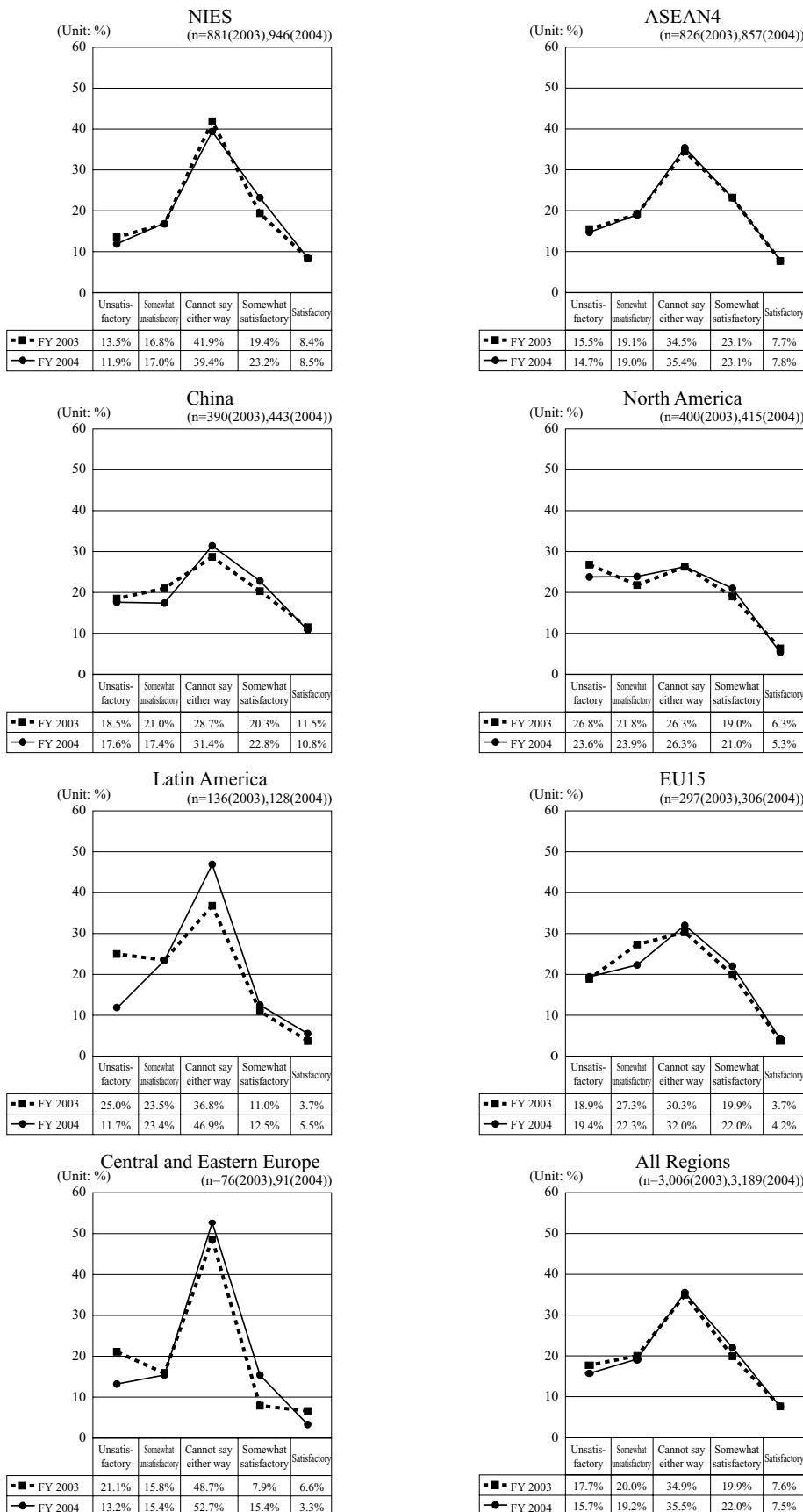
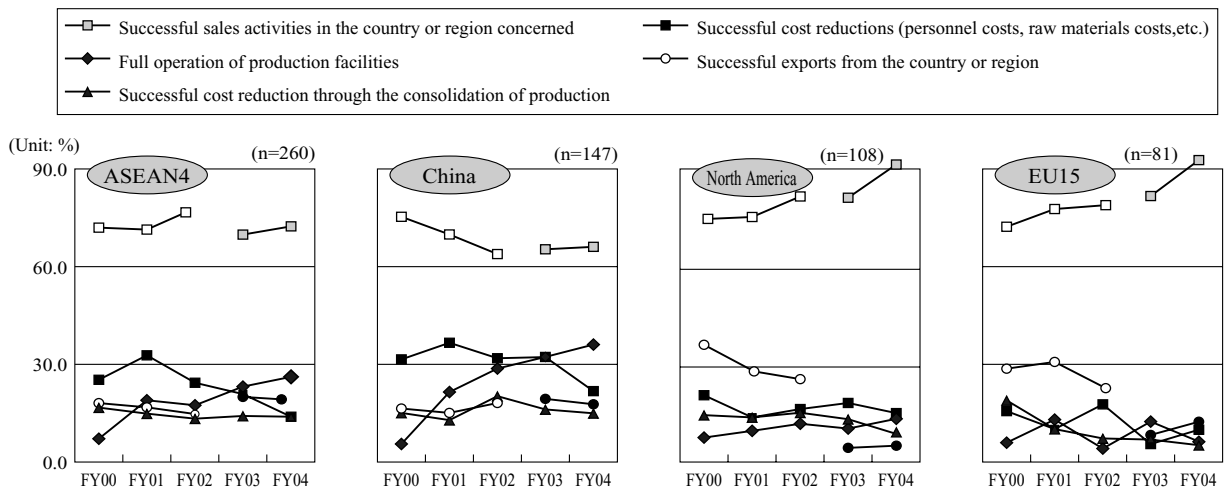


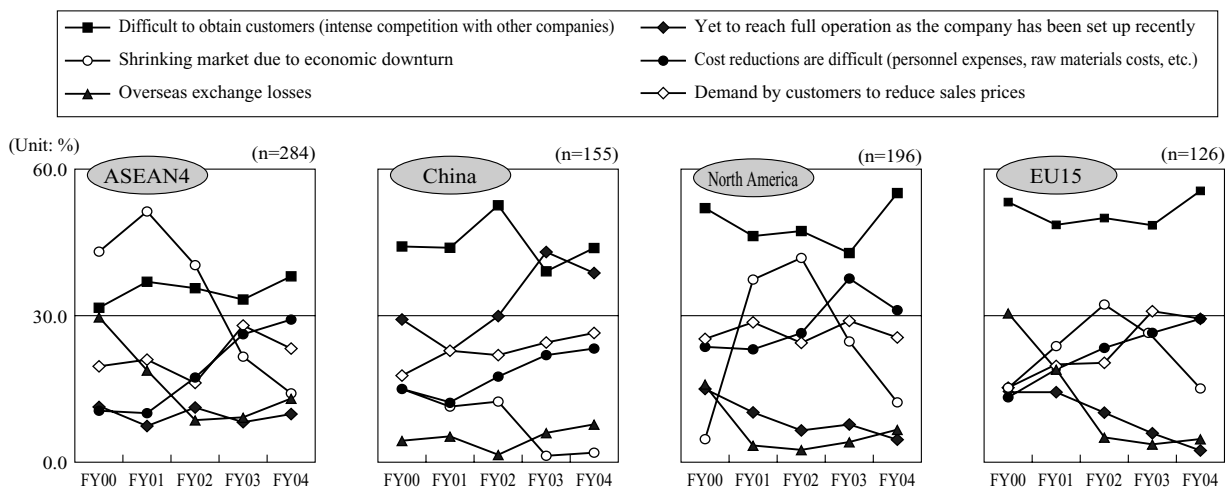
Figure 41: Reasons for Evaluations of Satisfaction with Profitability (satisfactory/somewhat satisfactory) as a time series comparison of major regions (multiple responses)



Note: The above reasons for the satisfaction levels of “satisfactory” and “somewhat satisfactory” may vary in definition depending on the year of survey, but all those which can be regarded as synonymous according to the above-classified keys are gathered together in respective key groups. Provided that the following two reasons, “successful sales activities in the country or region concerned” and “successful exports from the country or region,” were added in the FY2003, thus, they have no chronological continuity with previous items. In the same figure, the empty squares (“□”) for FY2000-FY2002 indicates “successful sales of existing products” and the empty circles (“○”) for the same period indicates “successful sales of new products.”

Note: In Figures 41 and 42, the figures in the parentheses indicate the number of samples in this year’s survey.

Figure 42: Reasons for Evaluations of Satisfaction with Profitability (unsatisfactory/somewhat unsatisfactory) as a time series comparison of major regions (multiple responses)



cited “difficult to obtain customers (intense competition with other companies)” were in the majority for all four regions. In this year’s survey, the proportion of respondent companies answering “successful sales activities in the country or region concerned” or “difficult to obtain customers” in all four regions is up compared to last year, indicating that the performance of sales activities in local markets is a key factor in assessing the profitability of business operations. As the reason why companies

evaluated profitability as “unsatisfactory” or “somewhat unsatisfactory,” the proportion of respondent companies who cited “shrinking market due to economic downturn” has recently become lower for each country/region, and this tendency is particularly evident in ASEAN4 and North America. China is characterized by this factor being very small. The ratio citing “cost reductions are difficult” is high for each country/region, and the increase of this factor is outstanding in ASEAN4 and China.

2. Evaluation of Overseas Business Performance by Region

(1) Evaluation of Business Performance in China

In this year's survey, both the evaluation of satisfaction with sales and evaluation of satisfaction with profitability in China have shown improved results (Figure 39). In relation to the satisfaction with profitability of Chinese operations, companies who responded "satisfactory" or "somewhat satisfactory" (these two evaluation stages are collectively called "High satisfaction" hereinafter) cited the following as major reasons. "Successful sales activities in the country or region concerned" (66.0%); "full-scale operation of the production unit" (36.1%); and "Successful cost reductions (personnel costs, raw materials costs, etc.)" (21.8%) (Appended Table 3). On the other hand, in relation to the satisfaction with profitability of China operations, companies who responded with "unsatisfactory" or "somewhat unsatisfactory" (these two evaluation stages are collectively called "Low satisfaction" hereinafter) cited the following as major reasons. "Difficult to obtain customers (intense competition with other companies)" (43.9%); "yet to reach full operation as the company has been set up recently" (38.7%); and "demand by customers to reduce sales prices" (26.5%).

Typical points in this year's survey results are that "yet to reach full operation as the company has been set up recently," whose ratio was the highest in the FY2003 survey, has become low, but the proportion of "full operation of production facilities" has risen (Figures 41 and 42). The full operation of production facilities is certainly one of the factors that should have contributed to an increased profit, but the ratios of such responses as "difficult to obtain customers," "demand by customers to reduce sales prices," and "cost reductions are difficult," have increased and the proportion of responses of "successful cost reductions" has shown a tendency to decline. The respondent companies have confided at interview: "If you advance the area where other firms of the same industry have already advanced together, and then you will find shortage of skilled workers and a hike in wages. No problem about unskilled workers, but engineers and educated mid-level

workers are in short supply" (Electrical equipment and electronics-Components), "In Shanghai, the level of workers' wages keeps on increasing lately. It is twice as much as it was before" (Same), "As a Japanese automaker is going to start its operation in Guangzhou along with its related manufacturers, concern is being expressed about shortage of workers, wage hikes, and job hopping. It is a scramble for workers among Japanese companies" (Precision machinery-Assembled products). These and more comments have been received, all expressing concern about wage increases.

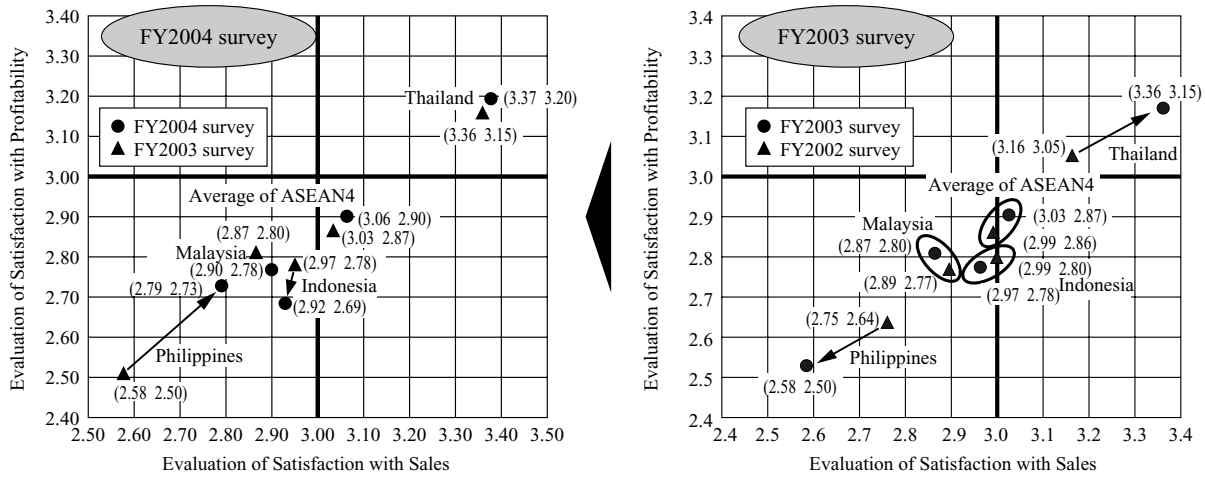
In order to secure a satisfactory level of profitability from operations in China in future, it will be all the more important not only to enlarge the scale of sales and production, but also to be armed with a well-planned market strategy and measures to achieve low costs so as to maintain the competitiveness of the products. Evaluation of business operations in China has shown improved results this year following a similar trend in the FY2003 survey, but profitability still leaves much to be desired. Many companies aim for strengthening or expansion of the production and sales sides of their business in China, but if they are to raise the profitability of that business, it is increasingly important for them to make efficient investments, well tailored to the market, as they develop and secure market positions.

(2) Evaluation of Business Performance in NIES

Through FY2002 and FY2003, evaluation of business performance of business operations in NIEs has maintained the highest level of all regions. Also, among each country/region constituting NIEs, namely Korea, Taiwan, Singapore, and Hong Kong, the evaluation of the results of operations is not much varied, standing generally at a high level and without much difference in comparison with last year's results (Figure 39).

Regarding reasons why profitability is evaluated as "satisfactory" in each country/region of NIEs (Appended Table 3), the greatest number of answers have cited "successful sales activities in the country or region concerned" (an overwhelming 82.0%), this proportion having increased more than last year. As to the reasons for "unsatisfactory" profitability, the top

Figure 43 Actual Evaluations for the ASEAN4 Countries



two have remained the same as last year, namely, “difficult to obtain customers (intense competition with other companies)” (48.5%) and “demand by customers to reduce sales prices” (31.4%); but for the third placed reason and below, proportions for the following items have increased greatly: “cost reductions are difficult” (17.9%) and “demand decreasing for matured products” (17.5%), suggesting that operations in NIEs are facing severer conditions in terms of cost and sales.

However, in each country/region of NIEs, particularly in Korea and Taiwan, there are powerful local makers in the field of digital devices and electronic components, and Japanese companies are steadily enlarging their operations by supplying key devices and parts to these makers under tie-up or joint-venture operations. These movements are probably part of the reason why the profitability in NIEs is evaluated highly.

(3) Evaluation of Business Performance in ASEAN4

Evaluation of sales and profitability satisfaction for ASEAN4 has stayed at almost the same levels as the FY2003 survey (Figure 43). Thailand is the most highly evaluated in ASEAN4. Ever since FY2002, satisfaction with both sales and profitability for Thailand had been evaluated over “3,” winning the best mark within ASEAN4, and in this year’s survey it has achieved even better results.

As to the Philippines, the evaluation result in the FY2003 survey was down in both sales and

profitability as compared to the previous year, but this year’s result has recovered to a level slightly higher than that of FY2002.

The evaluations for Malaysia and Indonesia are almost even with the previous year’s results. As the reason why profitability for ASEAN4 is evaluated as “satisfactory,” “successful sales activities in the country or region concerned” (72.3%) has been selected by the largest proportion of respondent companies, and a similar result has been obtained for each individual country of the region (Appended Table 3). However, for Thailand the proportion choosing “full operation of production facilities” (35.8%) is higher than in other countries, seemingly evidencing that production systems are being steadily streamlined in Thailand and that Japanese manufacturers of late are showing the strongest intention of “strengthening or expansion” of their operations among ASEAN4 countries. In the Philippines: “previously, the yield rate was too low to achieve good profitability, but by changing the production items, profitability has been much improved” (Electrical equipment and electronics-Components), and “presently, orders are coming in well from the Automobiles industry” (Precision machinery-Components). As shown in these comments, improved evaluation of profitability by industries relating to Electrical equipment and electronics and Automobiles looks like pushing up the profitability evaluation for the whole of the Philippines (Figures 47 and 48).

The reasons why profitability for ASEAN4 is

evaluated as “unsatisfactory” are cited as “difficult to obtain customers” (38.0%, the largest proportion), followed by “cost reductions are difficult” (29.2%). Evaluation is varied by countries, particularly with “cost reductions are difficult,” the proportion of which is above 35% for Malaysia and Indonesia and incidentally the highest proportion for Indonesia. For a long time, Indonesia has been highly regarded as an exporting and processing base centering on Textiles and on Electrical equipment and electronics, but “The issues of late are the hikes in wages, electricity prices, oil price, etc. Wages are particularly affected by demands for increases and strikes, inasmuch as the government is following a generous labor policy toward laborers” (Textiles), “Defective goods are sufficient to offset the merit of low wages” (Same), “The minimum wage in Indonesia is continuing to substantially increase every year, with its competitive edge in costs over China gradually narrowing” (Chemicals). These comments seem to make it clear that the position of Indonesia as a destination for investment is being degraded because it is losing its advantage as a base for export operations supported by inexpensive labor force. As mentioned in Chapter 6: “Prospects for Overseas Business Operations over the Medium Term,” the proportion of companies in the Electrical equipment and electronics industry who responded that they “will strengthen or expand” their business operations in Indonesia is far below that for Thailand, which is also a member of ASEAN4 (Figure 23). One of the factors in this seems to be that Indonesia’s severe cost problem is being aggravated.

(4) Evaluation of Business Performance in North America

With reference to evaluation of satisfaction with sales and profitability for North America (Figure 39), evaluation of sales has shown some advancement, but evaluation of profitability has shown only a small improvement, keeping the profitability satisfaction for North America at the lowest level ever within the seven major regions. Comparison of respondent companies indicates that the number of “High satisfaction” companies was 108, while the number of “Low satisfaction” companies was 196, almost double the former, suggesting that many companies are not satisfied with the profitability of their North

American business operations (Figure 42).

As the reason why profitability has been evaluated as “High satisfaction” by companies, “successful sales activities in the country/region concerned” obtained overwhelming support (90.7%), an advance of 10 points from the FY2003 survey. Those respondent companies whose evaluation was of “Low satisfaction” have cited the following reasons: the response with the highest proportion was the “difficult to obtain customers” (55.1%), an increase of 12 points from the FY2003 survey, followed by “cost reductions are difficult” (31.1%), and “demand by customers to reduce sales prices” (22.5%). It is observed that in the North American market, where competition is severe in costs and sales, companies are polarized by comparative merits and demerits in competitiveness.

(5) Evaluation of Business Performance in the EU

The evaluations for the EU show that some improvements from the FY2003 survey are recognizable in both sales and profitability (Figure 39). As the reason for profitability being evaluated as “High satisfaction,” the following was cited: “Successful sales activities in the country or region concerned,” the proportion of which is overwhelming with an increase by 11 points from the FY2003 survey (81.4% in FY2003 to 92.6% this year) (Figure 42). Also, as the reasons for profitability being evaluated as low satisfaction, “difficult to obtain customers” (55.6%) had the largest proportion, followed by “demand by customers to reduce sales prices” (29.4%), and “cost reductions are difficult” (29.4%).

3. Evaluations of Overseas Business Performance by Major Industries

(1) Chemicals

With reference to the profitability evaluation of Chemicals manufactures, the reasons for high satisfaction are compared with those for low satisfaction by means of distribution graphs. The proportion responding “success in domestic marketing” has increased for every region, generally surpassing that of “failure in domestic marketing”

(Figure 44). Also for each region, the number of companies who responded “cost reductions are difficult” outweighs that of “successful cost reduction,” revealing a situation in which many companies are faced with difficulty in finding effective cost-cutting

measures.

Region-by-region comparison of evaluations between the FY2003 and FY2004 survey indicates that the profitability evaluation for this year as compared to the last year shows a downward trend

Figure 44 Reasons for Evaluations of Satisfaction with Profitability -Comparison by Major Region and Major Industry-

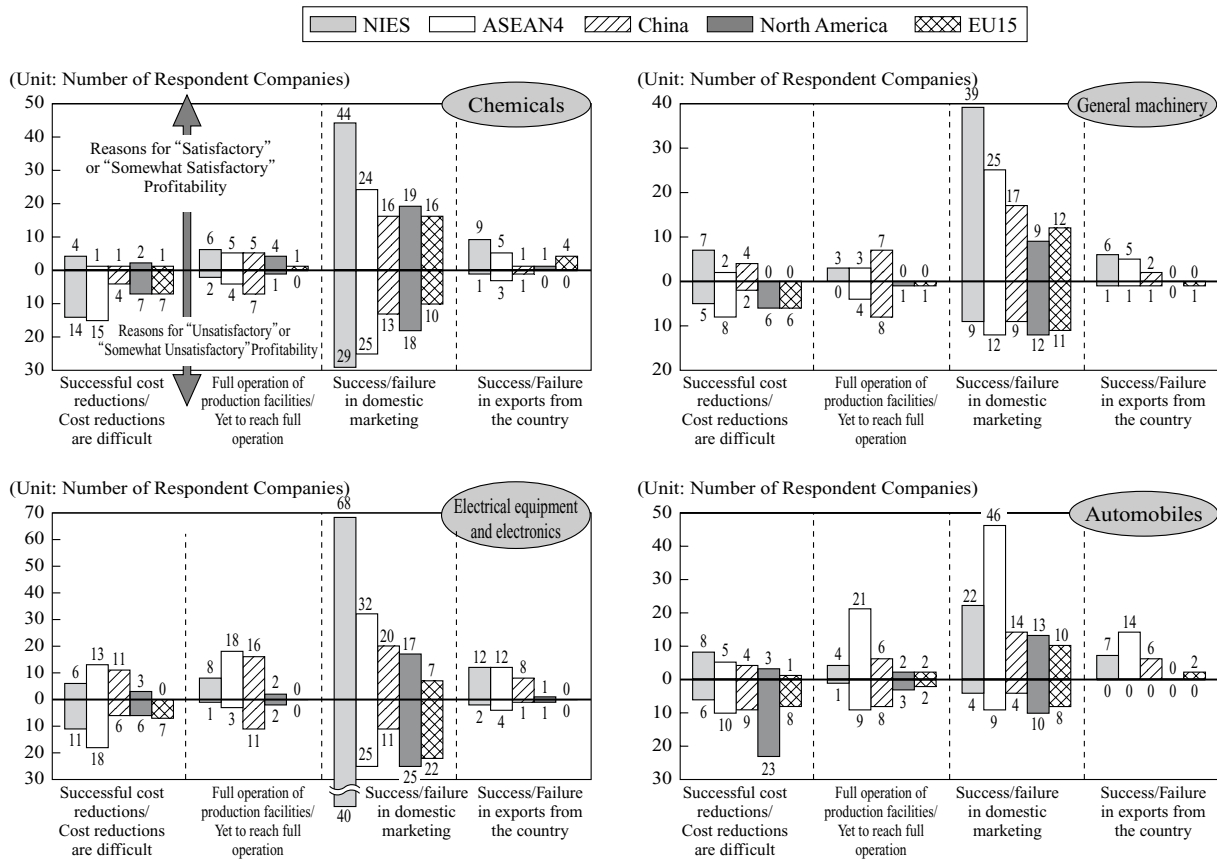
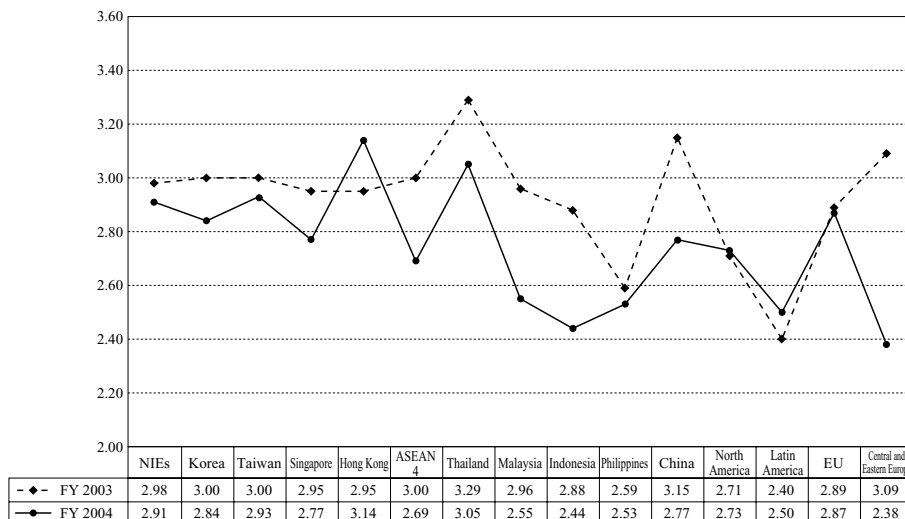


Figure 45 Comparison of Evaluations of Satisfaction with Profitability between FY2003 and FY2004 (Chemicals)



generally, with a large drop in particular for ASEAN (except for Thailand), China, and Central and Eastern Europe. It is only for Thailand and Hong Kong that in this year’s survey the profitability evaluation has attained a mark higher than “3” (the middle point in the 5-step evaluation). Thailand is the one and only country for which the profitability evaluation was higher than “3” for the second year in a row (Figure 45).

(2) General machinery

With reference to the profitability evaluation of General machinery, the reasons for high satisfaction are compared with those for low satisfaction by means of distribution graphs. The proportion citing “success in domestic marketing” has increased for every region, surpassing that of “failure in domestic marketing” except for North America (Figure 44). For NIEs, ASEAN4 and China, “success in domestic marketing” exceeded “failure in domestic marketing” by a large margin. On the other hand, for ASEAN4, North America, and the EU, the number of respondents citing “cost reductions are difficult” has increased.

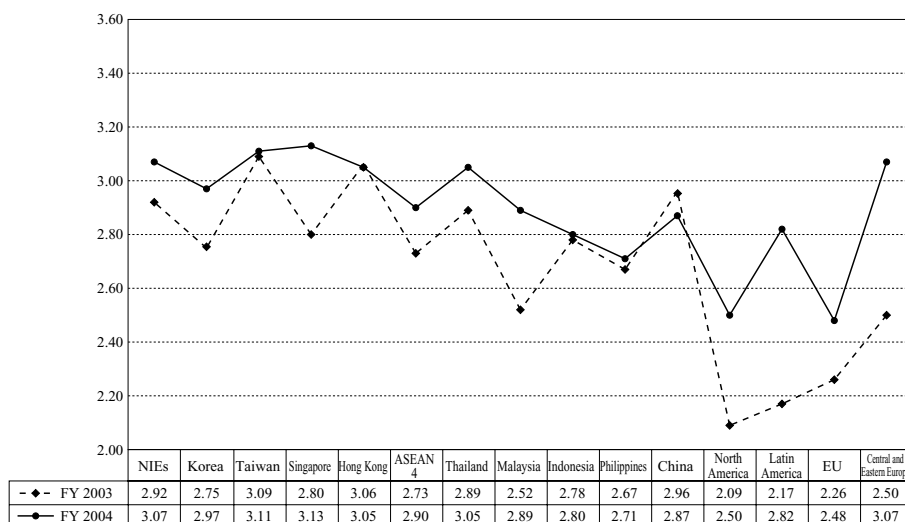
Region-by-region comparison of evaluations between the FY2003 and FY2004 survey indicates that the profitability evaluation of this year has improved generally and has surpassed that of FY2003 (Figure 46). Particularly, the evaluation for NIEs stays at a level above “3” due to the fact that the number of respondent companies citing high satisfaction

exceeds those of low satisfaction on all the four items in Figure 44. The evaluation for such developed countries and regions as North America and the EU is below 2.5. The profitability evaluation for North America has improved from the FY2003 survey, but the number of respondent companies of low satisfaction is higher than for elsewhere on all the four items in Figure 44. For the principal North American market, it can therefore be expected that further efforts will be made to strengthen the domestic market and cost competitiveness.

(3) Electrical equipment and electronics

In relation to the profitability evaluation of Electrical equipment and electronics manufacturers, a comparison of the reasons for high satisfaction with those for low satisfaction shows that “success in domestic marketing” is answered by many companies in all regions, and for NIEs, ASEAN4, and China, it exceeds the selection of “failure in domestic marketing” by a large margin (Figure 44). The above three regions are also characterized by many companies having responded “full operation of production facilities” and “success in exports from the country.” For China, many companies expressed high satisfaction with all of the four items, showing the successful state of business operations in that country. For other regions, the number of respondent companies who cited “cost reductions are difficult” exceeded those selecting “successful cost reduction,” and for North America and the EU none of the four

Figure 46 Comparison of Evaluations of Satisfaction with Profitability between FY2003 and FY2004 (General machinery)



items gained sufficient votes of high satisfaction to surpass those of low satisfaction.

Region-by-region comparison of evaluations between the FY2003 and FY2004 survey indicates that the profitability evaluation of this year has improved generally and has surpassed the evaluation for FY2003 (Figure 47). The three notable points of this year's results are that the evaluations for Thailand and China have advanced above "3," that only Indonesia has a lower score in comparison with the FY2003 result, and that the evaluations for the developed regions including North America and the EU, though improved, still remain at a low level. The high evaluation for China is derived from the fact that it obtained high profitability satisfaction ratings in the various aspects of cost, production, domestic sales, and export. In ASEAN4, Thailand obtained a high evaluation, and Malaysia and the Philippines have an improved evaluation as compared to the FY2003 survey results. Only Indonesia has fallen into the doldrums, splitting the evaluation of profitability satisfaction of ASEAN4 countries into two distinct parts. The evaluation for North America and the EU has improved by comparison with the FY2003 survey result, but still remains at a low level of "2.5" or thereabouts.

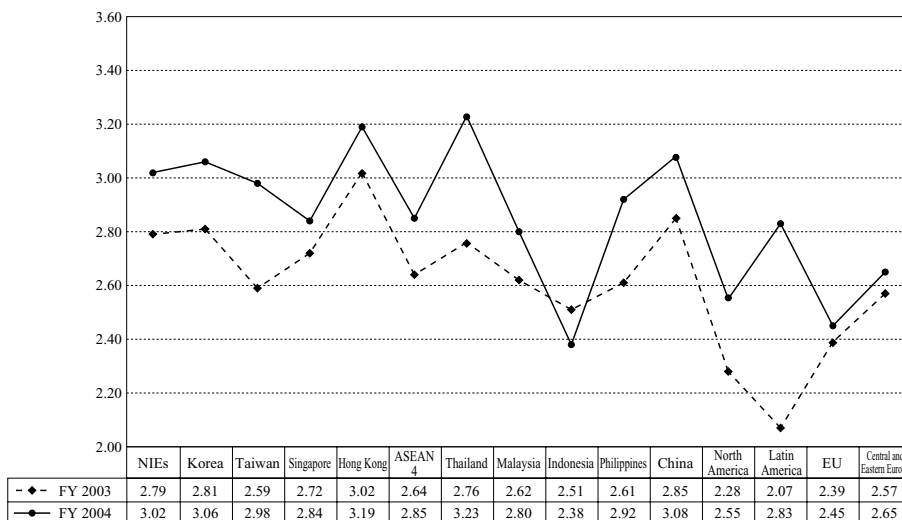
(4) Automobiles

With reference to the profitability evaluation of Automobile makers, the reasons for high satisfaction

are compared with those for low satisfaction by means of response distribution graphs. The proportion citing "success in domestic marketing" is high for every region, generally surpassing "failure in domestic marketing" (Figure 44). For NIEs, ASEAN4 and China, many companies cited "success in domestic marketing." Particularly for NIEs, all four items attracted many reasons for high satisfaction. For China, responses of "cost reductions are difficult" and "yet to reach full operation" exceed others, but profitability in China is expected to increase as production facilities enter full operation. For ASEAN4, many companies responded "full operation of production facilities" and "success in exports from the country," suggesting that the Automobile industry is making good progress throughout the region but particularly in Thailand where the industrial cluster has been advancing. However, it is noted that many responses for Thailand pointed out "cost reductions are difficult," and some cost-reducing measures will become important hereafter. Lastly, for North America, 16 companies responded high satisfaction, and 38 companies low satisfaction, and an overwhelming number of 23 out of the said 38 companies also indicated "cost reductions are difficult."

A review of evaluations of satisfaction with profitability evaluation by regions shows that the result was above "3," the same level as the previous year, for NIEs and ASEAN4, while for China it

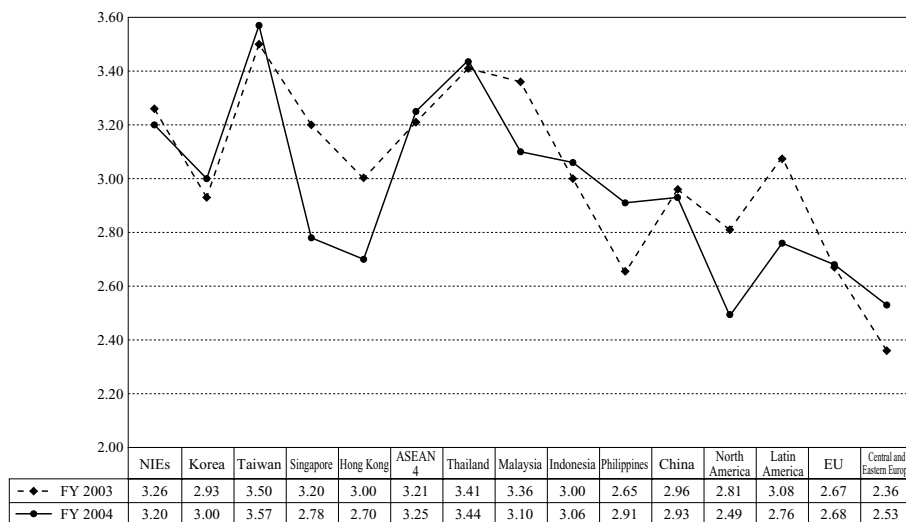
Figure 47 Comparison of Evaluations of Satisfaction with Profitability between FY2003 and FY2004 (Electrical equipment and electronics)



remains the same as the previous year, and that the evaluation for the main market of North America has greatly decreased (Figure 48). The high evaluation for ASEAN4 is attributable to the high rating given to Thailand. It is also noteworthy that the evaluation for Indonesia is above “3.” For North America, many companies have cited “cost reductions are difficult”

and so the profitability evaluation in this year’s survey result has fallen to the lowest level in all the regions. In North America, Japanese automakers are enjoying favorable sales, but so far as the result of this survey is concerned, the auto parts makers appear to be faced with difficulties in reducing cost.

Figure 48 Comparison of Evaluations of Satisfaction with Profitability between FY2003 and FY2004 (Automobiles)



<Column 6> Evaluations of Satisfaction with Profitability for ASEAN4 Countries

The trend of the profitability evaluation for ASEAN4 countries, the major destinations for overseas business operations by Japanese manufacturers, can be traced as follows. Before the Asian currency crisis of 1997, Malaysia and Thailand had been acting as a sort of regional dynamo enabling the profitability evaluation for the whole region to stay at a relatively high level. The evaluation, however, declined greatly in 1998 after the currency crisis. Thereafter, the rating improved to reach a peak in 2000, since which Thailand has been improving its evaluation rating every year, while the evaluations for the other three countries have been leveling off (Column Figure 11).

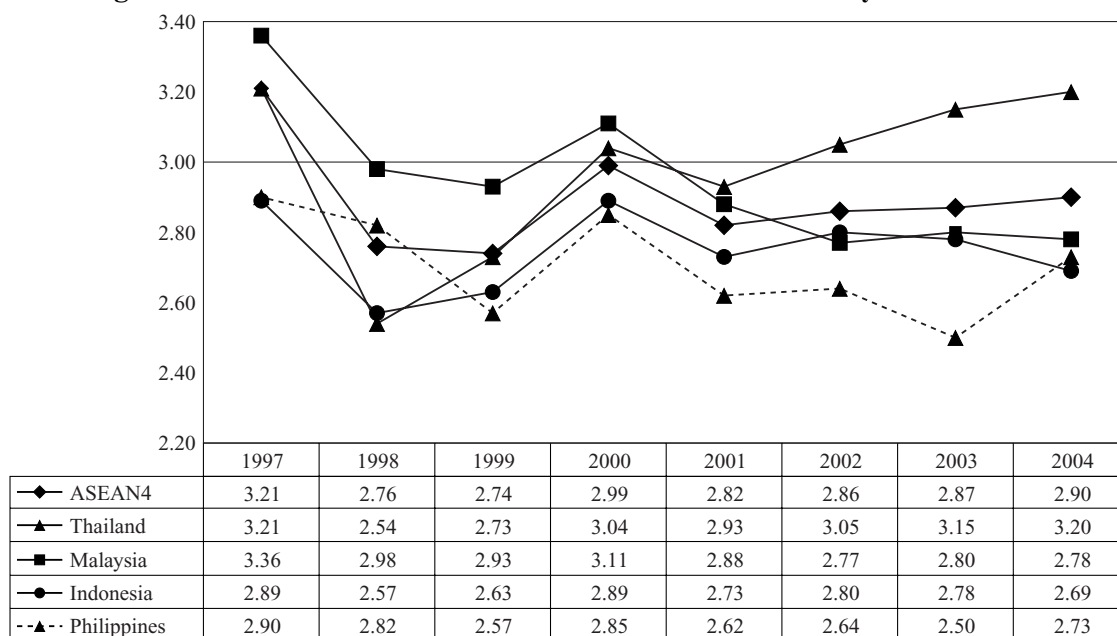
The analysis of the profitability evaluation for ASEAN4 countries in this year’s survey shows that Thailand obtained marks above “3” for all of the four major industrial classifications, the highest evaluation among the ASEAN4 countries. Above all, Automobiles and Electrical equipment and electronics obtained high evaluations (Column Figure 12). The evaluation of Electrical equipment and electronics in Malaysia is still below “3,” and this same evaluation worsens even further in Indonesia. By contrast, Automobiles had a high evaluation of above “3” in Indonesia. In the Philippines, the evaluation of Electrical equipment and electronics is slightly above Automobiles, staying at a relatively high level. With reference to the order of rank of countries/regions according to their medium-term prospect, classified by the major four industries, Indonesia for Electrical equipment and electronics is now ranked 10th, down from the previous year’s 5th, reflecting this industry’s more severe evaluation of that country from the viewpoint of medium-term prospect (Table 26).

Furthermore, for Indonesia, the profitability evaluation in respect of Electrical equipment and electronics is the lowest of the four countries, while the same evaluation for Automobiles is rated as high

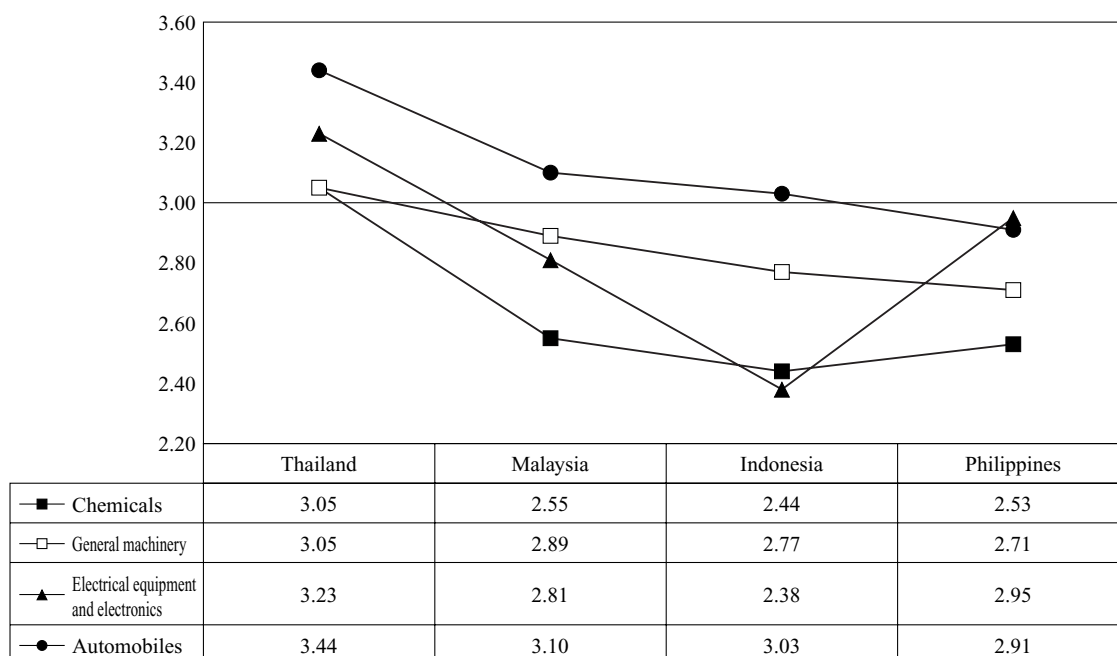
as above “3.” Corresponding to the profitability evaluation, the Electrical equipment and electronics manufacturers’ “strengthening or expansion” attitude is at its lowest in Indonesia among ASEAN4 countries, while the Automobiles manufacturers’ attitude is at the second highest, next to Thailand (Figures 23 and 25).

The above analysis suggests that it may be more suitable for Japanese manufacturers to define Indonesia as a potential market with a large population, rather than as a production and export base where inexpensive labor force is available. Such a realignment of concept might help revitalize Japanese manufacturers’ operations in that country.

Column Figure 11 Trend of Evaluations of Satisfaction with Profitability for ASEAN4 Countries



Column Figure 12 Evaluations of Satisfaction with Profitability for ASEAN4 Countries by Major Industry (FY2004 Survey)



Chapter 8: Chinese Operations and Risks

1. Economic Growth in China

One of the objectives of this year’s survey was to investigate the risks relevant to development of business operations in China and the possible countermeasures against them, as Japanese companies are positively strengthening or expanding their business operations in the country.

First of all, examining how long companies expect the current high rate of economic growth in China to continue as they draw up their business plans, the most common answer is “until 2010 (Shanghai Expo)” (174 companies out of 555), “until 2008 (Beijing Olympics)” (150 companies), and “continue beyond 2010” (125 companies) (Figure 49). Breaking down this result by major industry, the Electrical equipment and electronics industry gave the largest vote to “until 2008 (the Beijing Olympics)”

(34 companies out of 105), and the Automobiles industry supported “until 2010 (the Shanghai Expo)” (38 companies out of 90),” showing that views of economic growth vary between industries (Figure 50).

The differences seen in the economic growth forecasts between industries seem to reflect the way that respondent companies use the forecast for their own products and markets to reach their forecast on the economic growth of China as a whole. The Electrical equipment and electronics manufacturers have a relatively long history of business operations within China and yet have severe competition with local manufacturers. Therefore, it is assumable that they are apt to see the prospects of market expansion confined within a relatively short time span. On the other hand, the Automobile manufacturers are still mostly new operators in China but have high competitive power, so it is assumed they tend to take

Figure 49 How long will China’s economic growth continue (All Industries)

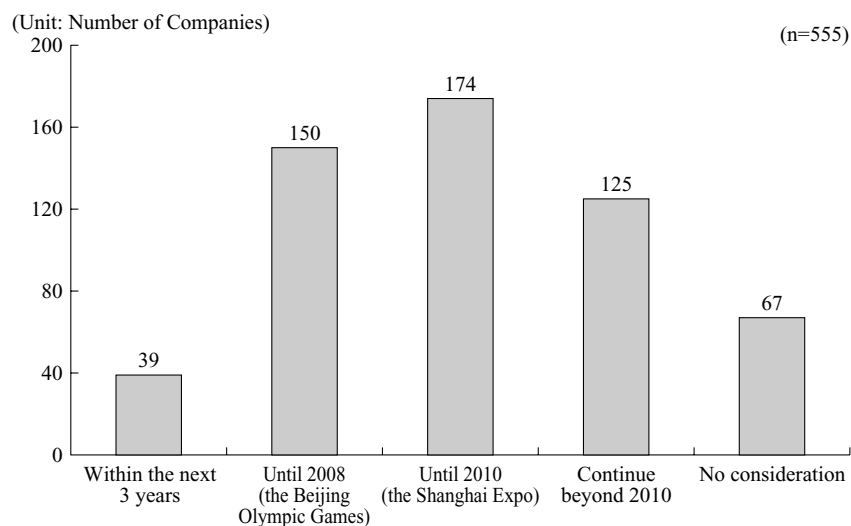
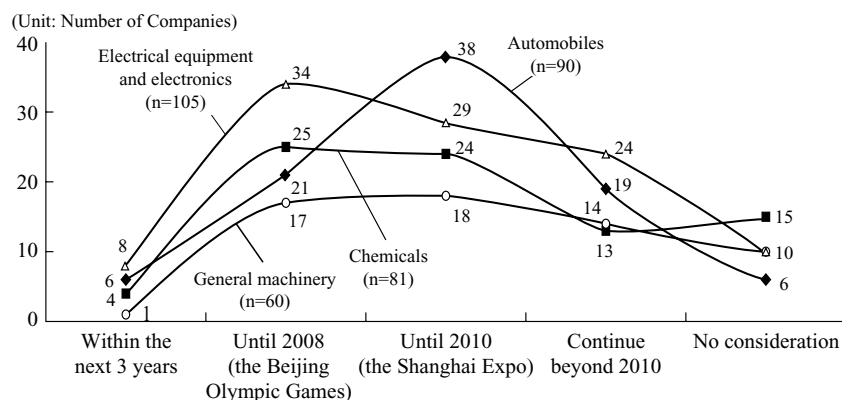


Figure 50: How long will China’s economic growth continue (By Major Industry)



a longer-term view of their prospects of market expansion.

2. China Risks

Risks that may occur while developing business operations in China and which may have a serious effect on those operations are classified into “risks faced now” and “future risks” for the purpose of the survey²⁷ (multiple responses).

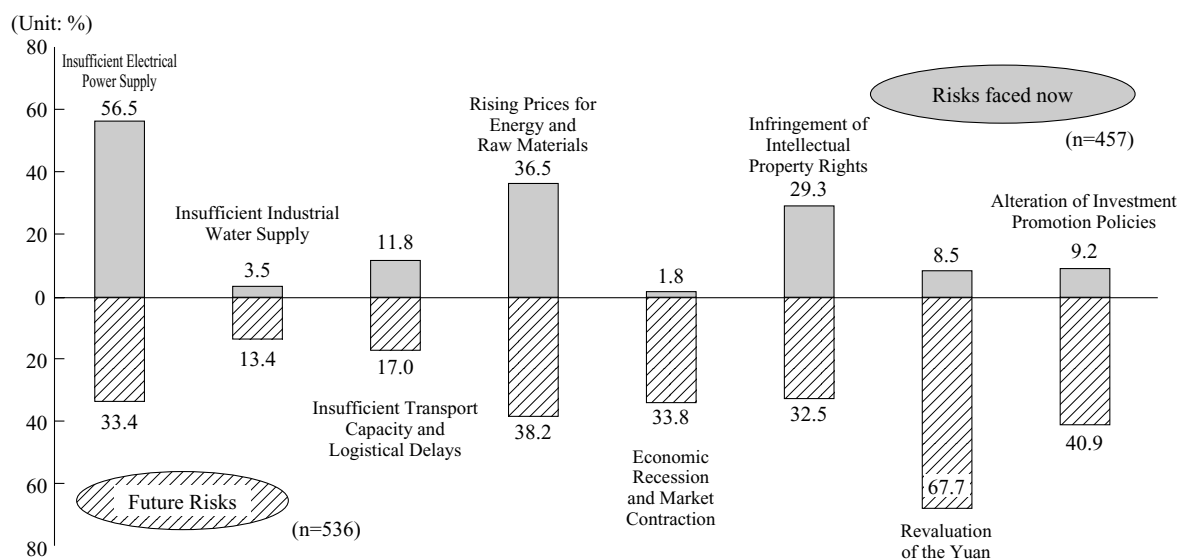
As to the “risks faced now,” companies who pointed out “insufficient electrical power supply” (56.5%, 258 companies out of 457) were in a majority (Figure 51). Then follows “rising prices for energy (other than electricity) and raw materials” (36.5%, 167 companies out of 457), and “infringement of intellectual property rights” (29.3%, 134 companies out of 457). Looking at this result by major industry, the three items, “insufficient electrical power supply,” “rising prices for energy and raw materials (other than electricity),” and “infringement of intellectual property rights,” may change places depending on industries, but these three risks constitute the top three rankings of each industry

(Table 21).

As regards “future risks” (Figure 51 and Table 22), the most common response was the “revaluation of the Yuan”²⁸ (67.7%, 363 companies out of 536) followed by “alteration of investment promotion policies (including foreign capital preferential taxation)” (40.9%, 219 companies out of 536) and “a rising prices for energy (other than electricity) and raw materials” (38.2%, 205 companies out of 536). As mentioned above, different risk items have been presented as “risks faced now” and “future risks.”

When such China risks are examined according to a time base, shortage of energy such as electricity and of raw materials is one of the immediate risks that reflects the surge in demand brought about by the rapid economic growth in China, and there is a future possibility that revisions of the system, such as the revaluation of the Yuan and the alteration of investment promotion policies, may take place as serious risks. The foregoing appears to show the way that companies comprehend the risks of operating their business in China.

Figure 51: China Risks (multiple responses)



Note: “Risks faced now” are those that have already occurred or are thought very likely to occur within the next year.

“Future risks” are those which have not yet emerged, but could occur within the coming 1-5 years.

27 “Risks faced now” are those which have already occurred or are thought very likely to occur within the next year. “Future risks” are those that have not yet emerged, but could occur within the coming 1-5 years.

28 Regarding “the revaluation of the Yuan,” an additional survey was made as to “how serious an impact it would have upon each company’s business operation” and “to what extent the revaluation would have a serious effect on each company’s business operation.” These questions were conducted for those companies who responded that revaluation is a risk for them. It was made during September to October 2004, with the results reported in detail in Column 8.

Table 21 Risks faced now by Major Industry (multiple responses)

(Unit: [Left Row] Number of Respondent Companies; [Right Row] %)

Chemicals			General machinery		
Risks faced now	Number of Companies	%	Risks faced now	Number of Companies	%
Number of Respondent Companies	69	100.0	Number of Respondent Companies	49	100.0
Insufficient Electrical Power Supply	35	50.7	Rising Prices for Energy and Raw Materials	26	53.1
Infringement of Intellectual Property Rights	30	43.5	Insufficient Electrical Power Supply	21	42.9
Rising Prices for Energy and Raw Materials	27	39.1	Infringement of Intellectual Property Rights	15	30.6
Alteration of Investment Promotion Policies	13	18.8	No Serious Risk	8	16.3
Insufficient Transport Capacity and Logistical Delays	12	17.4	Insufficient Transport Capacity and Logistical Delays	6	12.2
No Serious Risk	10	14.5	Alteration of Investment Promotion Policies	5	10.2
Revaluation of the Yuan	7	10.1	Others	3	6.1
Others	4	5.8	Economic Recession and Market Contraction	2	4.1
Insufficient Industrial Water Supply	2	2.9	Revaluation of the Yuan	2	4.1
Economic Recession and Market Contraction	1	1.4	Insufficient Industrial Water Supply	1	2.0
Electrical equipment and electronics			Automobiles		
Risks faced now	Number of Companies	%	Risks faced now	Number of Companies	%
Number of Respondent Companies	87	100.0	Number of Respondent Companies	70	100.0
Insufficient Electrical Power Supply	54	62.1	Insufficient Electrical Power Supply	42	60.0
Rising Prices for Energy and Raw Materials	28	32.2	Rising Prices for Energy and Raw Materials	27	38.6
Infringement of Intellectual Property Rights	27	31.0	Infringement of Intellectual Property Rights	15	21.4
Insufficient Transport Capacity and Logistical Delays	11	12.6	No Serious Risk	11	15.7
Alteration of Investment Promotion Policies	10	11.5	Revaluation of the Yuan	9	12.9
Others	10	11.5	Insufficient Transport Capacity and Logistical Delays	8	11.4
No Serious Risk	10	11.5	Alteration of Investment Promotion Policies	6	8.6
Revaluation of the Yuan	8	9.2	Insufficient Industrial Water Supply	3	4.3
Insufficient Industrial Water Supply	4	4.6	Others	2	2.9
Economic Recession and Market Contraction	0	0.0	Economic Recession and Market Contraction	1	1.4

Table 22 Future Risks by Major Industry (multiple responses)

(Unit: [Left Row] Number of Respondent Companies; [Right Row] %)

Chemicals			General machinery		
Future Risks	Number of Companies	%	Future Risks	Number of Companies	%
Number of Respondent Companies	79	100.0	Number of Respondent Companies	57	100.0
Revaluation of the Yuan	56	70.9	Revaluation of the Yuan	36	63.2
Alteration of Investment Promotion Policies	34	43.0	Alteration of Investment Promotion Policies	27	47.4
Insufficient Electrical Power Supply	31	39.2	Infringement of Intellectual Property Rights	25	43.9
Economic Recession and Market Contraction	27	34.2	Economic Recession and Market Contraction	20	35.1
Rising Prices for Energy and Raw Materials	26	32.9	Insufficient Electrical Power Supply	16	28.1
Infringement of Intellectual Property Rights	25	31.6	Rising Prices for Energy and Raw Materials	16	28.1
Insufficient Transport Capacity and Logistical Delays	15	19.0	Insufficient Transport Capacity and Logistical Delays	10	17.5
Insufficient Industrial Water Supply	12	15.2	Insufficient Industrial Water Supply	6	10.5
Others	5	6.3	No Serious Risk	4	7.0
No Serious Risk	3	3.8	Others	1	1.8
Electrical equipment and electronics			Automobiles		
Future Risks	Number of Companies	%	Future Risks	Number of Companies	%
Number of Respondent Companies	100	100.0	Number of Respondent Companies	90	100.0
Revaluation of the Yuan	72	72.0	Revaluation of the Yuan	58	64.4
Alteration of Investment Promotion Policies	43	43.0	Rising Prices for Energy and Raw Materials	37	41.1
Economic Recession and Market Contraction	40	40.0	Alteration of Investment Promotion Policies	35	38.9
Rising Prices for Energy and Raw Materials	36	36.0	Insufficient Electrical Power Supply	32	35.6
Insufficient Electrical Power Supply	32	32.0	Economic Recession and Market Contraction	32	35.6
Infringement of Intellectual Property Rights	31	31.0	Infringement of Intellectual Property Rights	25	27.8
Insufficient Industrial Water Supply	14	14.0	Insufficient Transport Capacity and Logistical Delays	22	24.4
Insufficient Transport Capacity and Logistical Delays	14	14.0	Insufficient Industrial Water Supply	12	13.3
Others	6	6.0	No Serious Risk	3	3.3
No Serious Risk	2	2.0	Others	2	2.2

<Column 7> China Risks

This column describes the opinions heard in the interviews concerning China risks which many companies have cited as being of concern.

① **“Insufficient Electrical Power Supply”**

“Our plant is affected by an electric power problem. We stop our operation one and a half days per week” (Steel). As this comment shows, rolling blackouts and shutdowns caused by them are major problems for companies. However, other comments were as follows: “because of power shortage, we changed operating days between Saturday/Sunday and weekdays for the months of July and August” (Electrical equipment and electronics-Assembled products), “We suspend operation when no power supply is available, and shift that portion of operation to another working day” (Electrical equipment and electronics-Components). These suggest that not a few companies shift their operation days to Saturday/Sunday, or install a private power generator in order to maintain output. “Owing to power shortages and resultant rolling blackouts, it has become difficult to exercise a three-shift work system as originally planned, but it has not yet caused inconvenience to the extent of affecting the number of units produced” (General machinery-Assembled products). As this case clarifies, many responses confirmed that they have not yet suffered from reduction in production or delay in delivery caused by power shortages.

② **“Rising Prices for Energy (Other than Electricity) and Raw Materials”**

With regard to this risk, short procurement, increased production cost, or other problems resulting from hikes of material cost, are pointed out. In the company interviews, the following comments were received. “In China, material cost is rising so much that our procurement department is experiencing difficulty in purchasing raw materials, also often causing delays in delivery” (Precision machinery-Assembled products), “power does not contribute much to total cost, but we have to care about the price hikes of raw materials. As a large part of our products are composed of iron and plastics, increased cost of raw materials really hits us” (Precision machinery-Assembled products).

③ **“Infringement of Intellectual Property Rights”**

In reference to this risk, many companies consider that infringement takes the form of trading and sales of imitations of their genuine products, or of products using fake trade marks similar to the genuine ones, and the harm arising from them constitutes the risks attributable to the “infringement of intellectual property rights.”

Specific examples of harmful effects are as shown in the following comments. “If imitations are traded in the market, we are afraid we might lose consumers’ confidence in our products in terms of safety and quality” (Automobiles-Assembled products). The big problem lies in the possibility that consumers may buy imitations of a quality much inferior to our genuine products but assume that these imitations are from our factory. The consumers might misunderstand that our products are not as good quality as expected” (Precision machinery-Assembled products). As represented by this comment, many manufacturers are concerned that their brand image, a most important factor to differentiate their products from other companies’ products in domestic sales, might be badly devalued.

Aside from the above, there are still more opinions. “Because China market is flooded with imitation goods, our sales cannot be increased in quantity” (Electrical equipment and electronics-Components). In this case, it is pointed out that a huge oversupply brought about by mass distribution of imitation goods can hinder enhancement of the company’s market share. “We are concerned that we might be drawn into a price war by imitation goods getting into circulation” (General machinery-Assembled products). The effect of deteriorated sales and profit that might be caused by competitive price cutting is also pointed out here.

④ **“Revaluation of the Yuan”**

Concerning the effect of revaluation of the Yuan, results vary depending on the contents of each company's business operations in China. "The revaluation of the Yuan will lead to a rise in export price and a hike in wage cost" (Textiles). Many such companies who define their bases in China as the export base are concerned about a decrease in export competitiveness and increase in local cost such as personnel expenses. When the raw materials are imported from Japan, the import price becomes lower, and it is possible that the effect of revaluation can be set off thereby. "Since the ratio of imports in the raw material total is obscure, it is difficult to calculate in detail the effect of the revaluation of the Yuan" (General machinery-Assembled products). The position of imports included in each raw material is so varied that estimation of the effect may be difficult. One company commented: "there is no way of knowing to what extent the effect can be minimized unless the revaluation has actually taken place."

Those companies who define their bases in China as a domestic sales base, "basically sell all products manufactured in China within China, and therefore not much effect is expected" (Electrical equipment and electronics-Components). Not a few companies have a similarly optimistic view. But, if a revaluation of the Yuan weakens competitiveness in export, it deals a heavy blow to Chinese economy which has so far grown by the lead of export. Therefore, there is a high degree of danger that "the economy of the whole China would be obliged to slow down" (Electrical equipment and electronics-Components). The same fear has also been expressed by not a few other companies.

Irrespective of what the base in China is defined to be, and "whether the Yuan is revalued or devalued, fluctuation of exchange itself is the risk" (Automobiles-Components); some other companies share the opinion that increased uncertainty caused by exchange rate fluctuations is itself a big risk.

If the same result is reviewed by major industry, the "revaluation of the Yuan" occupies the highest proportion of the future risks for all the four major industries (Table 22). The ratio for each industry, however, varies depending on the characteristics of the individual industry's business operations in China. For the General machinery industry which regards China mainly as a selling market (the proportion of companies in this category who have cited "revaluation of the Yuan" as a future risk is 63.2%) and for the Automobile industry which sells products manufactured in China mainly within Chinese market (the proportion on the same basis: 64.4%), the portions are below the all-industry average of 67.7%. On the other hand, for the Chemicals industry (70.9%) and for the Electrical equipment and electronics industry (72.0%) both of which export products manufactured in China to third countries at a high rate, the corresponding proportions are well above the all-industry average.

⑤ "Alteration of Investment Promotion Policies (including Foreign Capital Preferential Taxation)"

Upon accession to the WTO in December 2001, China promised to abolish the 2-year tax exemption and 3-year tax reduction, the reduced tax rate, and other preferential taxation for foreign companies. In addition to preferential taxation, other various incentives for promoting foreign capital introduction, which are all in breach of the WTO principle of national treatment, are also going to be abolished gradually. For those enterprises that have already completed entry into the China market, abolishment will be effected with a proper transition period and by stages.

In such circumstances, during the interview a large number of companies expressed concern about the change and abolishment of various investment incentive measures, particularly the preferential taxation. "In relation to China risks, we are highly concerned about the change of preferential taxation on high-tech products" (Electrical equipment and electronics-Components), "The benefits we now enjoy, including the high-technology enterprise preferential taxation, the export enterprise preferential taxation, and the 2-year tax exemption and 3-year tax reduction system, will be abolished in the near future. As a result, we are afraid we will be left with a negative effect, namely less profit that the company will be allowed to keep" (Electrical equipment and electronics-Components). There are many who feel apprehensive about a downslide of profit resulting from the abolishment of preferential taxation.

Even before the change and abolishment of preferential taxation, sudden modifications and/or cancellation without prior notice of various investment systems have often been tactics used by China authorities, and such sudden modifications and cancellations are seen by many Japanese companies as a great risk. “Sudden changes of legislation and legal systems, non-fulfillment of firmly established practices such as the return of added value tax, and so forth; these are really great risks” (Electrical equipment and electronics-Assembled products), “when the investment promotion plan is changed, we see the change itself as a problem in addition to the fact that the change is non-transparent and unforeseeable” (General machinery). As expressed in the comments, many companies point out as a grave problem the fact that stability is markedly lacking in operating laws, regulations, and legal systems, and that revisions and/or amendments are made so abruptly that it is very difficult for companies to prepare for such changes.

3. Risks Viewed as Most Serious in Chinese Operations

Respondents were asked to choose one risk from among “risks faced now” and “future risks” that the company considers the most important for the company’s business operations in China.

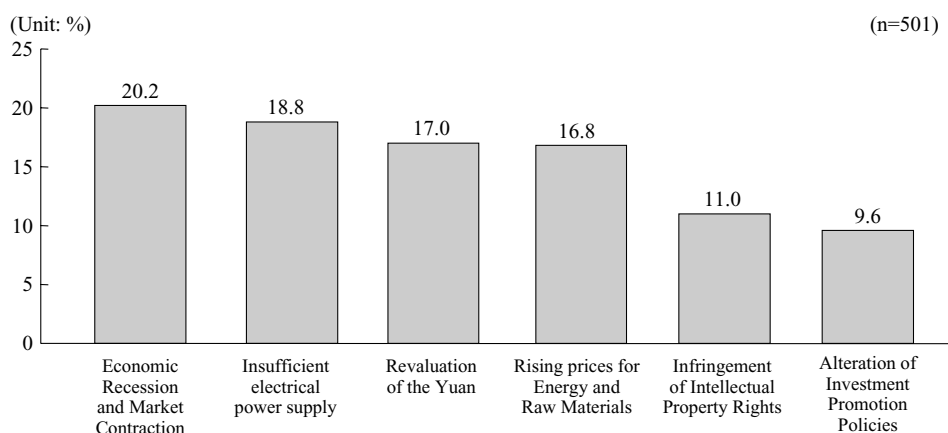
As the result, “economic recession and market contraction” was the highest response (20.2%, 101 companies out of 501), followed by “insufficient electrical power supply” (18.8%, 94 companies out of 501), and “revaluation of the Yuan” (17.0%, 85 companies out of 501) (Figure 52).

Many companies expressed concerns about deteriorated sales and profit, and also difficulty in redeeming capital invested, resulting from an “economic recession and market contraction.” “If the economy shrinks, there is a possibility that it will become difficult to recoup even the capital invested. Without stable growth, we, as a company, will probably have to take a very cautious stance on

business operation in China” (Automobiles-Components). In fact, most of the companies who are strengthening production and sales activities in China should have drawn up their business plans on the basis of China’s stable and high economic growth. Therefore, should that economic growth slow down, it would become necessary for companies to modify their business strategies.

As seen in Figure 49, most companies assume that the high economic growth in China will continue until around 2010, while the same companies also consider the “economic recession and market contraction” as their most serious risk. Regarding the background to this risk, “we are rather apprehensive about the bubble-like boom China is experiencing right now” (Electrical equipment and electronics-Components). Many people share the view that Chinese economy is rather over-heated. Its economic growth is supposed to continue for a while longer, but some companies feel that its real state might be very

Figure 52 Risks Viewed as Most Serious in Chinese Operations



much like a bubble burst which might suddenly lose its momentum. Or, if the high economic growth can continue until 2010 or thereabouts, the real state of the economy thereafter is still obscure, hence people's anxiety²⁹.

Examining this result by major industry (Table 23), Automobile manufacturers have chosen "economic recession and market contraction" (26.8%, 22 companies out of 82) as the largest proportion of its perceived risks. For Chemicals, the largest proportion chose "infringement of intellectual

property rights" (21.1%, 16 companies out of 76), and the proportion of companies who cited "economic recession and market contraction" was only 17.1%, which is below the all-industry average of 20.2%. As analyzed above, the trend of China's domestic economy is regarded as most important for Automobiles, while for Chemicals the protection of intellectual property rights is listed at the top. As with the views on the economic growth of China, some differences are observed based on industry characteristics.

Table 23 Risks Viewed as Most Serious in Chinese Operations by Major Industry

(Unit: [Left Row] Number of Respondent Companies; [Right Row] %)

Chemicals			General machinery		
Risks Viewed as Most Serious	Number of Companies	%	Risks Viewed as Most Serious	Number of Companies	%
Number of Respondent Companies	76	100.0	Number of Respondent Companies	52	100.0
Infringement of Intellectual Property Rights	16	21.1	Economic Recession and Market Contraction	14	26.9
Insufficient electrical power supply	15	19.7	Revaluation of the Yuan	10	19.2
Economic Recession and Market Contraction	13	17.1	Rising prices for Energy and Raw Materials	8	15.4
Rising prices for Energy and Raw Materials	11	14.5	Alteration of Investment Promotion Policies	6	11.5
Revaluation of the Yuan	9	11.8	Insufficient electrical power supply	5	9.6
Alteration of Investment Promotion Policies	7	9.2	Infringement of Intellectual Property Rights	5	9.6
Others	4	5.3	Others	3	5.8
Insufficient Transport Capacity and Logistical Delays	1	1.3	Insufficient Transport Capacity and Logistical Delays	1	1.9
Insufficient Industrial Water Supply	0	0.0	Insufficient Industrial Water Supply	0	0.0
Electrical equipment and electronics			Automobiles		
Risks Viewed as Most Serious	Number of Companies	%	Risks Viewed as Most Serious	Number of Companies	%
Number of Respondent Companies	95	100.0	Number of Respondent Companies	82	100.0
Insufficient electrical power supply	26	27.4	Economic Recession and Market Contraction	22	26.8
Economic Recession and Market Contraction	19	20.0	Rising prices for Energy and Raw Materials	15	18.3
Revaluation of the Yuan	15	15.8	Revaluation of the Yuan	15	18.3
Alteration of Investment Promotion Policies	12	12.6	Insufficient electrical power supply	12	14.6
Rising prices for Energy and Raw Materials	10	10.5	Alteration of Investment Promotion Policies	11	13.4
Infringement of Intellectual Property Rights	6	6.3	Infringement of Intellectual Property Rights	4	4.9
Others	6	6.3	Others	2	2.4
Insufficient Transport Capacity and Logistical Delays	1	1.1	Insufficient Transport Capacity and Logistical Delays	1	1.2
Insufficient Industrial Water Supply	0	0.0	Insufficient Industrial Water Supply	0	0.0

<Column 8> Anxiety about Revaluation of the Yuan

In this year's survey, about 70% of the respondent companies cited "revaluation of the Yuan" as a "future risk." What serious effect does this matter of revaluation of the Yuan have upon each company's business operation? The contents and results of the additional survey conducted on this issue are described below³⁰.

As alternative answers to each question, we listed various possible effects that might result from the

²⁹ As the causes of economic slowdown, some companies pointed out the following in the interviews: "increase in the prices of raw materials and in general prices, and reformation of state enterprises" (Transportation (excluding Automobiles)), "income disparity between inland areas and coastal areas in China, and emotional objections arising from them on the part of the inland areas" (General machinery-Assembled products).

³⁰ The survey was conducted in September through October 2004. It was done by telephone or personal interview. The number of respondent companies was 50.

revaluation of the Yuan. Then, we asked the respondent companies to say what they think would be the most serious effect(s) upon them (multiple responses). The highest proportion of responses included a “rise in export prices from China or decreased competitiveness in the export market” (40.0%, 20 companies out of 50). The second most frequently selected effect was an “increase in local cost in China” (in foreign currency) (26.0%, 13 companies out of 50) (Column Table 6).

The above outcome shows that concerns about deteriorating competitive power in third country markets, together with a rise in wages and other local processing costs, account for more than 60% of the responses, and has also clarified how severe the effects would be upon manufacturers who treat bases in China as their production base. Such decreased export competitiveness and rising production costs provide a good example by which to redefine the merit of productive activity in China. “If the Yuan should be revalued by 20% or more at one time, it would cause substantial damage to us. Should it really happen, we should move the base from China to Thailand or Vietnam” (Precision machinery-Assembled products). As shown by this comment, revaluation of the Yuan could stimulate manufacturers into re-examining the *raison d’être* of China bases and restructuring their entire base layout. In fact, as shown in Figure 53, many companies, when asked what countermeasures they would take against revaluation of the Yuan, responded that they will move their part of the operation to outside China, and the above analysis is quite consistent with these responses.

The additional survey investigated to what extent the revaluation is thought likely to seriously affect their operations, with alternative answers giving various levels of exchange rate to choose from. Column Table 7 shows the results. A revaluation level of “1-10%” was selected by 8 companies out of 50 and “11-20%” by 4 companies out of 50. The largest response was “unavailable/not sure” (31 companies)³¹.

The feature of this result is, firstly, that about half of the 17 companies, except for 31 respondent companies who said “unavailable/not sure,” consider that there will be a serious effect on their operations even if the revaluation level is 10% or below, but that the other half believe they can withstand a revaluation of over 10%. Therefore, the 10% level of revaluation seems to be the dividing line for whether the effect on companies is serious or not.

Secondly, few companies at present have a correct estimation as to what level of revaluation would seriously affect their business operations. Regarding what makes the calculation in relation to a level of revaluation difficult, the comment has been made that, “depending on operations, the ratio of foreign currency used in sales, procurement, etc., varies greatly, so that any effect of revaluation may take a different shape according to each operation” (Transportation (excluding Automobiles)). Many other comments have also indicated the difficulty in keeping control over the foreign currency positions of business operations overall in China. Because a precise calculation is difficult, “we are going to consider

Column Table 6 Effect of Yuan Revaluation (multiple responses) (n=50)

Effect of Yuan Revaluation	Number of Respondent Companies
Rise in Export Prices from China (Decreased Competitiveness in the Export Market)	20
Increase in Local Cost in China (in Foreign Currency)	13
Rise in Export Prices from China (Rise in Intermediate Product Cost for Japan)	6
Increase in Yuan-denominated Liability (Reimbursement in Foreign Currency)	3
Others	7
Unavailable/Not sure	6

Column Table 7 Yuan Revaluation Level Causing Serious Effect on Own Operation (n=50)

Effect of Yuan Revaluation	Number of Respondent Companies
1%~10%	8
11%~20%	4
21%~30%	3
31%~40%	1
41% and over	1
Unavailable/Not sure	31

* Two companies did not respond.

31 Two companies did not respond.

various measures corresponding to assumed levels of revaluation of the Yuan” (Precision machinery-Assembled products). It is observed that each company’s strategy against revaluation is unavoidably ex-post under the current conditions.

From the above results of the additional survey, we may say that the reason why “revaluation of the Yuan” was cited as the “future China risk” by the largest proportion of the respondent companies in this year’s survey is that it reflected a series of anxieties and concerns, including: (i) advantages that China has as an exporting production base might deteriorate because of a decreased export competitiveness and a rise in local costs; (ii) the effect of revaluation on individual companies is unpredictable; and (iii) because the effect is unpredictable, it is difficult to come up with a set of precautionary measures to cope with different levels of revaluation.

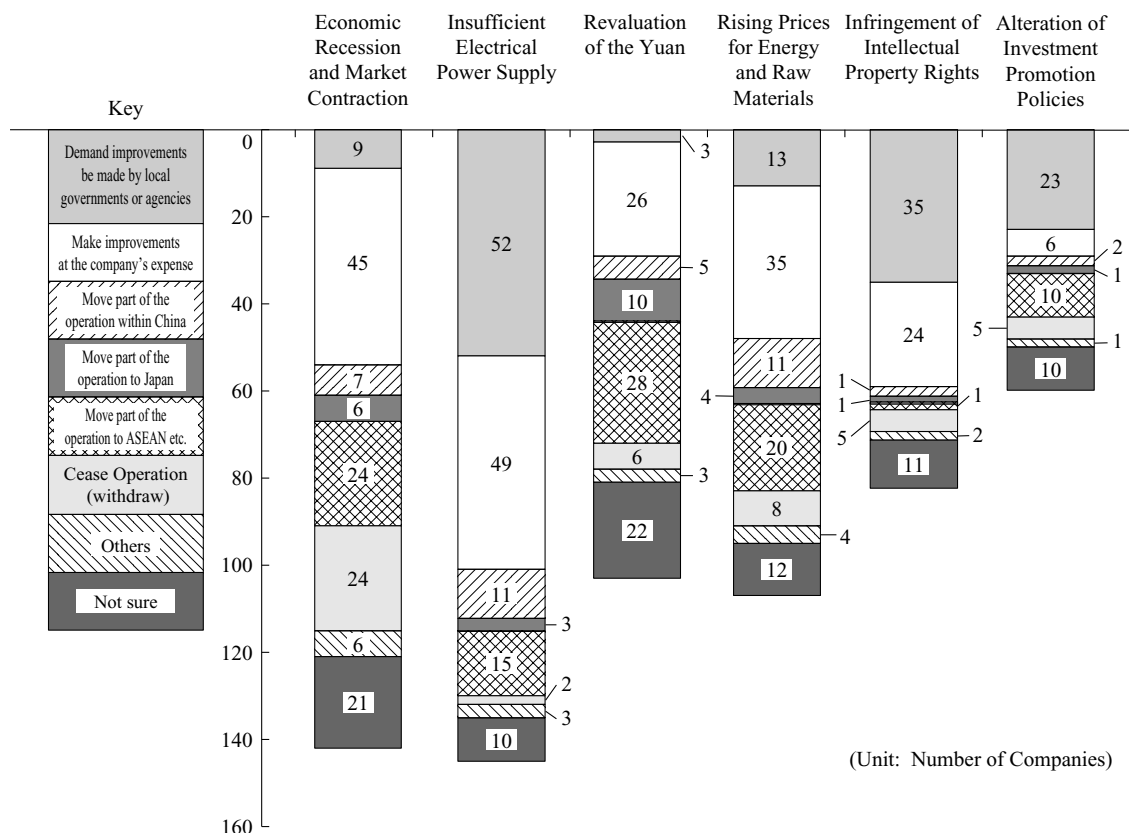
4. Countermeasures against China Risks

In this section, we will examine the countermeasures (on a “multiple responses” basis) that companies plan to take if the performance of their operation in China falls far short of initial plans due to the impact of the most serious risks.

As the measure by which to cope with “economic recession and market contraction,” “make improvements at the company’s expense” (45 companies) was the most common result (Figure 53). Against “insufficient electrical power supply,”

“demand improvements be made by local governments or agencies” (52 companies) and “make improvements at the company’s expense” (49 companies) also gained a high proportion of responses. Comments concerning countermeasures were obtained during company interviews. In the summer of 2004, when power supply shortage was an acute problem in Eastern and Southern China, “In Shanghai, we had to shift work days to holidays, one to two days a week” (Textiles), “We had a private generator brought in to cope with rolling blackouts” (Electrical equipment

Figure 53 Countermeasures against the Risks Viewed as Most Serious (multiple responses)



and electronics-Components).

As countermeasures against “economic recession and market contraction,” and against “revaluation of the Yuan,” a large proportion of responses indicated the companies’ intentions to relocate their business in China to other places: “move part of the operation to Japan,” and “move part of the operation to ASEAN or elsewhere outside China.” Also, against “economic recession and market contraction,” many companies responded: we will “cease the local operation (withdraw)” (24 companies). Evident here are companies’ intentions to take a broad array of

Chapter 9: Free Trade Agreement (FTA)

In recent years, FTAs (Free Trade Agreements) and EPAs (Economic Partnership Agreements) have come to include high-level content and not only trade liberalization, such as rules for investment, movement of personnel, intellectual property rights (IPR) and competition policies, and liberalizing a wide range of economic activities. In this survey, the above information of FTAs (hereinafter, the term “FTA” is used as including “EPA,” too) was introduced first, and then asked companies to detail their expectations of them.

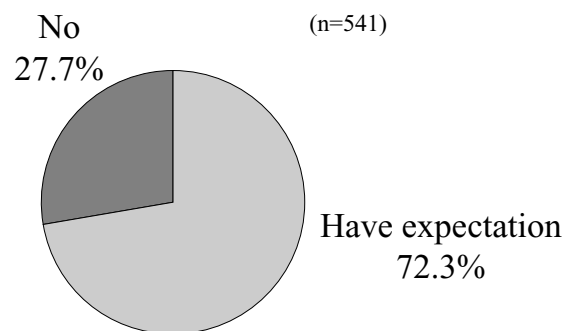
To begin with, companies who responded that they expect something of an FTA if Japan concludes one, amounted to 72.3% of all respondent companies (391 companies out of 541) (Figure 54). “FTA has a significant effect on the supply-side strategy of our overseas business operation, and so we are even reorganizing our overseas business unit inline with the development of FTA” (Automobiles-Assembled products). As represented by this comment, FTA already has considerable influence on companies’ overseas business operations and, the expectations and concerns for the contents of an FTA that each company has will surely grow. Options (“multiple responses” basis) were prepared to investigate in more detail what contents companies are expecting of an FTA in relation to China, Korea, and Thailand. The country for which companies expect the most from an FTA has been shown to be China (381 companies), followed by Thailand (236 companies) and Korea (179 companies) (Figure 55).

Among the specific contents, “expanded exports

countermeasures against perceived China risks, including even such drastic actions as withdrawal from China and relocation to a third country.

The countermeasures indicated above are merely some of the possible choices and are not certain to be used even if any assumed risk should actually occur. However, considering the great impact that any China risk could have, it is not enough only to discuss whether the risk may occur or not. It is important for each company to prepare in advance countermeasures to the various risks.

Figure 54 Expectations held for the Formation of FTA

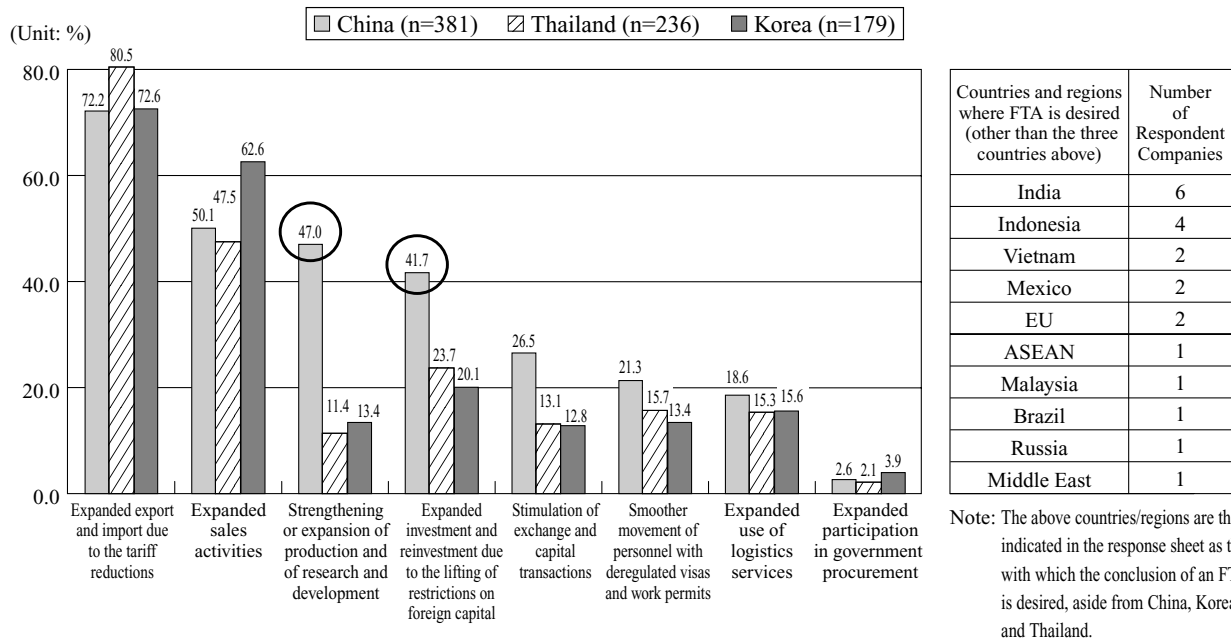


and imports due to the tariff reductions” obtained the largest vote for each of the three countries (China: 72.2%, Thailand: 80.5%, and Korea: 72.6%), signaling that calls are growing for enhanced trading activities through reduced tariffs.

On the other hand, a large number of responses addressed service sector items such as “expanded sales activities” (China: 50.1%, Thailand: 47.5%, Korea: 62.6%), and the “expanded investment and reinvestment due to the lifting of restrictions on foreign capital” (China: 41.7%, Thailand: 23.7%, Korea: 20.1%). For China, it is characteristic that the proportion of respondent companies who cited “strengthening or expansion of production, and of research and development, through the strong protection of intellectual property rights” (47.0%) and “expanded investment and reinvestment due to lifting of restrictions on foreign capital” (41.7%) is remarkably higher than for Thailand and Korea.

The above results show that many companies are expecting that a business environment much improved from what it is now will be realized by

Figure 55 Expectations from the Formation of FTA (multiple responses)



having wide-ranging contents, such as sales activities, research and development activities, and other activities relating to entire business operations, in addition to tariff measures, incorporated in an FTA.

Chapter 10: Reasons and Issues for Promising Countries/Regions for Future Overseas Business Operations

1. Promising Countries/Regions for Overseas Business Operations over the Medium Term

(1) Summary

We asked companies to name up to five countries/regions suitable for medium-term (next three years or so) business operations (respondent companies: 497). As a result, China and Thailand respectively retained their previous year's first and second placement in the order of preference. India, the previous year's fifth, moved up to third place this year, changing places with the U.S. which moved down two places to fifth (Table 24). Russia, which was tenth in the FY2003 survey has gone up to sixth place, and previously sixth placed Indonesia has gone down to seventh. Vietnam stays in fourth place, unchanged from the FY2003 survey but with a much increased number of votes (plus 22). This survey

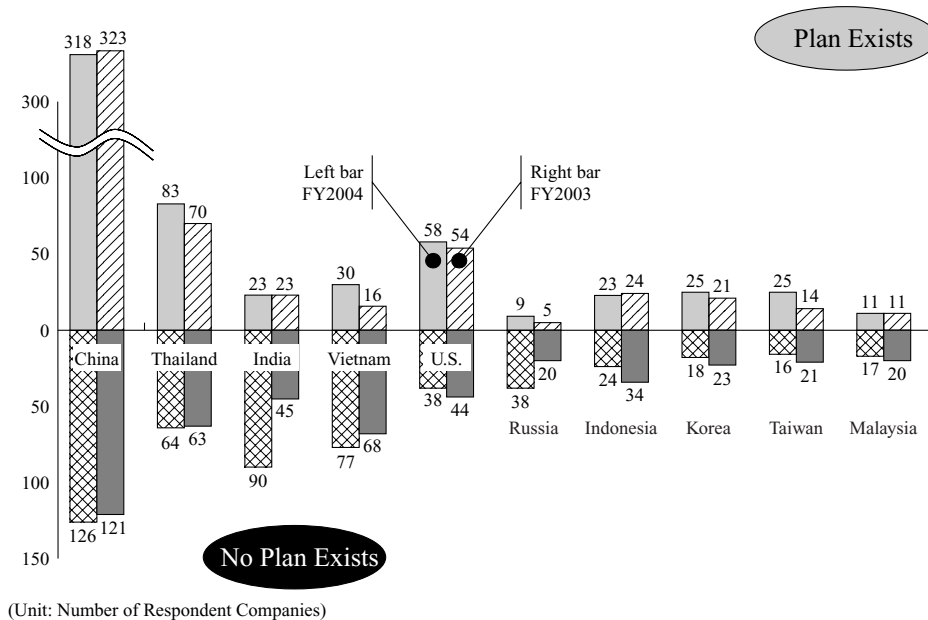
Table 24 Promising Countries/Regions for Overseas Business Operations over the Medium Term (next 3 years or so) (multiple responses)

Rank	FY2004 Survey	Number of Companies (Companies)	Response Rate (%)	FY2003 Survey	Number of Companies (Companies)	Response Rate (%)
1	China	453	91	China	456	93
2	Thailand	151	30	Thailand	143	29
3	India	117	24	U.S.	106	22
4	Vietnam	110	22	Vietnam	88	18
5	U.S.	100	20	India	70	14
6	Russia	49	10	Indonesia	63	13
7	Indonesia	48	10	Korea	44	9
8	Korea	44	9	Taiwan	35	7
9	Taiwan	41	8	Malaysia	31	6
10	Malaysia	28	6	Russia	25	5
11	Singapore	17	3	Singapore	23	5
12	Germany	17	3	Philippines	18	4
13	Brazil	16	3	Czech Republic	17	3
14	Philippines	15	3	Hong Kong	15	3
15	France	15	3	Mexico	12	2
16	Czech Republic	12	2	Brazil	11	2
17	Australia	11	2	Germany	11	2
18	Poland	10	2	France	10	2
19	Mexico	9	2	Australia	9	2
20	U.K.	9	2	Poland	9	2

Note 1: In this survey, respondent companies cited the top 5 countries that they saw as having promising prospects for business operations in the medium term (next 3 years or so). Tallies were calculated based on the number of companies that named each countries/regions and the above countries were listed according to that number.

Note 2: Besides the countries/regions shown in the list, some of the responses also named other countries/regions, such as North America and the EU. In this year's survey, North America was named by 44 companies (response rate: 8.9%), and the EU by 29 companies (5.8%).

Figure 56 Existence of Concrete Business Plans for Promising Countries/Regions



previous third place³². Chemicals rated U.S. highest (21.0%) among all industries. The ratio (21.0%) of Chemicals selected the U.S. as promising is 6.2 points higher than the said industry’s proportion (14.8%) among all respondent companies.

Among countries ranked sixth or lower, it is noticeable that Russia has jumped up to sixth place from the previous year’s tenth place. A breakdown by industry shows that the General machinery (24.5%) is the most enthusiastic. Because of Russia’s big advancement in the rankings, Indonesia, Korea, Taiwan, and Malaysia have been compelled to step down one rank each, and Indonesia has suffered most with a loss of 15 votes. Among the industries that regard Indonesia as promising, the Automobiles is at the top having a share of 29.2%, and outdistanced Chemicals and Electrical equipment and electronics which tie at 14.6% in second place. Electrical equipment and electronics in particular has reduced its selection by 7 votes (from the previous 14 votes) making it a large factor in Indonesia’s overall loss of votes.

(3) Existence of Concrete Business Plans

With regard to the countries/regions cited in responses as promising, we asked if the company has

concrete business plans in respective countries/regions. It is notable that for China, Thailand, and the U.S., the number of companies who have concrete business plans exceeds those who do not have such plans, but this situation is reversed for Vietnam, India, and Russia (Figure 56).

This means that though Vietnam, India, and Russia are rated in the upper ranks of promising countries, the number of companies who are ready with concrete business plans are limited and immediate realization of investment by those who have specified these countries as promising is still unlikely. In other words, only expectations for these countries are moving ahead. The number of companies who not only have cited India or Vietnam as promising but also are ready with concrete business plans is almost the same as for Indonesia, Korea, and Taiwan. The fact that India, Vietnam, and Russia are ranked high this time in no way allows an optimistic view that number of investments will start quite soon in these countries. However, from a different viewpoint, this may be considered as an important opportunity for these countries to try to improve the investment environment and to promote it.

32 The number of companies who stated their intention of setting up a new base: 2 companies for Brazil, 11 companies for Russia, 8 companies for India, and 122 companies for China (Appended Table 2).

2. Promising Destinations for Overseas Business Operations over the Medium Term, for Major Industries

When looking into the rankings of promising countries/regions by each of four major industries, it can be seen that China, Thailand, and India are considered promising by every industry (Table 26). Some notable points for each industry are as follows. For Chemicals, the U.S. is ranked relatively high, and for General machinery, India and Russia are highly placed. For Electrical equipment and electronics, Malaysia and Indonesia are ranked rather low, at eighth and tenth places respectively. For Automobiles, Indonesia is evaluated higher than Vietnam.

3. Promising Countries/Regions for Overseas Business Operations over the Medium Term- Reasons for Promising Prospect-

As for each promising country/region, we asked the reasons for promising prospect (multiple responses). For each of the top 10 countries, the “growth potential of the market” was cited as either the first or second reason, and in any of these countries, a good possibility of expanding local market for the company’s own products has been proved to be one of the most important factors for the promising prospect. The other of the top two reasons varied, depending on the particular nature of each country (Table 27. Also refer to Appended Table 5 for details.). One group consists of China, Thailand,

India, Vietnam, Russia, and Indonesia, for which “inexpensive labor force” can be cited as the other reason for being promising. Another group, for which the “present local market size” is cited as the other reason for being promising, consists of the U.S., Korea, and Taiwan. One exception is Malaysia, for which “stable political and social conditions” (38.5%) is the other reason cited for it being promising.

With reference to the top 10 promising countries/regions, we classified the reasons for their being promising into three areas, i.e. the production aspects, sales aspects, and infrastructure and systems, and examined as to which area of reasons is considered most important, as shown in Figure 57. This figure shows the composition ratios of three respective aspects after classifying the reasons for being promising into three aspects of production, sales, and infrastructure and systems. From the figure, it can be recognized that for Vietnam and Indonesia, the proportion of reasons on production aspects is high, while for Russia, expectations mainly come from the sales aspects. In the case of Russia, the second and third promising reasons are cited as “inexpensive labor force” and “excellent human resources,” both belonging to the production aspects, but the number of votes given to these reasons is much fewer as compared with other countries. This may be taken to indicate that the respondent companies are not yet absolutely sure that production in Russia is advantageous.

For the top 5 countries, the reasons for which these countries are judged promising have been

Table 26 Top 10 Promising Countries/Regions selected by 4 Major Industries (multiple responses)

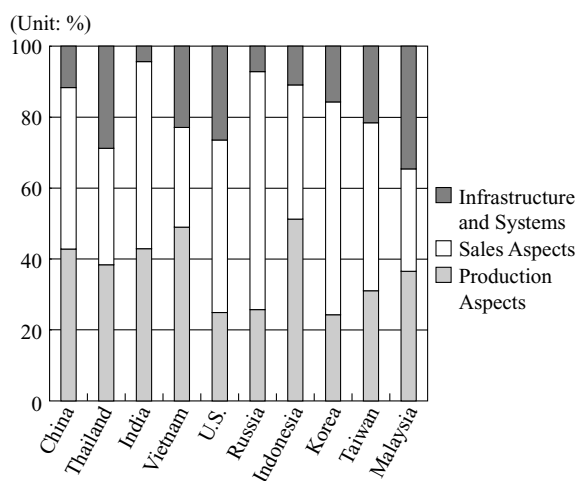
Chemicals (76 companies)				General machinery (56 companies)				Electrical equipment and electronics (91 companies)				Automobiles (82 companies)			
Rank	Country	Number of Respondent Companies	Composition Ratio	Rank	Country	Number of Respondent Companies	Composition Ratio	Rank	Country	Number of Respondent Companies	Composition Ratio	Rank	Country	Number of Respondent Companies	Composition Ratio
1	China	68	89.5%	1	China	50	89.3%	1	China	88	96.7%	1	China	73	89.0%
2	Thailand	22	28.9%	2	India	22	39.3%	2	Thailand	30	33.0%	2	Thailand	32	39.0%
3	U.S.	21	27.6%	3	Thailand	16	28.6%	3	Vietnam	24	26.4%	3	India	23	28.0%
4	India	18	23.7%	4	Vietnam	14	25.0%	4	U.S.	20	22.0%	4	U.S.	15	18.3%
5	Vietnam	13	17.1%	4	Russia	12	21.4%	5	India	18	19.8%	5	Indonesia	14	17.1%
6	Taiwan	12	15.8%	6	U.S.	10	17.9%	6	Korea	11	12.1%	6	Vietnam	12	14.6%
7	Korea	9	11.8%	7	Korea	6	10.7%	6	Taiwan	11	12.1%	7	Russia	10	12.2%
8	Indonesia	7	9.2%	7	Indonesia	6	10.7%	8	Russia	8	8.8%	8	Brazil	5	6.1%
9	Russia	5	6.6%	9	Taiwan	4	7.1%	8	Malaysia	8	8.8%	8	South Africa	5	6.1%
10	Singapore	4	5.3%	9	Germany	4	7.1%	10	Indonesia	7	7.7%	10	Mexico	4	4.9%
				9	Czech Republic	4	7.1%					10	Czech Republic	4	4.9%
												10	Turkey	4	4.9%

Table 27 Main Reasons for Selection of the Top Ten Most Promising Countries/Regions

<p>1. China (448 companies)</p> <p>(1) Growth potential of the market 83.3%</p> <p>(2) Inexpensive labor force 66.1%</p> <p>(3) Supply base for assembly manufacturers 28.6%</p>	<p>2. Thailand (146 companies)</p> <p>(1) Growth potential of the market 56.8%</p> <p>(2) Inexpensive labor force 49.3%</p> <p>(3) Stable political and social conditions 39.7%</p>	<p>3. India (112 companies)</p> <p>(1) Growth potential of the market 82.1%</p> <p>(2) Inexpensive labor force 56.3%</p> <p>(3) Excellent human resources 37.9%</p>
<p>4. Vietnam (108 companies)</p> <p>(1) Inexpensive labor force 75.9%</p> <p>(2) Growth potential of the market 48.1%</p> <p>(3) Excellent human resources 35.2%</p>	<p>5. U.S. (98 companies)</p> <p>(1) Present local market size 66.3%</p> <p>(2) Growth potential of the market 49.0%</p> <p>(3) Developed local infrastructure 38.8%</p>	<p>6. Russia (49 companies)</p> <p>(1) Growth potential of the market 95.9%</p> <p>(2) Inexpensive labor force 18.4%</p> <p>(3) Excellent human resources 14.3%</p>
<p>7. Indonesia (45 companies)</p> <p>(1) Inexpensive labor force 68.9%</p> <p>(2) Growth potential of the market 62.2%</p> <p>(3) Base for export to the third countries 26.7%</p>	<p>8. Korea (44 companies)</p> <p>(1) Growth potential of the market 63.6%</p> <p>(2) Present local market size 56.8%</p> <p>(3) Excellent human resources 18.2%</p> <p>(3) Developed local infrastructure 18.2%</p>	<p>9. Taiwan (41 companies)</p> <p>(1) Growth potential of the market 58.5%</p> <p>(2) Present local market size 46.3%</p> <p>(3) Developed local infrastructure 29.3%</p>
<p>10. Malaysia (26 companies)</p> <p>(1) Stable political and social conditions 38.5%</p> <p>(2) Growth potential of the market 30.8%</p> <p>(3) Inexpensive labor force 26.9%</p> <p>(3) Developed local infrastructure 26.9%</p>		

Note: Figures in parentheses are numbers of responding companies.

Figure 57 Reasons Why Each Country is Viewed as Promising



examined. For China, expectations are high in the sales aspects as represented by such reasons as the “growth potential of the local market” (83.3%), and the “present local market size” (23.9%), but expectations in the production aspects are equally high as shown by the reasons of “inexpensive labor force” (66.1%), “supply base for assembly manufacturers” (28.6%), “low-cost parts and raw materials” (21.4%), and “base for export to the third countries” (20.8%). Particularly, the expectations of

China as a “supply base for assembly manufacturers” is high, second only to Thailand and with an actual number of votes amounting to 128 companies. This is noticeable, as it is indicative of China’s potential for parts makers to follow the assemblers and pave the way for industrial accumulation to grow further in future. On the other hand, there were many comments that imply the existence of competition with local enterprises, along with the progress of industrial accumulation, such as, “we consider China as our main source of overseas procurement. We start with buying parts from Japanese-related companies but after that are willing to increase procurement from local enterprises” (Electrical equipment and electronics), “the technical level of the local parts makers has been much improved lately. Our present stance is to take compartmentalization in production” (Automobiles). For Thailand, expectation in the sales aspect such as the “growth potential of the local market” (56.8%) is not small, but that in the production aspects is also high as shown by “inexpensive labor force” (49.3%), “supply base for assembly manufacturers” (30.1%), “base for export to the third countries” (27.4%), and “industrial cluster” (23.3%). Such reasons as those of “supply base for assembly manufacturers,” and “industrial cluster,” are

cited by relatively many companies, showing that not only the low cost but also the effect of industrial accumulation as required for a production base is contributing to the high evaluation of Thailand. Furthermore, as evidenced by the citing of “stable political and social conditions” (39.7%) and “developed local infrastructure” (25.3%), the evaluation for Thailand is also high in the basic infrastructure and systems required for attracting foreign capital. Centering on the automobile industry, a high evaluation has been voiced in the interviews: “local suppliers are reliable. If any part is unobtainable in other ASEAN countries, in Thailand you will often know where to find it” (Automobiles), “labor troubles being few, you have a feeling of security” (Automobiles).

For India, concentration is very high in the top three reasons: the “growth potential of the local market” (82.1%), “inexpensive labor force” (56.3%), and “excellent human resources” (36.6%). As compared to this appreciation of human resources, however, evaluation is low regarding reasons directly relating to production strategy, such as “supply base for assembly manufacturers,” and “bases for export for the third countries.” Evaluation concerning the infrastructure and systems is also low. It was often emphasized in the interviews that the future potential of India is worth investment, but not many companies are yet ready with concrete investing plans. In order to inspire these companies to actual investment, this country will probably be required to broadly upgrade its merits as a business base. Comments in the interview like “it is a promising market in the sense it has a large population with a sufficient middle class, but cities are scattered so that business operations may not be easy” (Textiles), “different marketing approach is necessary by states, or by north or south regions. Just one marketing entity is not enough to cover the entire land” (Electrical equipment and electronics) have pointed out that though it is a promising and attractive market, its infrastructure still needs further development in order for the whole country to become integrated, single market.

Regarding Vietnam, the “growth potential of the market” (48.1%) remains rather small among the upper-ranking developing countries, but the country is highly appreciated in the aspects of production as

shown by: “inexpensive labor force” (75.9%), “excellent human resources” (35.2%), “risk diversification” (25.0%), “base for export to the third countries” (20.4%), and “base for exports to Japan” (18.5%). It is notable that the position of Vietnam as an export base is rated very close to that of the preceding China and Thailand, and that the country is also highly evaluated as a receiver of a part risk diversified from production concentration in other countries. In the interviews with respondent companies, it was learned that though studies were made as to which location was most advantageous production base among Vietnam, China, and other ASEAN countries, investment decisions based on the study result vary between companies without any clear tendency. What is clear from this is that, although Vietnam is gaining from some companies a certain rating as a production base, it is still in competition with China, Thailand, and Indonesia.

As an already mature market, expectations of the U.S. are mainly in connection with local sales, such as the “present local market size” (66.3%), and the “growth potential of the local market” (49.0%). However, expectations of the U.S. as a production base are rather limited compared to other countries/regions. “The American customer company or the consignee has shifted their production to Asia, leaving us without a customer.” This is a comment received from an electrical equipment and electronics parts manufacturer who has been operating a production base in the U.S.

Among other countries, some notable points are that Russia is promising because of the virtually unique reason of the “growth potential of the market” (95.9%), and that Malaysia has no reason assigned a share of more than 50%, apparently reflecting the absence of positive inducement for Japanese companies to invest.

4. Promising Countries/Regions for Overseas Business Operations over the Medium Term-Issues of Promising Countries/Regions-

The companies who responded regarding promising countries/regions were also asked a question (multiple responses) about the issues of these countries/regions (Table 28; refer to Appended Table

Table 28 Main Issues for the Top Ten Most Promising Countries/Regions

<p>1. China (423 companies)</p> <p>(1) Unclear operation of legal system 63.4%</p> <p>(2) Insufficient protection of intellectual property rights 52.0%</p> <p>(3) Difficulty in collecting receivables 42.8%</p>	<p>2. Thailand (102 companies)</p> <p>(1) Intense local competition 45.1%</p> <p>(2) Increase in labor costs 40.2%</p> <p>(3) Difficulty in securing local managers 27.5%</p>	<p>3. India (95 companies)</p> <p>(1) Under-development of infrastructure 43.2%</p> <p>(2) Insufficient information on investment climate 34.7%</p> <p>(3) Instability of security and social conditions 33.3%</p>
<p>4. Vietnam (82 companies)</p> <p>(1) Under-development of legal system 40.2%</p> <p>(2) Unclear operation of legal system 36.6%</p> <p>(3) Under-development of infrastructure 32.9%</p>	<p>5. U.S. (74 companies)</p> <p>(1) Intense local competition 68.9%</p> <p>(2) Increase in labor costs 32.4%</p> <p>(3) Local labor problems 23.0%</p>	<p>6. Russia (42 companies)</p> <p>(1) Instability of security and social conditions 45.2%</p> <p>(2) Insufficient information on investment climate 42.9%</p> <p>(3) Under-development of legal system 38.1%</p>
<p>7. Indonesia (38 companies)</p> <p>(1) Instability of security and social conditions 57.9%</p> <p>(2) Intense local competition 31.6%</p> <p>(3) Difficulty in securing local managers 28.9%</p>	<p>8. Korea (28 companies)</p> <p>(1) Intense local competition 64.3%</p> <p>(2) Local labor problems 42.9%</p> <p>(3) Increase in labor costs 32.1%</p>	<p>9. Taiwan (27 companies)</p> <p>(1) Intense local competition 66.7%</p> <p>(2) Increase in labor costs 40.7%</p> <p>(3) Insufficient protection of intellectual property rights 18.5%</p> <p>(3) Increase in tax burden 18.5%</p>
<p>10. Malaysia (18 companies)</p> <p>(1) Increase in labor costs 55.6%</p> <p>(2) Intense local competition 22.2%</p>		

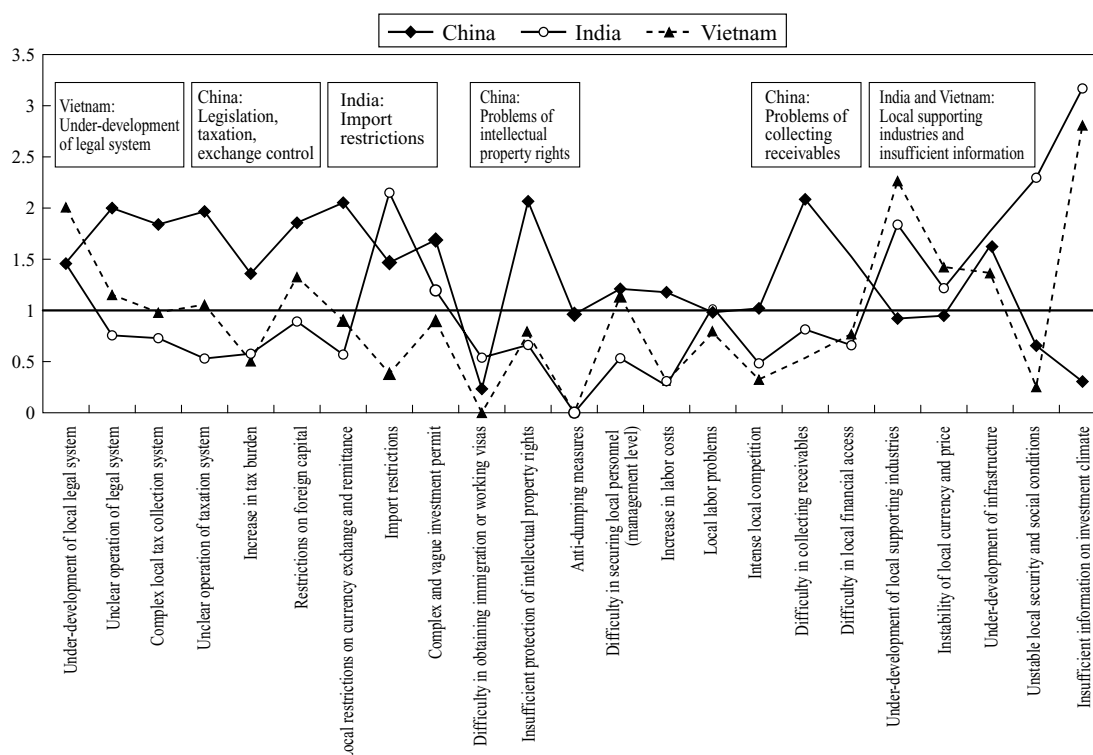
Note: Figures in parentheses are numbers of responding companies.

6 for details.). Of the top 10 countries/regions, “intense local competition” is cited as the major problem in Thailand, the U.S., Korea, and Taiwan.

Unlike systems or infrastructure, among the alternatives of issues, “intense local competition” is not a matter directly responsible to recipient

countries/regions, but generally, a matter companies will face in the matured market. However, it was pointed out that China, India, Vietnam, and Russia have many problems in various areas such as legislation, intellectual property rights, underdeveloped infrastructure, public security and

Figure 58 Issues Characteristically Indicated for China, India, and Vietnam



Note: Assuming the all-country average ratio of citing each problem as “1,” the figure is designed to show whether the average ratio of citing of any problem for a specified country is above the all-country average (larger than “1”) or below the average (smaller than “1”). (multiple responses)

social situations, insufficient information on investment climate, and so forth, that can be improved by the efforts of the local governments.

Figure 58 shows problems pointed out in particular in China, India, and Vietnam in an easy-to-see format. Assuming the all-country average ratio of citing each problem as “1,” the figure is designed to show whether the average ratio of citing of any problem for a specified country is above the all-country average (larger than “1”) or below the average (smaller than “1”).

For China, the following problems relating to legislation, taxation, and foreign exchange control have been pointed out. “Unclear operation of legal system” (63.4%), “local restrictions on currency exchange and remittance” (41.6%), “tax collection systems” (38.5%), “restrictions on foreign capital” (32.4%), and also, “insufficient protection of intellectual property rights” (52.0%), “difficulty in collecting receivables” (42.8%), and so forth. These problems have been pointed out at a higher rate as compared to other countries/regions. Further, personnel problems such as “difficulty in securing local personnel (management level)” (28.4%), “increase in labor costs” (32.4%), and so on, and infrastructure such as “under-development of infrastructure” (39.2%), etc., were not negligible. Still more, “intense local competition” (41.8%) was cited by many. Consequently, China’s average number of issues pointed out per company, which is 5.7 problems per company; is the largest number among all countries. Though China is regarded as the most promising country, it is also the country with an overwhelmingly heavy volume of problems. Thus, China is indeed in a unique situation.

For India, such problems have been pointed out as “under-development of infrastructure” (43.2%), “insufficient information on investment climate” (34.7%), and “unstable local security and social conditions” (33.7%). It is characteristic of India that problems which can be improved directly by the local government have been pointed out at a high rate. Comparison with other countries/regions shows that the rate of pointing out such problems as “import restrictions” (13.7%) and “under-development of local supporting industries” (20.0%) is relatively high. India has a very high proportion of companies that do

not yet have any concrete investment plans (77%), and “insufficient information on investment climate” is cited at a high rate, which give us the implication that as each company expands their overseas operations in India, more problems may come to light based on actual experiences.

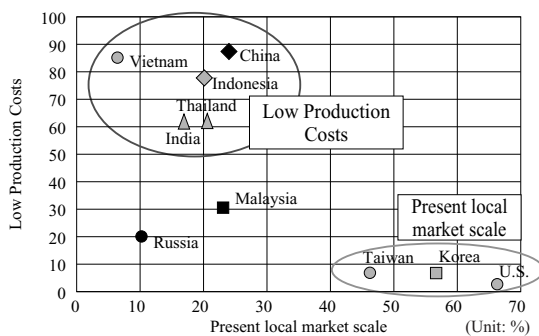
For Vietnam, “under-development of local legal system” (40.2%) and “unclear operation of legal system” (36.6%) occupy first and second places, and “restrictions on foreign capital” (23.2%), and “unclear operation of taxation system” (20.7%) have also been pointed out by many companies. This demonstrates companies’ feelings that the country has problems in legislation, taxation, and so forth. “Under-development of infrastructure” (32.9%) has also been pointed out by many. Comparison with other countries/regions indicates that besides the legislative aspect, “under-development of local supporting industries” (24.4%) and “insufficient information on investment climate” (30.5%) are pointed out at a high rate. It is also characteristic of Vietnam that there are many issues which the government can use its influence directly to improve, such as legislation and the taxation system.

For Thailand, following “intense local competition” (45.1%), the “increase in labor costs” (40.2%) and “difficulty in securing local personnel (management level)” (27.5%), both being human resources problems, have been indicated. This draws attention, since it might possibly hinder the advantage in the production aspect currently held by this country. As for Russia, “unstable local security and social conditions” (45.2%), “insufficient information on investment climate” (42.9%), “under-development of local legal system” (38.1%), and “unclear operation of legal system” (35.7%), have been cited. As similar to Vietnam, there seems to be a large scope for the government to use its influence so as to improve the business environment.

<Column 9> Incentives and Issues of Investment Destination in Major Countries/Regions

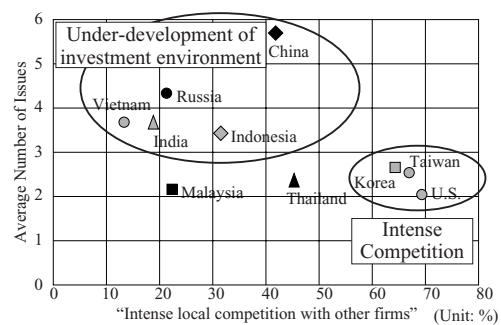
Column Figures 13 and 14 show the investment-related incentives and problems from the viewpoint of companies. Column Figure 13 shows the proportions of “low production costs” and “present local market size” chosen by the companies as the reason for each of the countries/regions as promising by arranging respective reasons along the longitudinal axis and the horizontal axis. The “low production costs” means a total of “inexpensive labor force” and “low-cost parts and raw materials.” It can be seen from this figure that the countries/regions are divided into two groups by the incentive items, one group, which is

Column Figure 13 Incentives for Corporate Investment



Note: The proportions naming “inexpensive labor force” and “low-cost parts and raw materials” as reasons for promise have been combined as “low production costs.”

Column Figure 14 Issues for Corporate Investment



Note: Average Number of Issues: Average number of issues indicated per country.

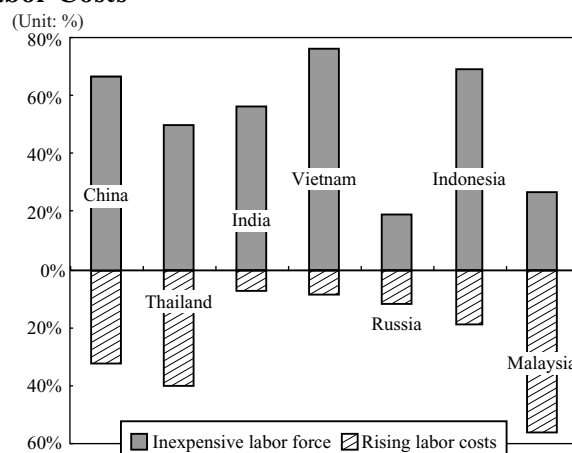
attractive for the low production costs, and the other is for the current scale of the market. The former group includes China, Thailand, India, Vietnam and Indonesia, and the latter group includes the U.S., Korea, and Taiwan. In Column Figure 14, the longitudinal axis indicates the average of the number of issues pointed out by respective companies, and the horizontal axis indicates the proportions of “intense local competition” chosen for respective countries/regions. If the average number of issues is larger, it means the investment environment is still underdeveloped. “Intense local competition” itself is not directly connected with the investment environment development for which the government should be responsible, but is more the result of the market having matured. Therefore, as any developing country makes economic progress, normally its position on this figure is expected to move toward the lower-right zone. China, India, Vietnam, Russia, and Indonesia are included in the countries/regions which have many problems of underdeveloped investment environment from the viewpoint of a company that makes actual investment, and the U.S., Korea, and Taiwan are included in the countries/regions which have severe competition with rivals as a problem.

These two figures are suggestive in various ways. Some examination may be made on China, Thailand, and Malaysia, mainly in terms of their competitiveness as a production base. As in the last fiscal year, China is again positioned at the top with the highest average number of issues among the top 10 countries. While this means China has enormous problems in point of the investment environment, it also has the largest number within the group in regard to severe competition with rivals. Worse still, the proportion pointing out this problem of competition with rival companies has been increasing year after year, from 20.1% in 2000 to 41.8% in the present survey. For Japanese companies, China is still heavily loaded with problems in the investment environment, and besides, competition with rival companies seems to be intensifying. China is considered to be an investment destination where it is highly possible that investors will be faced with various problems. Normally, as a country’s economy makes progress,

the investment environment will be improved with problems decreasing in number. By that much, however, the market will mature and the competition is likely to become fierce (This means a position in Column Figure 13 will move from upper-left to lower-right.). In the case of China, however, it is characteristic that many problems remain in relation to the investment environment (in the figure, the position stays high) and yet competition is intensifying (in Column Figure 14, the position shifts from left to right). As incentives for investment, the growth potential of the market as well as low production cost are highly evaluated, but on the other hand, as shown in Column Figure 15, the proportion pointing out “increase in labor costs” has been steeply increasing from 16.2% in 2000 to 32.4% in 2004. Even though China is certainly attractive as a sales market with growth potential, its advantage as a future production base will have to be ascertained after making sure of the currency exchange trend and the existing cost problems. In the interviews, concerns have been expressed about the rising labor costs in the southern and eastern regions.

Among the countries where low production cost is attractive, Thailand has a slightly high rate of severe competition being cited, but it has the smallest average number of issues. As compared to other countries/regions, its profitability evaluation is quite high, and the companies’ inclination to strengthen or expand operations is also strong. Therefore, its overall balance as a destination of investment is considered to be worth high evaluation. However, even for Thailand, concern about the rise of labor cost is strongly pointed out, and careful attention is required to how far into the future the country can keep its advantage in production costs. What is common to China and Thailand is the high ratio of “low-cost parts and raw materials” in the low production costs. As compared to other countries in the same group, the industrial cluster including group companies and local makers is relatively large that it may be adding a positive effect to cost control. In the interviews, a high evaluation has been particularly accorded to Thailand: “accumulation of parts makers is so dense we can get parts of equal quality locally. Both raw materials cost and production cost are the lowest there” (Automobiles). In Malaysia, the problem relating to investment environment is relatively small, but it has another problem that it does not have incentives for investment that are both positive and remarkable. The reasons why Malaysia is promising are pointed out as follows. “Stable political and social conditions” (38.5%), “growth potential of the market” (30.8%), “inexpensive labor force” (26.9%), “developed local infrastructure” (26.9%). These are the top-ranking reasons. “Stable political and social conditions” and a “developed infrastructure” represent the very basic level of investment environment being provided, but these promising aspects of Malaysia are rather weak compared with other countries/regions, as incentives to

Column Figure 15 The Appeal of the Inexpensive Labor Force and Concern over Rising Labor Costs



Note: The proportion indicating “inexpensive labor force” as a reason for promise is on the upper level and the proportion indicating “rising labor cost” is on the lower level.

induce companies to decide on investment. “Growth potential of the market” and “inexpensive labor force” are also cited for other country/region, but the ratio of these reasons is rather less for Malaysia. In the interviews, rather severe opinions concerning its possibilities as a production base were heard, such as “the cost is higher in Malaysia than in Thailand. It will be very hard to run an export base here” (Electrical equipment and electronics). Figure 29 “Prospects of Overseas Business Operations” also shows that the companies’ willingness to expand their operations in Malaysia is lower than in China or Thailand.

5. Promising Countries/Regions for Overseas Business Operations over the Long Term

This year’s survey concerning the promising countries/regions for overseas business operations over the long term (next ten years or so), compared with the FY2003 survey, can be characterized that with regard to changes in ranking, the U.S. has gone down from the previous third to fifth, Thailand and Vietnam have gone up one step respectively to third and the fourth, and that Brazil has gone up by one step to eighth overtaking Korea (Table 29). As to the number of votes, India (from the previous 123 votes to 164 votes this time), Russia (from 43 votes to 82 votes), and Brazil (from 23 votes to 37 votes) have increased their vote with their spacious lands and large populations being appreciated as suitable for long-term promising countries.

In the voting for long-term promising

countries/regions, there seems to be a general inclination to place more weight on future growth potential than the possibility of realizing the business operation. Of the BRICs countries which have a vast potential market, all countries other than China have so far received rather low attention from Japanese companies, but they now appear to have gained better evaluation as long-term promising countries/regions. In the long-term view, Brazil has entered the top ranks (as a medium-term promising country, it is ranked in thirteenth place), while Malaysia has conversely dropped out of the top 10 of the long-term rankings.

The vote obtained by Brazil as a long-term promising country can be analyzed by industries: 32.4% by Automobiles, 18.9% by Electrical equipment and electronics, 10.8% by Chemicals, and 10.8% by General machinery.

Table 29 Promising Countries/Regions for Overseas Business Operations over the Long Term (multiple responses)

Rank	FY2004 Survey	Number of Companies 403	Response Rate (%)	FY2003 Survey	Number of Companies 407	Response Rate (%)	FY2002 Survey	Number of Companies 344	Response Rate (%)	FY2001 Survey	Number of Companies 318	Response Rate (%)	FY2000 Survey	Number of Companies 267	Response Rate (%)
1	China	341	85	China	356	87	China	306	89	China	274	86	China	188	70
2	India	164	41	India	123	30	U.S.	92	27	India	88	28	U.S.	102	38
3	Thailand	87	22	U.S.	88	22	India	89	26	U.S.	80	25	India	60	22
4	Vietnam	84	21	Thailand	84	21	Vietnam	70	20	Thailand	59	19	Thailand	55	21
5	U.S.	82	20	Vietnam	83	20	Thailand	56	16	Vietnam	46	14	Indonesia	37	14
6	Russia	82	20	Russia	43	11	Indonesia	49	14	Indonesia	43	14	Vietnam	37	14
7	Indonesia	39	10	Indonesia	39	10	Brazil	28	8	Brazil	25	8	Malaysia	26	10
8	Brazil	37	9	Korea	24	6	Russia	27	8	Taiwan	22	7	Brazil	24	9
9	Korea	28	7	Brazil	23	6	Malaysia	20	6	Malaysia	20	6	U.K.	23	9
10	Taiwan	17	4	Malaysia	17	4	Korea	15	4	Korea	17	5	Taiwan	22	8
							Germany	15	4	Philippines	17	5			

<Column 10> Difference in Recognition of Investment Environment Affected by Existence or Absence of Local Base

Is there any difference in recognition of the investment environment of each country between the headquarters in Japan and the local bases? This survey obtained responses from the Japan-based staffs

in charge of management of overseas operations (hereinafter called “Headquarters”) and shows their views. As a way of verifying the aforesaid question, we classify the responses for the sake of comparison into those from companies having local bases and those from companies without local bases.

From the survey data concerning the promising countries/regions for medium-term overseas business operations, the responses of the companies who pointed out China, Thailand, India, Vietnam and Indonesia as promising have been extracted and classified according to whether the company has a local base or not (Breakdown is shown in the table below.). For comparison, the following two methods are used. One method is to compare the upper-ranked problems pointed out by the companies with local bases against those of companies without local bases (Upper-rank Problems Analysis). If there is a distinct difference between the two groups, it means that recognition of the problems of the investment environments in the promising countries/regions is different according to whether the respondent has a local base or not. The other method is to compare the problems for which the cited ratio shows a considerable difference depending on whether the companies are with or without local bases (Ratio Differential Analysis). The merit of this analysis is that any problem of too small a proportion of responses can still be analyzed for any difference in recognition of the problem due to whether a local base is present or absent.

Column Table 8 Ratio of Number of Companies Having a Local Base in the Total Number of Companies Who Pointed Out Issues of Promising Countries

	Number of Companies Who Pointed out Issues of Promising Countries	Of which: Number of Companies Having a Local Base	Ratio
China	423	358	84.6%
Thailand	102	75	73.5%
India	95	29	30.5%
Vietnam	82	18	22.0%
Indonesia	38	27	71.1%

(1) Analysis of Upper-ranked Problems

Column Table 9 Difference in Upper-ranked Problems According to Whether Local Base is Present or Not, for Major Countries

China

With Local Base (358 companies)	Number of Companies	%	Without Local Base (65 companies)	Number of Companies	%
Unclear operation of local legal system	233	65.1%	Unclear operation of local legal system	35	53.8%
Insufficient local protection of intellectual property rights	188	52.5%	Insufficient local protection of intellectual property rights	32	49.2%
Local restrictions on currency exchange and remittance	159	44.4%	Intense local competition with other firms	29	44.6%

Thailand

With Local Base (75 companies)	Number of Companies	%	Without Local Base (27 companies)	Number of Companies	%
Intense local competition with other firms	33	44.0%	Intense local competition with other firms	13	48.1%
Increase in local labor cost	32	42.7%	Increase in local labor cost	9	33.3%
Difficulty in securing personnel (management level)	20	26.7%	Difficulty in securing personnel (management level)	8	29.6%

India

With Local Base (29 companies)	Number of Companies	%	Without Local Base (66 companies)	Number of Companies	%
Under-development of local infrastructure	9	31.0%	Under-development of local infrastructure	32	48.5%
Unstable local security and social conditions	9	31.0%	Insufficient information on investment climate	29	43.9%
Under-development of local legal system, etc. (3 problems)	8	27.6%	Unstable local security and social conditions	23	34.8%

Vietnam

With Local Base (18 companies)	Number of Companies	%	Without Local Base (64 companies)	Number of Companies	%
Under-development of local legal system	8	44.4%	Under-development of local legal system	25	39.1%
Restrictions on foreign capital	8	44.4%	Unclear operation of local legal system	23	35.9%
Unclear operation of local legal system, etc. (2 problems)	7	38.9%	Insufficient information on investment climate	23	35.9%

Indonesia

With Local Base (27 companies)	Number of Companies	%	Without Local Base (11 companies)	Number of Companies	%
Unstable local security and social conditions	13	48.1%	Unstable local security and social conditions	9	81.8%
Intense local competition with other firms	10	37.0%	Unclear operation of local taxation system	4	36.4%
Instability of local currency and price, etc. (2 problems)	8	29.6%	Under-development of local infrastructure	4	36.4%

The above table shows the top 3 issues on the local investment environment pointed out respectively by companies with a local base and those without a local base (items common to both are shaded). Though there is some difference between the two, the top issue is common to both. Particularly for countries that have collected many responses, the top-ranking issues are mostly common and do not generally present much difference. This is probably because of the following situation. In those countries/regions regarded as promising and interesting, even a company not having a local base can obtain necessary information through their marketing activities, via liaison representatives, and by other general means of collecting information. Therefore, whether or not they have a local base themselves does not cause much difference in their recognition, and it can be assumed that they are well versed in the major important issues. However, for those countries, like India and Vietnam, for which many votes were polled by companies not having their own local base, it is quite natural that insufficient information on investment climate is highly ranked as a problem by the voting companies. For those countries, companies without a local base should feel relatively uneasy with the limited accessible information, and whatever they may understand as recognition of the problem would have to be properly considered.

(2) Ratio Differential Analysis**Column Table 10 Issues for Which Large Difference in Proportion of Recognition is Observed Depending on Whether Company Has Local Base or Not****China**

High proportion of recognition by company with local base	Difference (%)	High proportion of recognition by company without local base	Difference (%)
Local restrictions on currency exchange and remittance	18.3%	Local labor problems	12.9%
Increase in local tax burden	17.7%	Instability of local currency and price	11.3%
Unclear operation of local legal system	11.2%	Difficulty in local financial access	6.7%

Thailand

High proportion of recognition by company with local base	Difference (%)	High proportion of recognition by company without local base	Difference (%)
Complex local tax collection systems	10.7%	Under-development of local infrastructure	23.3%
Increase in local labor cost	9.3%	Unclear operation of local legal system	14.5%
Increase in local tax burden	7.6%	Under-development of local supporting industries	12.1%

India

High proportion of recognition by company with local base	Difference (%)	High proportion of recognition by company without local base	Difference (%)
Local restrictions on currency exchange and remittance	23.0%	Insufficient information on investment climate	30.1%
Local import restrictions	15.0%	Under-development of local infrastructure	17.5%
Unclear operation of local taxation system	14.6%	Difficulty in collecting receivables	9.4%

Vietnam

High proportion of recognition by company with local base	Difference (%)	High proportion of recognition by company without local base	Difference (%)
Restrictions on foreign capital	27.3%	Insufficient information on investment climate	24.8%
Increase in local labor cost	17.5%	Difficulty in local financial access	6.3%
Unclear operation of local taxation system	16.1%	Unstable local security and social conditions	4.7%

Indonesia

High proportion of recognition by company with local base	Difference (%)	High proportion of recognition by company without local base	Difference (%)
Instability of local currency and price	20.5%	Unstable local security and social conditions	33.7%
Intense local competition with other firm	18.9%	Under-development of local infrastructure	21.5%
Local labor problems	16.8%	Unclear operation of local taxation system	17.8%

The left column of the above table shows the issues for which the proportion of citing by companies with local bases is greater than the proportion of citing by companies without a local base, and the right column is the other way around.

Therefore, the former may be taken as a “warning” from the companies that have a local base to the

companies that have no local base yet, and the latter may be taken as the problems that, after the start of an operation, could be easier to cope with than had been expected.

As a result, the former case is characterized by abundance of citations of problems relating to systems, such as legislation, taxation, and exchange control. When actual operation is started locally, various problems relating to systems are expected to hinder the daily business³³. On the other hand, in the latter case, such matters as “under-development of infrastructure,” “insufficient information on investment climate,” “difficulty in local financial access,” and “unstable local security and social conditions” are pointed out for various countries. Relatively speaking, the issues cited by the group of companies without a local base who pointed out the highest proportion are problems rarely pointed out by companies that have a local base. Generally, when a local base is actually set up, these problems can be coped with comparatively easily by taking advantage of locally available information, choosing a proper location for the base, and by their own efforts. It is self-apparent that the problem of “insufficient information on investment climate” will be solved gradually once local activity is started. “Under-development of infrastructure” and “unstable local security and social conditions” will also be possible to alleviate or cope with to some extent by getting into a well-equipped industrial park, purchasing a private generator, and taking thorough measures for safety and security including access to local security information.

With regard to these problems, it will be very effective if actual examples of success in solving problems experienced by other companies³⁴ can be learnt in the course of studying investment plans. “Headquarters is worried about the local security and social situations more than is necessary,” is often heard from the local affiliate. This is not without justification. Issues relating to local security and social situations are inclined to be pointed out often by companies who do not have a local base. But this does not mean there is no problem. It is definitely important for companies to acquire correct information about the target location, and also necessary to make further efforts in choosing the best location for the base, taking thorough measures for safety, and strengthening collection of safety information, so that the effect of any risks on the business may be minimized. Should there still exist any unavoidable risks, withdrawal or removal of the local base might have to be studied as possible alternatives.

From the above two comparisons, there is no significant difference in major problem recognition according to whether or not a company has a local base, at least in respect of those countries about which large numbers of responses were received. However, problems relating to systems are likely to be pointed out more often by companies who already have their own local bases, whereas those companies having no local base are inclined to point out matters relating to the security and social situations, infrastructure, and insufficient information on investment climate.

For any company considering setting up a local base overseas, it will be very useful to pay particular attention to matters relating to the systems, and at the same time to learn from the successes experience in coping with problems by companies already operating abroad.

33 The Japan Business Council for Trade and Investment Facilitation, a Japanese private consultative body for economic groups, periodically compiles requested detailed definitive reports by countries/regions into a form of “Problems and Requests Relating to Trade and Investment by Countries/Regions.” Because of its nature as a document to be submitted to the government, the requested information for each country/region contained in it is mostly concerned with improvements to systems, including legislation, taxation, and various other regulations. These improvements in systems are strongly recognized by companies operating at local bases as matters that they have to seriously address by lobbying the local government.

34 A case in which a joint venture was formed with an influential local company to build a good relationship with the authorities and to ease risks relating to unclear administration; a case in which all the staff in the company made a thorough study of the relevant laws to avoid difficulties; a case in which local consultants were utilized to cope with problems; these and other various ideas to prevent difficulties from occurring were mentioned during company interviews.

Appendix: Overseas Business Operations of Small and Medium Enterprises (SMEs)

1. Introduction

This Appendix has been compiled by extracting the data of companies having a capital of less than one billion yen, or the “Small and Medium Enterprises (hereafter referred to as SMEs)” as defined here, from the respondent companies in the FY2004 Survey into Overseas Business Operations, with a view to clarifying the status and prospects for overseas business operations and investments along with notable trends and movements of these companies as compared with the overall companies (Number of respondent companies: 135 companies.) (Table A-1 - A-5).

*Number of respondent companies: 135
 *The ratio of SMEs within all the respondent companies³⁵ (responses received from 595 companies): 22.7% (22.8% in the previous year's survey).
 *Overseas affiliate companies owned by the SMEs: 760 affiliates (Of this total, the number of overseas affiliate companies in the Asian region is 544, or 71.6% of the total, showing a high concentration in Asia.).

Table A-1 Number of Respondent Companies, by paid-in capital (Individual company base)

	Number of Companies	Composition Ratio (%)
less than ¥100 million	42	31.1%
¥100 million~less than ¥500 million	63	46.7%
¥500 million~less than ¥1,000 million	30	22.2%
Total	135	100.0%

Table A-2 Number of Respondent Companies, by annual sales (Consolidated base)

	Number of Companies	Composition Ratio (%)
Less than ¥50.0billion	120	89.6%
¥50.0 billion~less than ¥100.0billion	10	7.5%
¥100.0billion~less than ¥200.0billion	3	2.2%
¥200.0billion~less than ¥300.0billion	1	0.7%
¥300.0billion~less than ¥500.0billion	0	0.0%
¥500.0billion~less than ¥1.0trillion	0	0.0%
¥1.0 trillion or more	0	0.0%
Total	134	100.0%

Note: 1 company did not provide this information.

Table A-3 Number of Respondent Companies, by number of employees (Individual company base)

	Number of Companies	Composition Ratio (%)
300 employees and less	64	47.4%
301 to 500 employees	35	25.9%
501 to 1,000 employees	25	18.5%
1,001 to 5,000 employees	11	8.1%
5,001 to 10,000 employees	0	0.0%
10,001 or more employees	0	0.0%
Total	135	100.0%

Table A-4 Number of Respondent Companies, by industrial classifications

Industrial classifications	Number of Companies	Ratio (%)
Foodstuffs	7	5.2%
Textiles	11	8.1%
Wood and wood products	1	0.7%
Paper and pulp	1	0.7%
Chemicals	14	10.4%
[Chemicals (excluding pharmaceuticals)]	[13]	[9.6%]
[Pharmaceuticals]	[1]	[0.7%]
Petroleum and rubber	3	2.2%
Ceramics, cement and glass	2	1.5%
Steel	1	0.7%
Nonferrous metals	3	2.2%
Metal products	13	9.6%
General machinery	13	9.6%
[Assembled products]	[7]	[5.2%]
[Components]	[6]	[4.4%]
Electrical equipment and electronics	21	15.6%
[Assembled products]	[6]	[4.4%]
[Components]	[15]	[11.1%]
Transportation (excluding Automobiles)	1	0.7%
Automobiles	22	16.3%
[Assembled products]	[—]	[—]
[Components]	[22]	[16.3%]
Precision machinery	10	7.4%
[Assembled products]	[5]	[3.7%]
[Components]	[5]	[3.7%]
Other	12	8.9%
Total	135	100.0%

35 In this survey, survey data corresponding to all the respondent companies will be shown under the abbreviated headings of “Overall Companies.”

Table A-5 Number of Overseas Affiliates, by type of base and region

(Unit: Number of Companies)

	NIES	ASEAN 4	China	Other Asian Countries	North America	Latin America	EU	Central and Eastern Europe	Other European Countries	Russia, other CIS	Southeast Asia Pacific	Middle East	Africa	Total
Production Base	55	123	162	20	65	12	23	2	1	—	2	—	1	466
Sales Base	76	27	46	3	50	6	41	1	1	—	5	—	—	256
R&D Base	2	3	4	—	2	—	—	—	—	—	1	—	—	12
Other	2	9	9	3	1	—	2	—	—	—	—	—	—	26
Total	135	162	221	26	118	18	66	3	2	—	8	—	1	760

2. Prospects for Domestic and Overseas Business Operations

(1) Top Priorities for Domestic and Overseas Business Operations

As the current top priority issues for domestic and overseas business operations, “strengthen or expand the overseas production” (73.3%) has taken the largest proportion of votes, followed by “strengthen or expand the customer base by the company’s own efforts” (39.7%), and “strengthen or expand R&D functions” (37.4%) (Table A-6). Fourth place was taken by “strengthen or expand the domestic production” (21.4%) which is higher than the all-company average by 3.6 points and is positioned

quite high as compared to the FY2002 survey result (ninth place, 11.5%). From the above, it is observed that the SMEs are placing emphasis not only on overseas production but also on the strengthening or expansion of domestic production.

(2) Prospects for Overseas Business Operations over the Medium Term

With reference to the medium-term (next 3 years or so) overseas business operations, the proportion of companies who responded that they “will strengthen or expand overseas business operations” was 80.0%, and of those that “will maintain the size of overseas business operations at the present level” was 20.0%, showing a trend similar to overall companies (Figure

Table A-6 Top priority issues to be tackled in domestic and overseas business

Number of Companies

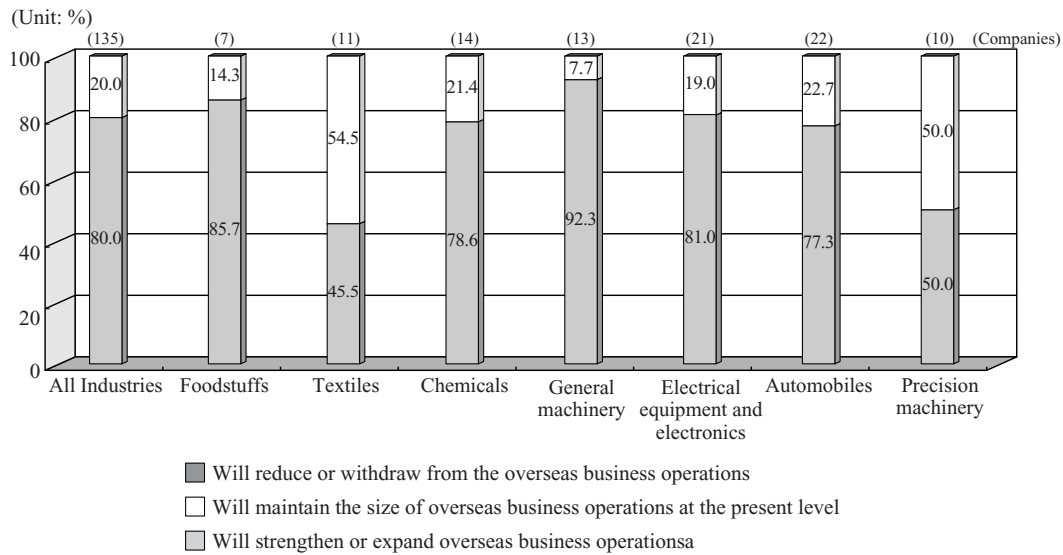
Rank	FY2004 Survey	Number of Companies	
		(Among 131 companies)	Ratio
1	Strengthen or expand the overseas production	96	73.3%
2	Strengthen or expand the customer base by the company’s own efforts	52	39.7%
3	Strengthen or expand the R&D functions	49	37.4%
4	Strengthen or expand the domestic production	28	21.4%
5	Review and improve efficiency of group companies’ management	24	18.3%
6	Active expansion into new business areas	23	17.6%
7	Reduce interest-bearing debt	21	16.0%
8	Introduce or establish a global supply chain management	18	13.7%
9	Strengthen or expand service operations related to the company’s product	17	13.0%
10	Acquire business resources to strengthen principal business	16	12.2%
11	Review domestic production systems from the viewpoint of total cost	15	11.5%
12	Review overseas production systems from the viewpoint of total cost	10	7.6%
13	Outsource the activities of production	5	3.8%
13	Concentrate on environmental issues and environment-related business	5	3.8%
15	Renewal of overage domestic plant	4	3.1%
16	Securing energy, resources and materials for the company’s own operations	2	1.5%

Note: 2 companies answered “Other” as a priority issue.

Rank	FY2002 Survey	Number of Companies	
		(Among 96 companies)	Ratio
1	Strengthen or expand the overseas production	67	69.8%
2	Strengthen or expand the customer base by the company’s own efforts	51	53.1%
3	Strengthen or expand service operations related to the company’s product	31	32.3%
4	Review domestic production systems from the viewpoint of total cost	24	25.0%
5	Reduce interest-bearing debt	23	24.0%
6	Review and improve efficiency of group companies’ management	18	18.8%
7	Active expansion into new business areas	14	14.6%
8	Acquire business resources to strengthen principal business	11	11.5%
8	Strengthen or expand the domestic production	11	11.5%
10	Introduce or establish a global supply chain management	10	10.4%
11	Outsource the activities of production	7	7.3%
12	Review overseas production systems from the viewpoint of total cost	6	6.3%
13	Concentrate on environment-related business	5	5.2%
14	Develop technology by utilizing venture companies	2	2.1%
14	Expand transactions over the Internet	2	2.1%

Note: 3 companies answered “Other” as a priority issue.

Figure A-1 Prospects for Overseas Business Operations over the Medium-term (next 3 years or so) (By major industry)

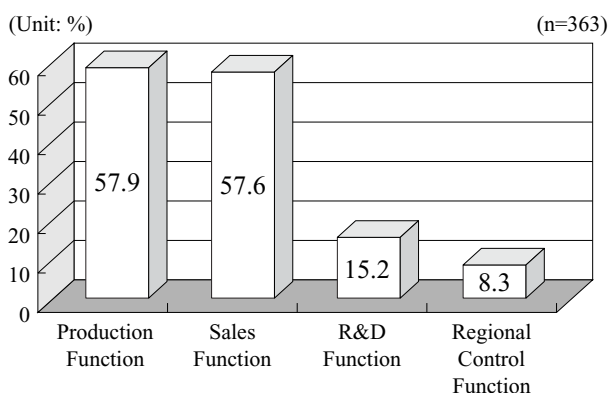


A-1). The proportion of companies who responded that they “will strengthen or expand” decreased by 8.2 points from the FY2002 survey (81.4%) to the FY2003 survey (73.2%), but in this year’s survey it has resumed the level of the FY2002 survey. Apparently, the positive stance of the SMEs toward overseas business operations has returned.

(3) Strengthening or Expansion Stance by Fields

Regarding activity fields to be strengthened or expanded by those companies who responded that they will do so, the “production function” (57.9%) and the “sales function” (57.6%) were almost equal in preference. Then follow the “R&D function” (15.4%), and the “regional control function” (8.4%) (Figure A-2).

Figure A-2 Strengthening or Expansion Stance by Fields



(4) Overseas Production Ratio

The overseas production ratio of the SMEs shows a trend slightly higher than the level for overall companies, and this year’s trend is similar (Figure A-3). The FY2003 actual value of overseas production ratio was 32.4% (Overall Companies: 26.1%), and the FY2007 mid-term planned value is expected to be 43.1% (Overall Companies: 33.2%). With regard to the overseas production ratio of the SMEs by major industries, the FY2003 actual value of Electrical equipment and electronics was 52.1%, a value well over 50%, and the FY2007 planned value is expected to be 63.6%, both figures representing a prominently high level of ratio for this industry as compared to other industries (Table A-7). Even in comparison with the ratio of overall companies, the ratio for Electrical

Figure A-3 Trend of Overseas Production Ratio (All industry average)

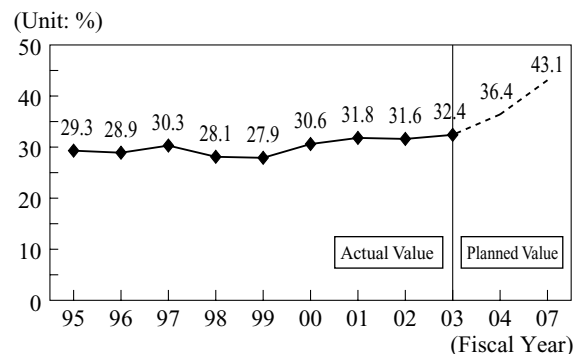


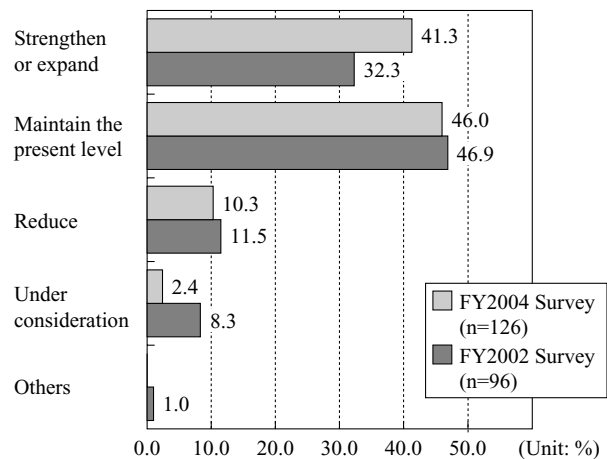
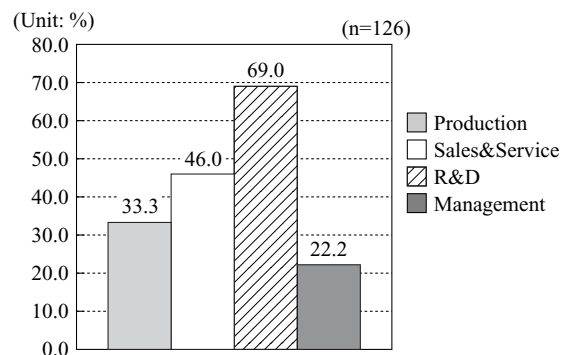
Table A-7 Overseas Production Ratio (by major industries)

	Number of respondent companies	FY 2003 actual value	FY 2004 estimated	FY 2007 planned value
All Industries	124	32.4%	36.4%	43.1%
Chemicals	13	18.9%	21.9%	28.1%
General machinery	10	14.0%	18.0%	27.0%
Electrical equipment and electronics	21	52.1%	56.9%	63.6%
Automobiles	18	21.7%	25.0%	31.1%

equipment and electronics is higher by 13.3 points than the FY2003 actual value (38.8%) of overall companies. The difference of 13.3 points is the largest among the major four industries.

(5) Prospects for Domestic Business Operations over the Medium Term

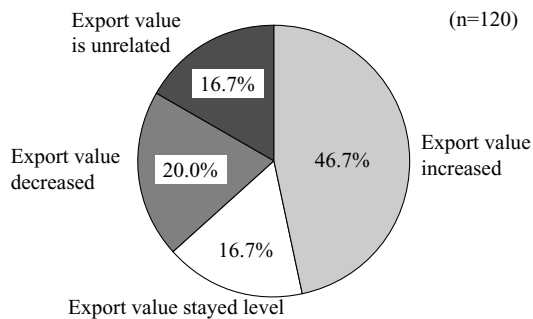
Regarding the medium-term (next 3 years or so) prospects for domestic business operations, nearly half of the respondent companies stated that they will “maintain the size of domestic business operations at the present level” (46.0%), and a similar number stated that they “will strengthen or expand domestic business operations” (41.3%) (Figure A-4). On the other hand, the proportion of companies who responded that they “will reduce domestic business operations” was 10.3%. In comparison with the FY2002 survey, the response of “strengthening or expansion” has increased by 9 points, the most significant increase among the options available. Compared with overall companies, respondent companies that they “will maintain the size of domestic business operations at the present level” and “will strengthen or expand domestic business operations” were at almost the same level, and the response that they “will reduce domestic business operations” was higher than overall companies by 5.7 points. As regards the fields of activity on which the respondent companies intend to focus their domestic efforts hereafter, the proportion of respondent companies who say that they will put effort into “R&D” was the largest at about 70% (Figure A-5). It can be recognized that quite a number of SMEs attach importance to heightening the high value-added products and services of their domestic business operations.

Figure A-4 Prospects for Domestic Business Operations over the Medium Term**Figure A-5 Fields to Focus in Japan Future Domestic Operations (multiple responses)**

(6) Relationship between Overseas and Domestic Business Operations

With reference to the relationship between the strengthening and expansion of overseas operations for the past three years or so and exports from Japan, nearly half (46.7%) of the respondent companies answered that “exports have increased” (Figure A-6). On the other hand, responses stating that “export value decreased” were 20%. The ratio of decreased export value is higher by 6.7 points as compared to overall companies, but it is quite clear that the strengthening or expansion of overseas business operations has helped to increase the exports of companies’ own products from Japan. In this survey, of the companies who responded that they will “strengthen or expand” their overseas business operations, the proportion of those who also responded that they will “maintain the current size of domestic business” was 44.0%, and of those that will “strengthen or expand domestic business operations”

Figure A-6 Relationship between Strengthening or Expansion of Overseas Business Operations and Exports from Japan



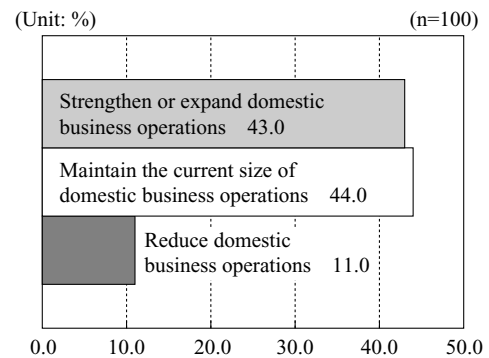
Note: Companies which responded “We did not expand overseas business operations in the last three years” were excluded.

was 43.0%, each percentage occupying nearly half the total (Figure A-7). The foregoing result shows that most of the SMEs are thinking to maintain the present size of their domestic business operations or to strengthen or expand them along with their overseas business operations.

(7) International Allocation of Production

When asked about the division of production between domestic and overseas bases, it has been clarified that general-purpose products are produced equally in Japan, China and ASEAN, and 80% of the respondent companies are producing high value-added products in Japan (Figure A-8~11). In the SMEs, the ratio of producing general-purpose products in China (61.6%) was the highest, exceeding production within Japan (52.0%). Regarding products embodying the newest technologies, 80% of respondent companies conduct production within Japan and about half of respondent companies assume Japan as the destination for future mass-production. For the mass-production destination, in the overall companies, the most common responses were “Japan” (71.1%), greatly exceeding that of China (41.0%), but the SMEs stated almost equal preference for “Japan” (54.2%) and “China” (48.3%) with only 5.9 points between the two. It is noteworthy that China is considered by many of the SMEs to be equal with Japan as a main candidate destination for mass production. By all industrial classification, the response rate obtained for “ASEAN” are lower than those for “China” for all the cases shown, with the

Figure A-7 Stance on Domestic Business Operations among Companies that chose “Strengthen or expand” Overseas Business Operations (medium-term outlook)



difference being larger than in the case of overall companies. Particularly, the ratio of respondent companies that have chosen “ASEAN” as a destination for future mass production is lower than for “China” by 18.6%, which difference is wider by about 5 points than on an overall companies basis. As compared to overall companies, the SMEs are more likely to select “China” than “ASEAN.”

3. Prospects for Overseas Business Operations by Region

(1) Stance for Overseas Business Operations by Region

On looking at the prospects of overseas business operations by regions, the countries/regions chosen to be strengthened or expanded run in the following order (in descending order of preference): Central and Eastern Europe (88.9%), China (77.8%), Russia, other CIS (75.0%), and so forth. For Central and Eastern Europe, and Russia, other CIS, the number of respondent companies having voted for these regions/countries is rather few but the attitude of the companies appears to be more positive than is seen in the case of overall companies (Figure A-12). As for business operations in China, following FY2003 about 80% of respondent companies expressed their intention to strengthen or expand their business operations to match a similar trend of overall companies (76.5%). With regard to the EU15, the proportion of respondent companies who will strengthen or expand their business operation has

Figure A-8 Current Production of General-purpose Products (multiple responses)

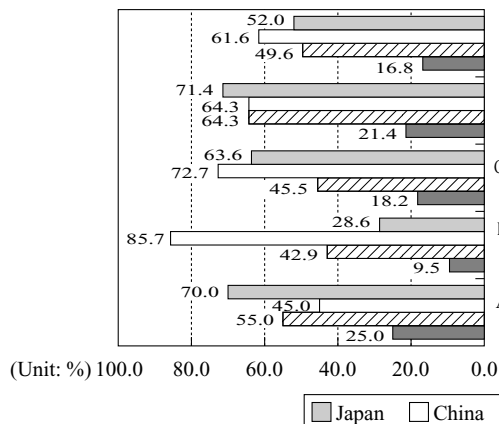
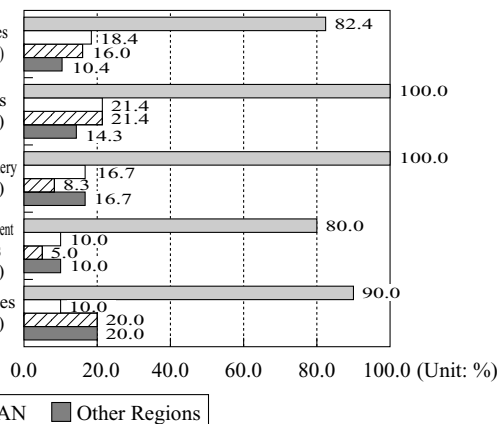


Figure A-9 Current Production of High Value-added Products (multiple responses)



Note: In this question, "ASEAN" means the six countries of Thailand, Malaysia, the Philippines, Indonesia, Singapore and Vietnam.

Figure A-10 Current Production for Products Embodying the Newest Technologies (multiple responses)

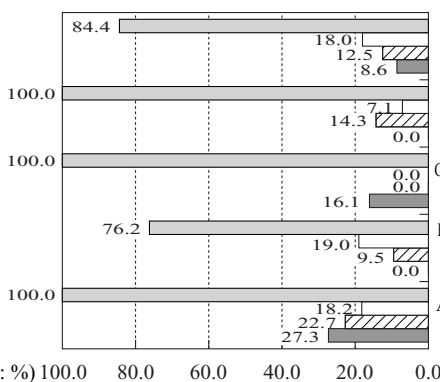
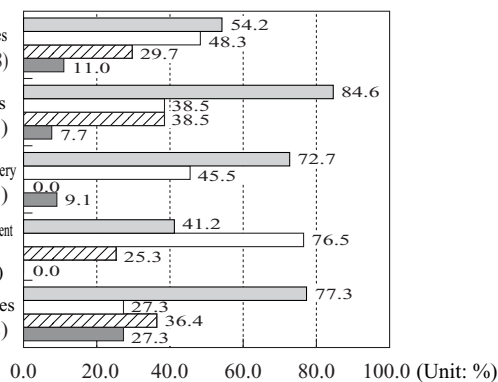


Figure A-11 Destinations for the Future Mass production of Products Embodying the Newest Technologies (multiple responses)*



Note: Local production to shift to mass production in the next 3 years or so.

surpassed overall companies by about 16 points (Overall companies: 46.5%; SMEs: 62.8%). Following the new accession of 10 countries in Central and Eastern Europe to the EU in May 2004, Japanese automakers are expected to expand their local production, and such movement of the automakers would be likely to prompt ever-increasing investment in the EU and in Central and Eastern Europe from the medium-to-small components makers. The stance of the companies can be compared with overall companies for each Asian country as follows (Figure A-13). In the NIEs, the stances for strengthening or expansion of the companies, as is the case of overall companies, have been the strongest for Korea. For second placed Hong Kong, the ratio of responses has exceeded overall companies by about 10 points. For ASEAN4, it is for

Thailand within this region that the stances for strengthening or expansion of the companies have been the strongest as is the case with overall companies. For China, overall companies show strong attitudes, particularly for the Eastern and Southern China, but on the other hand, the attitude toward strengthening or expansion of the SMEs has generally been 70%-80% for every region with the feature that the difference in proportion among regions is relatively small. For Vietnam, the stance for strengthening or expansion of the SMEs is stronger than that of overall companies by about 13 points, indicating the keen interest shown in this country.

(2) Countries/Regions for Strengthening or Expansion

When examining the number of companies intending

Figure A-12 Prospects for Overseas Business Operations in the medium term (next 3 years or so) (By Regions)

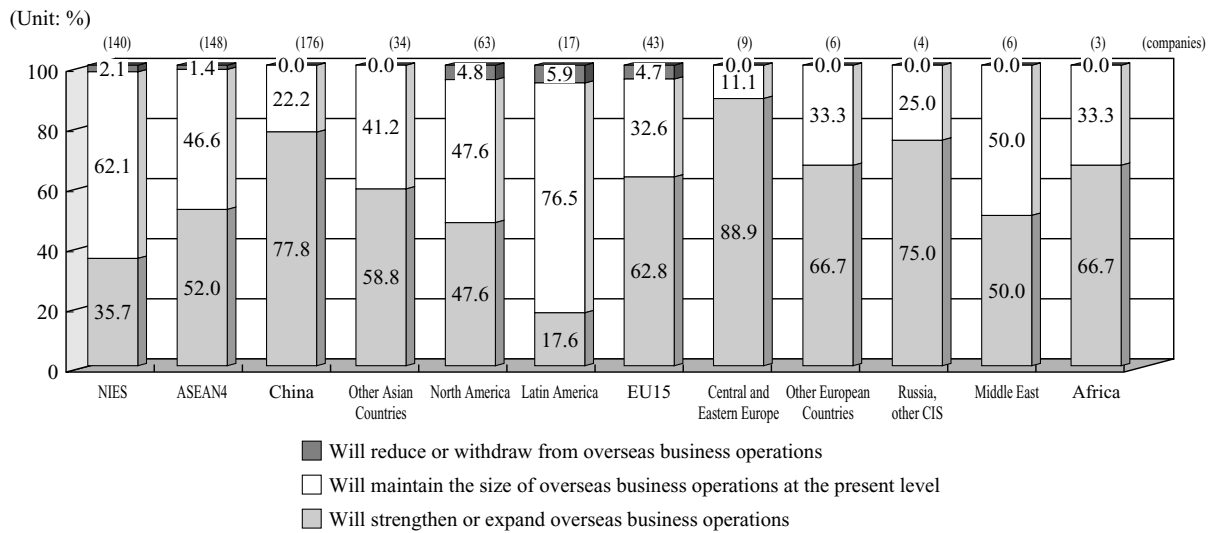


Figure A-13 Prospects for Overseas Business Operations in the medium term (next 3 years or so) (NIES)

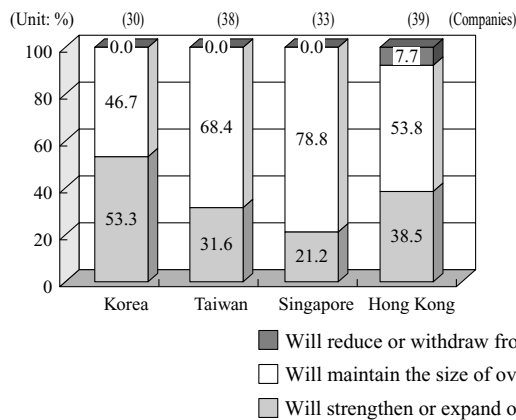


Figure A-13 Prospects for Overseas Business Operations in the medium term (next 3 years or so) (ASEAN4)

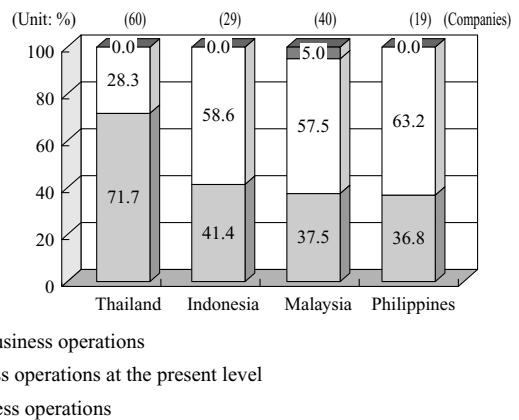


Figure A-13 Prospects for Overseas Business Operations in the medium term (next 3 years or so) (China)

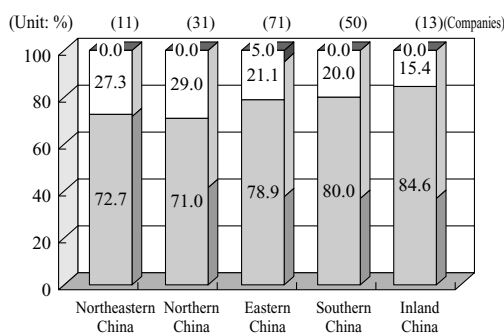
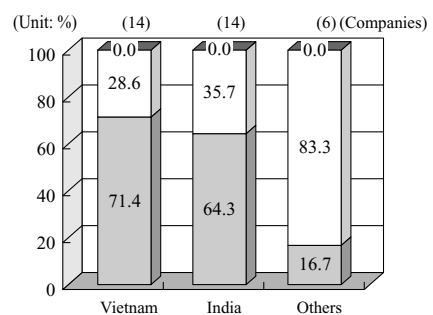


Figure A-13 Prospects for Overseas Business Operations in the medium term (next 3 years or so) (Other Asian Countries)



to strengthen or expand overseas business operations in the medium-term (next 3 years or so), it became clear that the number planning to strengthen or expand their business operations in Eastern China and Southern China and in Thailand has increased remarkably (Figure A-14).

For North America, the proportion of the respondent companies is lower by 16.5 points than overall companies, revealing that the stance for strengthening or expanding of the SMEs is rather weaker than overall companies as far as North America is concerned.

For Latin America and Africa, the companies citing “strengthening or expansion of business operations in these regions” are much fewer than for other regions

4. Evaluation of Overseas Business Performance

The evaluation of satisfaction with sales and

profitability for the overseas business performances of the SMEs is generally lower than overall companies. It is almost at the same level as overall companies for NIEs, ASEAN4, and China, but is left behind for the EU15, Central and Eastern Europe, and Latin America (Figure A-15 and Table A-8). For China, in FY2003 the evaluation of both sales and profitability satisfaction was the highest (sales: 2.90, profitability: 2.78) as compared with other regions, but this year it has gone down to second place below NIEs (sales 2.90, profitability 2.84). It is only for NIEs that the evaluation with both sales and profitability has been kept above the middle point of “3,” and for all other regions the evaluation has stayed at an unsatisfactory level of below “3.” Looking at the main reasons why the satisfaction with profitability for China is evaluated as “satisfactory” or “somewhat satisfactory,” respondent companies cited as follows: “successful sales activities in the country or region concerned” (51.6%); “full operation of production facilities” (41.9%); and “successful cost reduction”

Figure A-14 Number of Companies for Strengthening or Expansion (Ratio)

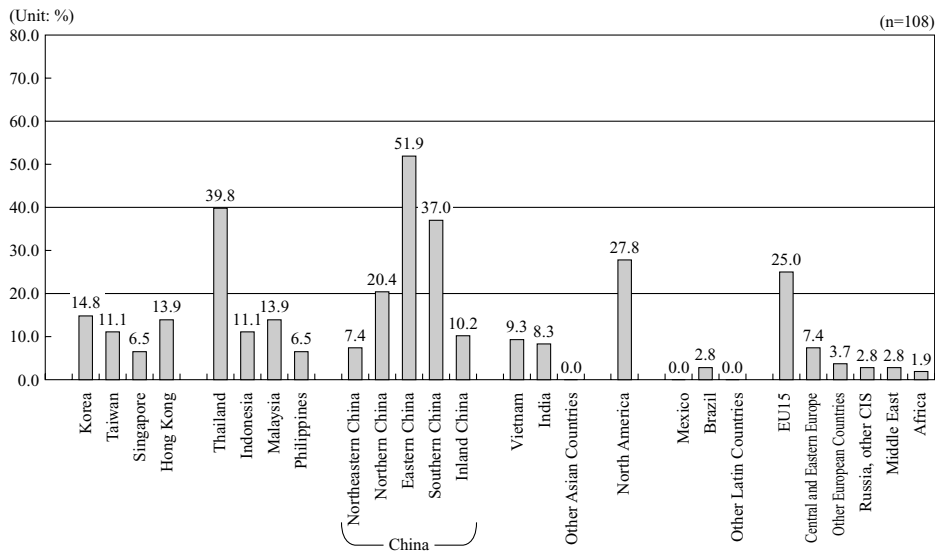
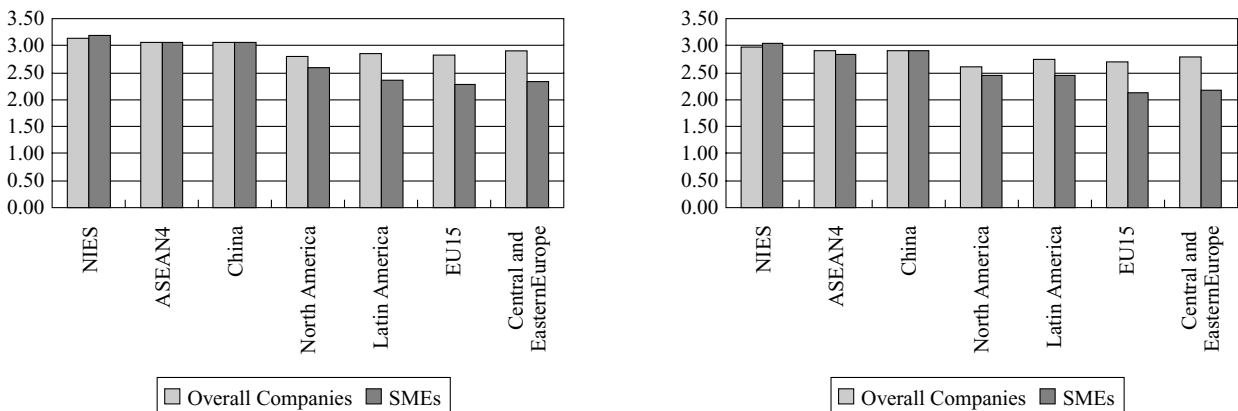


Figure A-15 Evaluation of Overseas Business Performance

(Upper graph: Evaluation of Satisfaction with Sales; Lower graph: Evaluation of Satisfaction with Profitability)



(29.0%). On the other hand, the main reasons cited by the companies who responded that the satisfaction with profitability for China has been “unsatisfactory” or “somewhat unsatisfactory” are as follows: “Yet to reach full operation as the company has been set up recently” (45.5%); “difficult to obtain customers (intense competition with other companies)” (39.4%); and “cost reductions are difficult (personnel expenses, raw materials costs, etc.)” (24.2%). The reason of “yet to

reach full operation of facilities,” though its proportion has reduced in the case of overall companies from the FY2003 survey, still remains at a high proportion in the case of the SMEs. For ASEAN4, the main reasons cited by companies who responded that the satisfaction with profitability was “unsatisfactory” or “somewhat unsatisfactory” are as follows: “Cost reductions are difficult (personnel expenses, raw materials costs, etc.)” (29.8%); “difficult to obtain customers (intense

Table A-8 Reasons for Evaluations of Satisfaction with Profitability

Reasons for Evaluations of Satisfaction with Profitability (satisfactory/somewhat satisfactory) (multiple responses)

	All Regions		NIES		ASEAN4* (See Note)		China		North America		Latin America		EU15		Central and Eastern Europe	
	Number of Companies (150 companies)	Ratio	Number of Companies (50 companies)	Ratio	Number of Companies (45 companies)	Ratio	Number of Companies (31 companies)	Ratio	Number of Companies (14 companies)	Ratio	Number of Companies (3 companies)	Ratio	Number of Companies (7 companies)	Ratio	Number of Companies (0 enterprise)	Ratio
Successful cost reductions (personnel costs, raw materials, etc.)	23	15.3%	7	14.0%	5	11.1%	9	29.0%	1	7.1%	1	33.3%	0	0.0%	0	0.0%
Successful cost reduction through the consolidation of production	19	12.7%	3	6.0%	8	17.8%	7	22.6%	0	0.0%	1	33.3%	0	0.0%	0	0.0%
Full operation of production facilities	34	22.7%	3	6.0%	16	35.6%	13	41.9%	1	7.1%	1	33.3%	0	0.0%	0	0.0%
Successful sales activities in the country or region concerned	107	71.3%	41	82.0%	27	60.0%	16	51.6%	14	100.0%	2	66.7%	7	100.0%	0	0.0%
Successful exports from the country or region concerned	27	18.0%	10	20.0%	9	20.0%	7	22.6%	1	7.1%	0	0.0%	0	0.0%	0	0.0%
Exchange rate profit (includes conversion efficiency rate of the yen at the time of consolidated accounting)	4	2.7%	1	2.0%	1	2.2%	2	6.5%	0	0.0%	0	0.0%	0	0.0%	0	0.0%
Partnership, effective M&A	2	1.3%	0	0.0%	1	2.2%	0	0.0%	1	7.1%	0	0.0%	0	0.0%	0	0.0%
Investment incentives for host country realized as planned	4	2.7%	0	0.0%	2	4.4%	2	6.5%	0	0.0%	0	0.0%	0	0.0%	0	0.0%
Other	0	0.0%	0	0.0%	0	0.0%	0	0.0%	0	0.0%	0	0.0%	0	0.0%	0	0.0%

Note: Responses were compiled from individual answers for ASEAN4.

Reasons for Evaluations of Satisfaction with Profitability (unsatisfactory/somewhat unsatisfactory) (multiple responses)

	All Regions		NIES		ASEAN4* (See Note)		China		North America		Latin America		EU15		Central and Eastern Europe	
	Number of Companies (201 companies)	Ratio	Number of Companies (42 companies)	Ratio	Number of Companies (57 companies)	Ratio	Number of Companies (33 companies)	Ratio	Number of Companies (32 companies)	Ratio	Number of Companies (6 companies)	Ratio	Number of Companies (28 companies)	Ratio	Number of Companies (3 companies)	Ratio
Cost reductions are difficult (personnel expenses, raw materials costs, etc.)	59	29.4%	11	26.2%	17	29.8%	8	24.2%	13	40.6%	2	33.3%	8	28.6%	0	0.0%
Yet to reach full operation as the company has been set up recently	31	15.4%	1	2.4%	8	14.0%	15	45.5%	2	6.3%	1	16.7%	3	10.7%	1	33.3%
Demand by customers to reduce sales prices	50	24.9%	13	31.0%	15	26.3%	3	9.1%	11	34.4%	1	16.7%	6	21.4%	1	33.3%
Difficult to obtain customers (intense competition with other companies)	85	42.3%	19	45.2%	15	26.3%	13	39.4%	15	46.9%	3	50.0%	19	67.9%	1	33.3%
Maturation of products (diffusion of products)	10	5.0%	1	2.4%	2	3.5%	1	3.0%	3	9.4%	0	0.0%	3	10.7%	0	0.0%
Shrinking market due to economic downturn	20	10.0%	6	14.3%	4	7.0%	0	0.0%	3	9.4%	3	50.0%	4	14.3%	0	0.0%
Unsuccessful exports from the country or region	11	5.5%	2	4.8%	2	3.5%	2	6.1%	0	0.0%	1	16.7%	4	14.3%	0	0.0%
Overseas Exchange losses (includes conversion efficiency rate of the yen at the time of consolidated accounting)	24	11.9%	4	9.5%	9	15.8%	5	15.2%	3	9.4%	1	16.7%	2	7.1%	0	0.0%
Discouraging responses by host country	3	1.5%	0	0.0%	3	5.3%	0	0.0%	0	0.0%	0	0.0%	0	0.0%	0	0.0%
Other	13	6.5%	3	7.1%	5	8.8%	3	9.1%	2	6.3%	0	0.0%	0	0.0%	0	0.0%

Note: Responses were compiled from individual answers for ASEAN4.

competition with other companies)”(26.3%); and “demand by customers to reduce sales prices” (26.3%). The above data makes it clear that not only overall companies but the SMEs are finding it an important task to cope with cost problems and securement of competitiveness for their products.

5. Chinese Operations and Risks

Examining how long companies expect the current high rate of economic growth in China to continue as they draw up their business plans; the most common answer is “until 2010 (Shanghai Expo)” followed by “until 2008 (Beijing Olympics).” This happens to be the same result as for overall companies (Figure A-16). Risks that may occur while developing business operations in China and which may have a serious effect on those operations are classified into “risks faced now” and “future risks” for the purpose of the survey. The “risks faced now” have been pointed out

in the following descending order: (1) “Insufficient electrical power supply” (60.0%), (2) “rising prices for energy and raw materials” (38.1%), and (3) “infringement of intellectual property rights” (18.1%) (Figure A-17). As to the “future risks,” the most common response was the “revaluation of the Yuan” (72.9%), reaching six points above the response rate of overall companies (67.7%). As the risks that companies consider to be the most important risk among “risks faced now” and “future risks,” the following were cited: (1) “Insufficient electrical power supply” (23.6%), (2) “revaluation of the Yuan” (20.8%), and (3) “rising prices for energy and raw materials” (16.0%) (Figure A-18). Compared to the fact that “economic recession and market contraction” occupied the top vote in the case of overall companies, the SMEs seem to be inclined to consider more important such risks as are directly connected to their business operations, for example, “insufficient electrical power supply.” As the countermeasures (multiple response) that companies plan to take if the performance of their operations in China falls far short of initial plans due to the impact of the most serious risks, the companies have responded that they would take the following countermeasures: (1) against the risk of “insufficient electrical power supply,” “make improvements at the company’s expense” (14 companies) and “demand improvements be made by local governments or agencies” (11 companies) have received much support. Particularly, the former countermeasure which collected the

Figure A-16 How long will China’s economic growth continue?

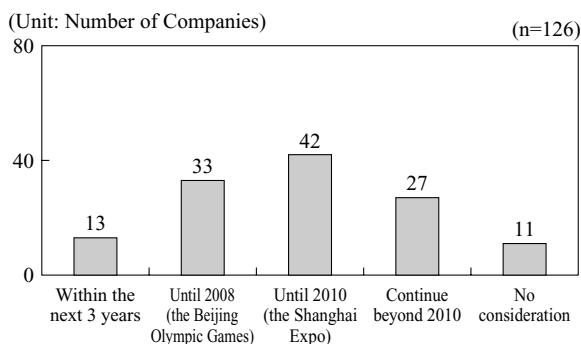


Figure A-17 China Risks (multiple responses)

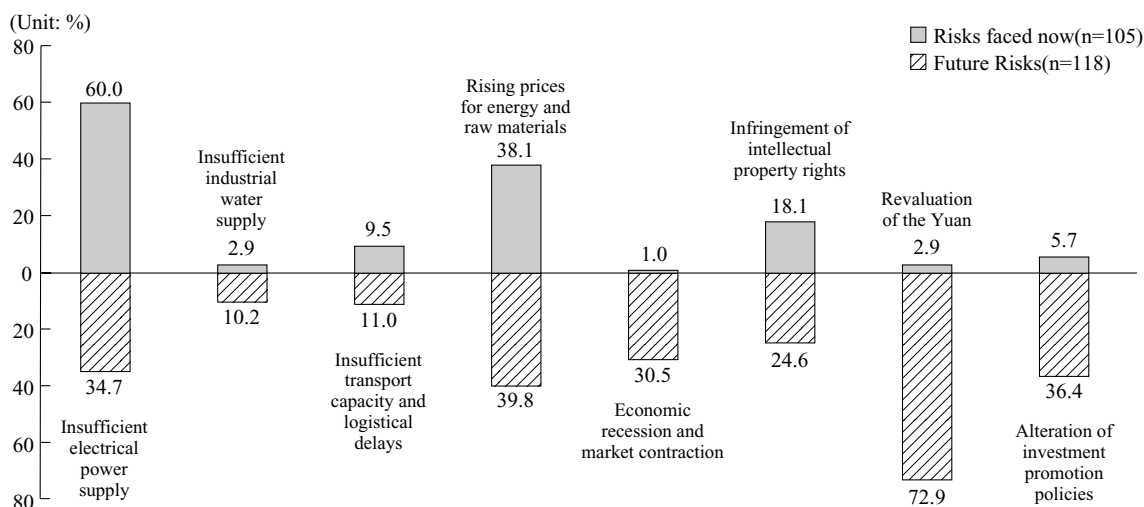


Figure A-18 Risks Viewed as Most Serious in Chinese Operations

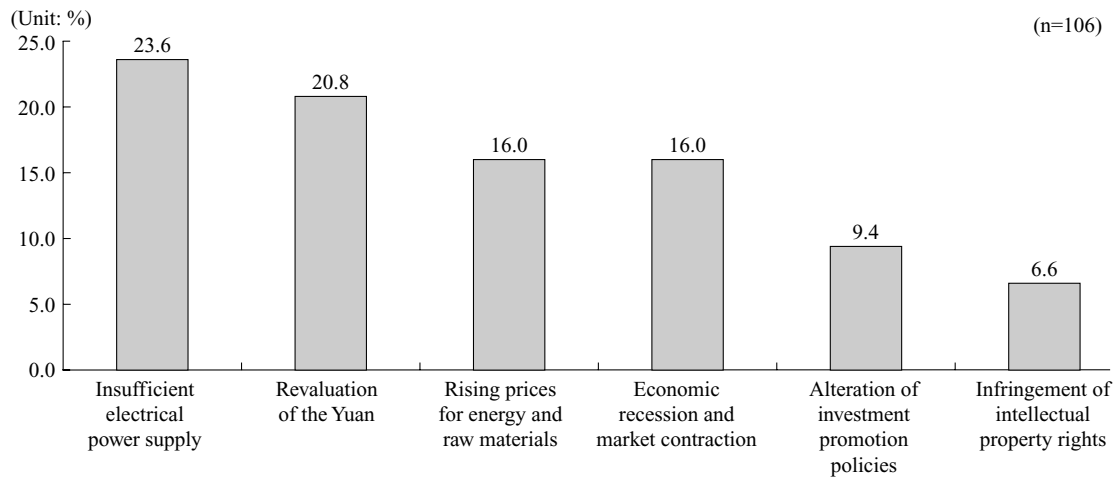
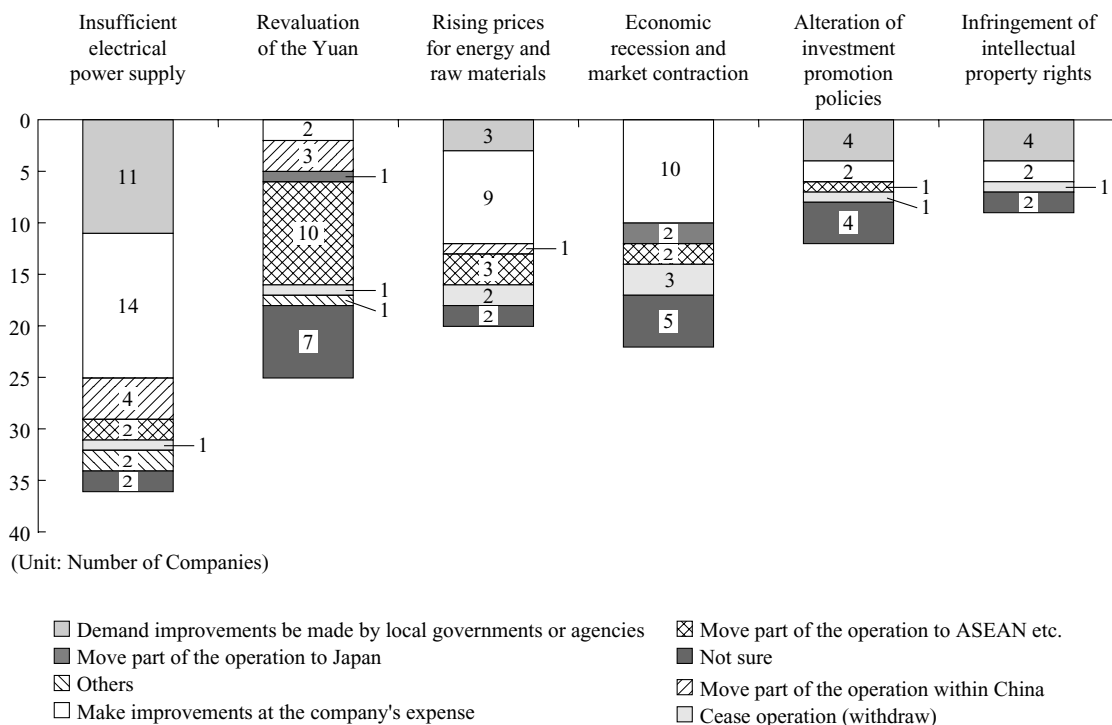


Figure A-19 Countermeasures against the Risks Viewed as Most Serious



largest number of votes, unlike the case of overall companies (Figure A-19). One opinion given in interview was “we are taking measures such as earlier ordering from suppliers, procurement of a private generator set, and so forth” (General machinery-Assembled products). Against the risk of “revaluation of the Yuan,” the countermeasure of “move part of the operation to ASEAN” (10 companies) obtained the largest proportion of respondent companies. In comparison with overall companies, most of the companies, though the number is rather limited, chose ASEAN (10 companies) as the relocation

destination rather than China (3 companies) and Japan (1 company).

6. Promising Countries/Regions for Overseas Business Operations over the Medium Term

The promising countries/regions for medium-term (next three years or so) overseas business operations take the following descending order of preference: 1st place China, 2nd place Thailand, and 3rd place Vietnam (Table A-9). There has been no change in the ranking from 1st to 3rd since the FY2002 survey.

Regarding Vietnam, SMEs have higher expectations of this country than do All Companies. Fourth-placed India and 5th Indonesia have changed places from the FY2003 survey, with the companies heightening their interest in India in line with overall companies. For Vietnam and India, however, the companies who are not yet ready with concrete business plans are far more in number than those who are ready, which suggests that also among the SMEs, only anticipation of these markets seems to be moving ahead (Figure A-20). Russia has been ascending the ranking steadily, though the number of respondent companies is very limited (from 12th with 3 responses to 9th with 6 responses). Russia has reached the top 10 this year for the first time.

China has been named as promising by 90% of

all responses, with a distinct lead over 2nd place, and great expectations continuously centered on this country. Among the reasons for promising for China (Table A-10), the largest ratio of responses has gone to “growth potential of the market” (78.3%), followed by “inexpensive labor force” (70.0%), “excellent human resources” (26.1%), and “base for export to the third countries” (26.1%). The reasons cited for the promise shown by second-place Thailand are “growth potential of the market” (63.6%), “inexpensive labor force” (39.4%), and “stable political and social conditions” (36.4%). For Vietnam, the reasons are cited in the following order: “inexpensive labor force” (79.4%), “growth potential of the market” (41.2%), and “excellent human resources” (29.4%).

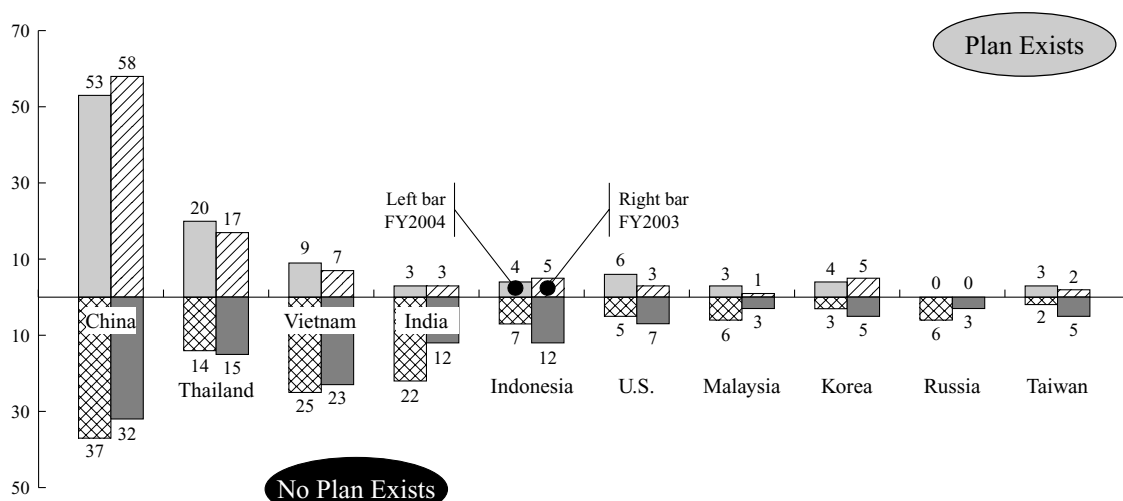
The main issues concerning China (Table A-11)

Table A-9 Promising Countries/Regions for Overseas Business Operations over the Medium Term (next 3 years or so) (multiple responses)

Rank	Promising Countries/Regions for Overseas Business Operations over the Medium Term (next 3 years or so)														
	FY2004 Survey	Number of Companies (104)	Ratio (%) 100	FY2003 Survey	Number of Companies (105)	Ratio (%) 100	FY2002 Survey	Number of Companies (73)	Ratio (%) 100	FY2001 Survey	Number of Companies (72)	Ratio (%) 100	FY2000 Survey	Number of Companies (66)	Ratio (%) 100
1	China	94	90	China	95	90	China	63	86	China	55	76	China	45	68
2	Thailand	35	34	Thailand	36	34	Thailand	20	27	U.S.	17	24	U.S.	21	32
3	Vietnam	35	34	Vietnam	30	29	Vietnam	14	19	Thailand	13	18	Thailand	15	23
4	India	25	24	Indonesia	18	17	Indonesia	11	15	India	9	13	Malaysia	11	17
5	Indonesia	11	11	India	16	15	U.S.	10	14	Germany	7	10	Indonesia	9	14
6	U.S.	11	11	U.S.	11	10	India	8	11	Vietnam	7	10	Taiwan	8	12
7	Malaysia	9	9	Korea	10	10	Malaysia	5	7	Hong Kong	5	7	Vietnam	7	11
8	Korea	7	7	Taiwan	7	7	Hong Kong	4	5	Indonesia	5	7	Mexico	7	11
9	Russia	6	6	Hong Kong	5	5	Korea and Taiwan	3	4	Brazil	5	7	Korea	6	9
10	Taiwan	5	5	Singapore	4	4	and Brazil and Mexico	3	4	France	5	7	U.K.	5	8
				Malaysia	4	4							Germany	5	8

Note: Besides the countries/regions shown in the list, North America (named by 10 companies, 9.6 %) gathered votes in FY2004 survey.

Figure A-20 Existence of Concrete Business Plans for Promising Countries/Regions



(Unit: Number of Respondent Companies)

Table A-10 Reasons for Promising Countries/Regions (multiple responses)

		China		Thailand		Vietnam		India		Indonesia		U.S.	
		Number of Companies		Number of Companies		Number of Companies		Number of Companies		Number of Companies		Number of Companies	
		(92 companies)	Ratio	(33 companies)	Ratio	(34 companies)	Ratio	(22 companies)	Ratio	(11 companies)	Ratio	(11 companies)	Ratio
Production	Excellent human resources	24	26.1%	4	12.1%	10	29.4%	11	50.0%	1	9.1%	1	9.1%
	Inexpensive labor force	65	70.7%	13	39.4%	27	79.4%	15	68.2%	7	63.6%	—	—
	Low-cost parts and raw materials	18	19.6%	2	6.1%	3	8.8%	2	9.1%	1	9.1%	1	9.1%
	Supply base for assembly manufacturers	20	21.7%	11	33.3%	7	20.6%	5	22.7%	2	18.2%	4	36.4%
	Industrial cluster (accumulation of suppliers, customers and alliance partners)	21	22.8%	9	27.3%	1	2.9%	—	—	—	—	2	18.2%
	Risk diversification	4	4.3%	4	12.1%	5	14.7%	1	4.5%	1	9.1%	—	—
	Base for exports to Japan	18	19.6%	3	9.1%	3	8.8%	1	4.5%	2	18.2%	—	—
	Base for export to the third countries	24	26.1%	5	15.2%	8	23.5%	4	18.2%	1	9.1%	1	9.1%
Sales	Present local market size	14	15.2%	5	15.2%	2	5.9%	5	22.7%	3	27.3%	6	54.5%
	Growth potential of the market	72	78.3%	21	63.6%	14	41.2%	12	54.5%	5	45.5%	3	27.3%
	Product development for local needs	7	7.6%	—	—	1	2.9%	—	—	—	—	1	9.1%
Infrastructure and systems	Developed local infrastructure (electricity, communication, transportation, etc.)	9	9.8%	8	24.2%	1	2.9%	—	—	1	9.1%	4	36.4%
	Tax incentives for investment	11	12.0%	4	12.1%	4	11.8%	—	—	1	9.1%	—	—
	Stable policy to attract foreign capital	10	10.9%	7	21.2%	1	2.9%	—	—	—	—	1	9.1%
	Benefits from regional integration (tariff reduction, etc.)	2	2.2%	1	3.0%	1	2.9%	—	—	—	—	—	—
	Stable political and social conditions	8	8.7%	12	36.4%	6	17.6%	1	4.5%	—	—	4	36.4%

are as follows: “Unclear operation of local legal system (frequent changes, etc.)” (57.5%), “insufficient local protection of intellectual property rights” (49.4%), and “intense local competition” (44.8%). Problems similar to the foregoing, each relating to legislation and administration, are pointed out by many companies, and the number of companies who have pointed out such issues are also substantially greater than for any other country. In respect of the protection of intellectual property rights, the comment has been made in the interviews: “the price of our product may be a little high, but its excellent performance is worth the price in the long run. That is our sales point. But we are afraid we might be pulled into a price competition if poor imitations get into circulation” (Chemicals). For Thailand, which is 2nd place, the following problems have been pointed out: “intense local competition” (45.0%), “difficulty in securing personnel (management level)” (35.0%), and “increase in labor cost” (25.0%). These problems reflect the severe competitive situation in the local market. For Vietnam, placed 3rd, the following problems have been cited: “under-development of local legal system” (39.1%), “unclear operation of local legal system (frequent changes, etc.)” (39.1%), “difficulty in securing personnel (management level)” (34.8%), and “under-development of infrastructure (electricity, communication, transportation, etc.)” (34.8%). Local

legislation and infrastructure development are required.

Table A-11 Issues for Promising Countries/Regions (multiple responses)

		1		2		3		4		5		6	
		China		Thailand		Vietnam		India		Indonesia		U.S.	
		Number of Companies (87 companies)	Ratio	Number of Companies (20 companies)	Ratio	Number of Companies (23 companies)	Ratio	Number of Companies (20 companies)	Ratio	Number of Companies (8 companies)	Ratio	Number of Companies (7 companies)	Ratio
Legislation and tax systems	Under-development of local legal system	27	31.0%	—	—	9	39.1%	4	20.0%	2	25.0%	—	—
	Unclear operation of local legal system (frequent changes, etc.)	50	57.5%	2	10.0%	9	39.1%	4	20.0%	2	25.0%	—	—
	Complex local tax collection systems	18	20.7%	3	15.0%	2	8.7%	1	5.0%	3	37.5%	—	—
	Unclear operation of taxation system (frequent changes, etc.)	28	32.2%	3	15.0%	5	21.7%	1	5.0%	3	37.5%	—	—
	Increase in tax burden (corporate tax, transfer price taxation, etc.)	22	25.3%	3	15.0%	1	4.3%	2	10.0%	1	12.5%	1	14.3%
Administration in general	Restrictions on foreign capital (limited equity participation, limited industry for investment, frequent changes, etc.)	27	31.0%	3	15.0%	5	21.7%	1	5.0%	1	12.5%	—	—
	Complex and vague investment permit procedures	20	23.0%	1	5.0%	2	8.7%	—	—	1	12.5%	—	—
	Difficulty in obtaining immigration or working visas	3	3.4%	—	—	—	—	—	—	—	—	3	42.9%
	Insufficient local protection of intellectual property rights	43	49.4%	—	—	4	17.4%	3	15.0%	1	12.5%	—	—
	Local restrictions on currency exchange and remittance	34	39.1%	1	5.0%	5	21.7%	2	10.0%	—	—	1	14.3%
	Local import restrictions (components, raw materials, etc.)	9	10.3%	—	—	2	8.7%	1	5.0%	—	—	1	14.3%
	Anti-dumping measures (abuse of safeguards, etc.)	3	3.4%	1	5.0%	—	—	—	—	—	—	2	28.6%
Labor issues	Difficulty in securing personnel (management level)	26	29.9%	7	35.0%	8	34.8%	1	5.0%	2	25.0%	1	14.3%
	Increase in labor cost	29	33.3%	5	25.0%	1	4.3%	1	5.0%	1	12.5%	3	42.9%
	Local labor problems (labor-management relations, etc.)	15	17.2%	1	5.0%	2	8.7%	1	5.0%	1	12.5%	2	28.6%
General Affairs	Intense local competition with other firms	39	44.8%	9	45.0%	3	13.0%	5	25.0%	2	25.0%	5	71.4%
	Difficulty in collecting receivables	38	43.7%	—	—	3	13.0%	1	5.0%	—	—	—	—
	Difficulty in local financial access	13	14.9%	1	5.0%	2	8.7%	—	—	1	12.5%	—	—
	Under-development of local supporting industries (difficulty in obtaining parts/raw materials)	11	12.6%	2	10.0%	3	13.0%	1	5.0%	1	12.5%	—	—
	Instability of local currency and price	7	8.0%	—	—	3	13.0%	2	10.0%	2	25.0%	—	—
	Under-development of infrastructure (electricity, communication, transportation, etc.)	36	41.4%	—	—	8	34.8%	7	35.0%	2	25.0%	—	—
	Unstable local security and social conditions	10	11.5%	—	—	—	—	6	30.0%	2	25.0%	—	—
Insufficient information on investment climate	2	2.3%	—	—	7	30.4%	9	45.0%	1	12.5%	—	—	

Appended Table 1 Number of Bases by Industry and Function

(Unit: Number of Bases)

All Industries	NIES					ASEAN4				China					Other Asian Countries					Total											
	Korea	Taiwan	Singapore	Hong Kong	Thailand	Indonesia	Malaysia	Philippines	Northeast China	Northern China	Eastern China	Southern China	Inland China	India	Vietnam	North America	Latin America	Mexico	Brazil		EU15	Central and Eastern Europe	Other Europe	Russia, other CIS	Southeast Asia Pacific	Middle East	Africa				
Production Base	612	174	241	128	69	1,190	503	291	263	133	1,346	87	236	614	320	89	188	84	72	759	216	84	83	454	84	16	11	68	16	24	4,984
Sales Base	830	124	172	264	270	383	162	59	107	55	463	13	94	263	81	12	52	25	10	637	177	45	56	969	101	70	32	141	53	38	3,946
Research and Development Base	25	5	8	11	1	29	13	1	9	6	67	5	19	30	8	5	6	3	2	108	4	1	2	60	3	0	0	8	0	0	310
Other	107	5	14	47	41	89	32	10	20	27	122	12	26	53	24	7	15	9	6	244	53	16	18	161	5	8	3	26	3	3	839
Total	1,574	308	435	450	381	1,691	710	361	399	221	1,998	117	375	960	433	113	261	121	90	1,748	450	146	159	1,644	193	94	46	243	72	65	10,079

Chemicals (n=88)

Production Base	141	44	56	38	3	174	70	46	44	14	189	9	25	104	40	11	20	6	7	135	23	8	10	79	5	1	0	12	2	4	785
Sales Base	148	26	30	46	46	58	30	8	14	6	65	3	10	40	9	3	14	4	1	79	14	6	7	125	6	4	0	18	0	3	534
Research and Development Base	6	2	1	3	0	7	4	1	2	0	11	1	5	2	1	2	3	1	1	23	1	1	0	9	0	0	0	3	0	0	63
Other	7	0	1	4	2	8	5	0	3	0	16	2	0	13	1	0	0	0	0	29	2	0	1	21	0	2	0	5	0	0	90
Total	302	72	88	91	51	247	109	55	63	20	281	15	40	159	51	16	37	11	9	266	40	15	18	234	11	7	0	38	2	7	1,472

General Machinery (n=64)

Production Base	40	12	16	9	3	58	30	14	12	2	85	5	14	51	11	4	8	7	1	48	19	7	10	45	8	0	0	3	2	0	316
Sales Base	94	17	25	35	17	62	29	8	14	11	58	1	9	36	11	1	3	2	1	74	47	18	11	126	9	6	5	21	6	4	515
Research and Development Base	3	0	1	2	0	1	0	0	0	1	7	0	0	6	1	0	0	0	0	5	0	0	0	8	0	0	0	0	0	0	24
Other	8	0	3	4	1	9	1	2	1	5	10	1	4	3	1	1	3	1	2	13	6	1	2	11	2	0	0	0	1	1	64
Total	145	29	45	50	21	130	60	24	27	19	160	7	27	96	24	6	14	10	4	140	72	26	23	190	19	6	5	24	9	5	919

Electrical Equipment and Electronics (n=111)

Production Base	162	31	64	36	31	288	112	58	84	34	402	37	55	162	126	22	34	14	17	121	51	26	15	103	16	0	2	4	2	4	1,189
Sales Base	294	42	58	93	101	110	40	14	37	19	124	2	23	74	24	1	7	4	2	204	46	8	17	353	28	22	1	31	18	5	1,243
Research and Development Base	8	0	3	4	1	6	0	0	5	1	23	2	6	13	2	0	1	1	0	36	1	0	0	21	1	0	0	1	0	0	98
Other	44	1	5	21	17	22	7	2	7	6	53	7	14	18	11	3	6	5	1	67	11	7	1	62	0	3	3	4	1	0	276
Total	508	74	130	154	150	426	159	74	133	60	602	48	98	267	163	26	48	24	20	428	109	41	33	539	45	25	6	40	21	9	2,806

Automobiles (n=94)

Production Base	74	32	38	2	2	244	128	63	30	23	189	3	43	59	57	27	58	38	13	188	55	29	21	63	28	8	0	6	6	8	927
Sales Base	37	6	6	10	15	36	20	4	6	6	15	0	5	7	3	0	9	2	1	59	27	2	4	99	10	13	2	21	20	14	362
Research and Development Base	2	2	0	0	0	9	7	0	0	2	3	0	1	2	0	0	2	1	1	15	0	0	0	16	0	0	0	0	0	0	47
Other	11	0	3	6	2	19	9	2	3	5	8	0	3	4	1	0	4	3	1	69	19	5	8	26	1	0	0	4	0	1	168
Total	124	40	47	18	19	308	164	69	39	36	215	3	52	72	61	27	73	44	16	331	101	36	33	204	39	21	2	31	26	23	1,498

Appended Table 2 Details on Medium-term Business Operations

(Unit: Number of Companies)

	NIES				ASEAN4				China	Other Asian and Pacific Countries					Vietnam	India	Other Asian Countries	North America	Latin America	Mexico	Brazil	Other Latin Countries	Europe	EUI5	Central and Eastern Europe	Other European Countries	Russia, other CIS	Middle East	Africa
	Korea	Taiwan	Singapore	Hong Kong	Thailand	Indonesia	Malaysia	Philippines		Northeastern China	Northern China	Eastern China	Southern China	Inland China															

(1) Stances on Business Strengthening or Expansion (multiple responses)

Number of Respondent Companies	240	291	255	241	338	230	239	161	113	233	389	281	97	132	123	77	397	110	116	57	327	131	76	81	95	76
Will strengthen or expand overseas business operations	117	103	58	65	231	102	75	55	66	169	333	230	54	77	75	22	214	34	40	13	152	84	27	51	37	24
Will maintain the size of overseas business operations at the present level	122	178	188	165	106	118	154	98	46	62	56	51	43	54	48	54	176	73	73	44	167	47	49	30	58	51
Will reduce or withdraw from overseas business operations	1	10	9	11	1	10	10	8	1	2	—	—	—	1	—	1	7	3	3	—	8	—	—	—	—	1

(2) Fields for Strengthening or Expansion (multiple responses)

Number of Respondent Companies	117	103	58	65	229	100	74	53	65	168	331	229	54	76	75	20	211	33	40	13	152	81	26	50	37	23
Production Function (companies responded)	44	40	13	7	174	66	36	29	34	97	240	150	25	41	36	7	121	19	19	3	49	39	4	6	8	10
1 Establishing new bases	8	6	—	2	17	5	1	2	10	31	78	49	10	14	8	3	23	2	2	—	1	13	1	3	5	3
2 Expanding existing production line	21	16	7	1	85	36	16	14	14	38	103	62	11	15	10	4	47	6	9	2	23	17	2	—	4	4
3 Establishing a production line for new products	12	7	1	1	67	15	8	9	11	31	85	45	9	12	9	1	32	4	2	—	16	11	1	—	2	2
4 Improving operation rates of existing production lines	10	15	6	5	62	25	15	14	8	27	71	39	7	14	11	2	48	8	8	1	19	4	1	—	—	2
5 Working partnership with other company	8	7	2	1	10	4	4	—	6	13	21	21	3	3	8	2	7	2	1	—	8	4	—	3	1	2
Sales Function (companies responded)	85	75	45	58	96	50	45	27	43	107	195	123	38	46	52	13	129	18	26	10	118	48	22	46	31	17
6 Establishing new bases	7	4	—	4	13	2	4	1	8	22	55	29	8	4	8	3	11	3	2	1	13	6	5	11	3	1
7 Expanding existing bases	24	32	19	32	44	15	12	10	10	42	93	47	9	17	13	2	62	5	9	2	51	14	5	12	11	7
8 Strengthening sales through the utilization of dealers and agents	53	43	28	26	42	34	31	18	30	56	78	59	25	30	33	7	62	11	18	8	71	33	16	27	21	10
9 Working partnership with other company	11	6	4	5	8	7	5	—	4	11	19	13	2	2	7	2	18	1	1	1	14	2	—	4	3	2
R&D Function (companies responded)	12	18	9	5	39	13	8	7	9	31	80	34	5	8	12	5	48	2	3	1	26	4	—	4	3	2
10 Securing skilled personnel	6	11	8	5	30	7	5	5	7	22	66	28	4	7	11	1	24	2	2	—	12	3	—	3	2	2
11 Basic research; long-term development	—	1	—	—	2	—	1	—	1	5	5	2	—	2	1	1	7	—	—	1	4	—	—	1	—	1
12 Applied research; developing new products, improving existing products	4	6	3	1	9	4	—	1	2	10	25	9	—	2	2	3	27	—	1	1	14	1	—	—	1	1
13 Working partnership with other company	3	2	1	—	1	2	2	1	2	3	6	2	1	1	1	1	6	—	—	—	1	—	—	1	—	1
Regional control function (companies responded)	6	6	18	17	14	5	4	1	5	9	43	19	—	4	3	1	17	1	2	—	14	2	2	—	1	1
14 Transferring functions of headquarters (Japan)	—	1	2	1	2	—	1	—	1	2	7	1	—	1	—	—	2	—	—	—	3	—	2	—	—	—
15 Finance	—	—	5	3	1	1	—	—	—	1	5	3	—	—	—	—	5	—	1	—	2	—	2	—	—	—
16 Sales	3	3	14	7	8	4	3	1	4	5	30	9	—	4	1	1	13	1	1	—	11	2	—	—	1	1
17 Purchasing (raw materials procurement)	3	2	3	8	4	2	1	—	2	4	19	11	—	1	2	—	1	—	—	—	1	—	1	—	—	1

(3)-1. Reduction or Withdrawal Functions (multiple responses)

Total

Companies responded (reduce or withdraw)	1	9	9	11	1	10	10	8	1	1	—	—	—	1	—	1	7	3	3	—	8	—	—	—	—	1	85
Production Function	—	6	1	—	—	10	10	7	1	—	—	—	—	—	—	1	4	2	2	—	5	—	—	—	—	1	50
Sales Function	1	3	9	10	1	2	—	2	—	1	—	—	—	—	—	—	3	1	1	—	4	—	—	—	—	—	38
R&D Function	—	—	—	—	—	—	1	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	1
Regional control function	—	—	1	2	—	—	—	—	—	—	—	—	—	1	—	—	—	—	1	—	—	—	—	—	—	—	5

(3)-2. After Having Reduced or Withdrawn Functions (multiple responses)

Reduce or withdraw to return to Japan	—	1	1	1	—	2	1	—	—	—	—	—	—	—	—	—	1	—	—	—	3	—	—	—	—	—	10
Reduce or withdraw to relocate or do the division of labor to third countries	1	5	5	6	1	4	4	2	—	—	—	—	—	—	—	—	2	3	—	—	4	—	—	—	—	—	37
Reduce or withdraw from the business concerned	—	4	3	4	—	4	5	5	1	1	—	—	—	1	—	1	4	—	3	—	1	—	—	—	—	1	38

Appended Table 3 Reasons for Profitability “Satisfactory” or “Unsatisfactory”

(1) Reasons for Evaluations of Satisfaction with Profitability (satisfactory/somewhat satisfactory)(multiple responses)

	NIES	Korea	Taiwan	Singapore	Hong Kong	ASEAN4	Thailand	Malaysia	Indonesia	Philippines	China	North America	Latin America	EU15	Central and Eastern Europe	All Regions
Number of Respondent Companies	295	61	99	71	64	260	137	56	43	24	147	108	21	81	17	929
Successful cost reductions (personnel costs, raw materials costs, etc.)	34	5	17	5	7	36	19	9	6	2	32	15	1	6	1	125
	11.5%	8.2%	17.2%	7.0%	10.9%	13.8%	13.9%	16.1%	14.0%	8.3%	21.8%	13.9%	4.8%	7.4%	5.9%	13.5%
Successful cost reduction through the consolidation of production	17	5	5	4	3	36	19	10	5	2	22	8	2	2	—	87
	5.8%	8.2%	5.1%	5.6%	4.7%	13.8%	13.9%	17.9%	11.6%	8.3%	15.0%	7.4%	9.5%	2.5%	—	9.4%
Full operation of production facilities	31	7	13	5	6	68	49	7	7	5	53	13	4	3	1	173
	10.5%	11.5%	13.1%	7.0%	9.4%	26.2%	35.8%	12.5%	16.3%	20.8%	36.1%	12.0%	19.0%	3.7%	5.9%	18.6%
Successful sales activities in the country or region concerned	242	55	80	58	49	188	102	35	35	16	97	98	17	75	15	732
	82.0%	90.2%	80.8%	81.7%	76.6%	72.3%	74.5%	62.5%	81.4%	66.7%	66.0%	90.7%	81.0%	92.6%	88.2%	78.8%
Successful exports from the country or region concerned	50	4	14	17	15	50	27	10	8	5	26	4	2	8	3	143
	16.9%	6.6%	14.1%	23.9%	23.4%	19.2%	19.7%	17.9%	18.6%	20.8%	17.7%	3.7%	9.5%	9.9%	17.6%	15.4%
Exchange rate profits (includes conversion efficiency rate of the Yen at the time of consolidated accounting)	2	—	1	—	1	4	1	1	2	—	2	4	1	7	1	21
	0.7%	—	1.0%	—	1.6%	1.5%	0.7%	1.8%	4.7%	—	1.4%	3.7%	4.8%	8.6%	5.9%	2.3%
Partnership, effective M&A	3	1	1	—	1	5	2	2	1	—	2	3	—	2	1	16
	1.0%	1.6%	1.0%	—	1.6%	1.9%	1.5%	3.6%	2.3%	—	1.4%	2.8%	—	2.5%	5.9%	1.7%
Investment incentives for host country realized as planned	—	—	—	—	—	7	6	—	—	1	6	—	—	1	—	14
	—	—	—	—	—	2.7%	4.4%	—	—	4.2%	4.1%	—	—	1.2%	—	1.5%
Other	3	1	—	1	1	4	1	1	2	—	2	3	1	4	—	17
	1.0%	1.6%	—	1.4%	1.6%	1.5%	0.7%	1.8%	4.7%	—	1.4%	2.8%	4.8%	4.9%	—	1.8%

(2) Reasons for Evaluations of Satisfaction with Profitability (unsatisfactory/somewhat unsatisfactory) (multiple responses)

Number of Respondent Companies	274	62	85	76	51	284	85	74	77	48	155	196	44	126	26	1,105
Cost reductions are difficult (personnel expenses, raw materials costs, etc.)	49	17	18	12	2	83	20	27	27	9	36	61	10	37	6	282
	17.9%	27.4%	21.2%	15.8%	3.9%	29.2%	23.5%	36.5%	35.1%	18.8%	23.2%	31.1%	22.7%	29.4%	23.1%	25.5%
Yet to reach full operation as the company has been set up recently	6	1	3	—	2	28	17	4	3	4	60	9	2	3	9	117
	2.2%	1.6%	3.5%	—	3.9%	9.9%	20.0%	5.4%	3.9%	8.3%	38.7%	4.6%	4.5%	2.4%	34.6%	10.6%
Demand by customers to reduce sales prices	86	18	24	28	16	66	23	16	17	10	41	50	5	37	8	293
	31.4%	29.0%	28.2%	36.8%	31.4%	23.2%	27.1%	21.6%	22.1%	20.8%	26.5%	25.5%	11.4%	29.4%	30.8%	26.5%
Difficult to obtain customers (intense competition with other companies)	133	26	43	41	23	108	30	32	26	20	68	108	19	70	7	513
	48.5%	41.9%	50.6%	53.9%	45.1%	38.0%	35.3%	43.2%	33.8%	41.7%	43.9%	55.1%	43.2%	55.6%	26.9%	46.4%
Maturation of products (diffusion of products)	48	8	14	17	9	47	10	15	14	8	10	35	5	24	—	169
	17.5%	12.9%	16.5%	22.4%	17.6%	16.5%	11.8%	20.3%	18.2%	16.7%	6.5%	17.9%	11.4%	19.0%	—	15.3%
Shrinking market due to economic downturn	39	12	8	11	8	40	3	13	12	12	3	24	12	19	2	139
	14.2%	19.4%	9.4%	14.5%	15.7%	14.1%	3.5%	17.6%	15.6%	25.0%	1.9%	12.2%	27.3%	15.1%	7.7%	12.6%
Unsuccessful exports from the country or region concerned	5	1	2	2	—	12	2	3	5	2	6	4	1	5	—	33
	1.8%	1.6%	2.4%	2.6%	—	4.2%	2.4%	4.1%	6.5%	4.2%	3.9%	2.0%	2.3%	4.0%	—	3.0%
Overseas exchange losses (includes conversion efficiency rate of the yen at the time of consolidated accounting)	24	7	7	6	4	37	7	6	16	8	12	13	8	6	—	100
	8.8%	11.3%	8.2%	7.9%	7.8%	13.0%	8.2%	8.1%	20.8%	16.7%	7.7%	6.6%	18.2%	4.8%	—	9.0%
Discouraging responses by host country	—	—	—	—	—	5	2	1	2	—	1	—	—	2	—	8
	—	—	—	—	—	1.8%	2.4%	1.4%	2.6%	—	0.6%	—	—	1.6%	—	0.7%
Other	14	4	5	2	3	20	6	3	7	4	9	10	5	1	—	59
	5.1%	6.5%	5.9%	2.6%	5.9%	7.0%	7.1%	4.1%	9.1%	8.3%	5.8%	5.1%	11.4%	0.8%	—	5.3%

Note: (Upper: No. of respondent companies, Lower: No. of respondent business operators by region)

Appended Table 4 Changes and Details for Promising Countries/Regions for Overseas Business Operations over the Medium term (next 3 years or so)

Rank	FY2004 Survey	Number of companies (497)	Response Rate (%)	FY2003 Survey	Number of companies (490)	Response Rate (%)	FY2002 Survey	Number of companies (418)	Response Rate (%)	FY2001 Survey	Number of companies (401)	Response Rate (%)	FY2000 Survey	Number of companies (372)	Response Rate (%)
1	China	453	91	China	456	93	China	373	89	China	327	82	China	242	65
2	Thailand	151	30	Thailand	143	29	Thailand	118	28	U.S.	127	32	U.S.	154	41
3	India	117	24	U.S.	106	22	U.S.	108	26	Thailand	99	25	Thailand	88	24
4	Vietnam	110	22	Vietnam	88	18	Indonesia	63	15	Indonesia	56	14	Indonesia	54	15
5	U.S.	100	20	India	70	14	Vietnam	62	15	India	52	13	Malaysia	43	12
6	Russia	49	10	Indonesia	63	13	India	54	13	Vietnam	48	12	Taiwan	41	11
7	Indonesia	48	10	Korea	44	9	Korea	34	8	Taiwan	44	11	India	37	10
8	Korea	44	9	Taiwan	35	7	Taiwan	34	8	Korea	33	8	Vietnam	35	9
9	Taiwan	41	8	Malaysia	31	6	Malaysia	33	8	Malaysia	32	8	Korea	32	9
10	Malaysia	28	6	Russia	25	5	Brazil	19	5	Singapore	24	6	Philippines	30	8
11	Singapore	17	3	Singapore	23	5	Singapore	18	4	Philippines	22	5	U.K.	28	8
12	Germany	17	3	Philippines	18	4	Philippines	17	4	Germany	19	5	Singapore	25	7
13	Brazil	16	3	Czech	17	3	Germany	16	4	Brazil	18	4	Germany	25	7
14	Philippines	15	3	Hong Kong	15	3	Mexico	15	4	Mexico	18	4	Brazil	21	6
15	France	15	3	Mexico	12	2	Czech	13	3	France	17	4	Mexico	18	5
16	Czech	12	2	Brazil	11	2	U.K.	11	3	Czech	15	4	France	17	5
17	Australia	11	2	Germany	11	2	Russia	11	3	U.K.	14	3	Spain	10	3
18	Poland	10	2	France	10	2	Poland	10	2	Hungary	12	3	Canada	8	2
19	Mexico	9	2	Australia	9	2	Hong Kong	9	2	Poland	11	3	Hong Kong	8	2
20	U.K.	9	2	Poland	9	2	Hungary	9	2	Hong Kong	8	2	Australia	8	2

Note 1: In this survey, respondent companies cited the top 5 countries that they saw as having promising prospects for business operations in the medium term (next 3 years or so). Tallies were calculated based on the number of companies that named each countries/regions, and the above countries were listed according to that number.

Note 2: Besides the countries/regions shown in the list, some of the responses also named other countries/regions, such as North America and the EU. In this year's survey, North America was named by 44 companies (response rate: 8.9%), and the EU by 29 companies (5.8%)

**Appended Table 5 Promising Countries/Regions for Overseas Business Operations
-Details of Reasons for Promising Prospect (multiple responses)**

FY 2004 Survey

		1		2		3		4		5		6		7		8		9		10	
		China		Thailand		India		Vietnam		U.S.		Russia		Indonesia		Korea		Taiwan		Malaysia	
		Number of companies	Ratio	Number of companies	Ratio	Number of companies	Ratio	Number of companies	Ratio	Number of companies	Ratio	Number of companies	Ratio	Number of companies	Ratio	Number of companies	Ratio	Number of companies	Ratio	Number of companies	Ratio
Number of Respondent Companies		448	100	146	100	112	100	108	100	98	100	49	100	45	100	44	100	41	100	26	100
Production	Excellent human resources	85	19	27	18.5	41	36.6	38	35.2	15	15.3	7	14.3	2	4.4	8	18.2	4	9.8	2	7.7
	Inexpensive labor force	296	66.1	72	49.3	63	56.3	82	75.9	2	2	9	18.4	31	68.9	2	4.5	2	4.9	7	26.9
	Low-cost parts and raw materials	96	21.4	19	13	6	5.4	10	9.3	1	1	1	2	4	8.9	1	2.3	1	2.4	1	3.8
	Supply base for assembly manufacturers	128	28.6	44	30.1	18	16.1	13	12	24	24.5	5	10.2	8	17.8	6	13.6	10	24.4	6	23.1
	Industrial cluster	72	16.1	34	23.3	2	1.8	5	4.6	18	18.4	—	—	4	8.9	5	11.4	10	24.4	3	11.5
	Risk diversification	12	2.7	17	11.6	2	1.8	27	25	2	2	2	4.1	4	8.9	1	2.3	1	2.4	5	19.2
	Base for exports to Japan	87	19.4	19	13	3	2.7	20	18.5	—	—	—	—	7	15.6	1	2.3	2	4.9	4	15.4
	Base for export to the third countries	93	20.8	40	27.4	12	10.7	22	20.4	2	2	1	2	12	26.7	4	9.1	6	14.6	7	26.9
Sales	Present local market size	107	23.9	30	20.5	19	17	7	6.5	65	66.3	5	10.2	9	20	25	56.8	19	46.3	6	23.1
	Growth potential of the market	373	83.3	83	56.8	92	82.1	52	48.1	48	49	47	95.9	28	62.2	28	63.6	24	58.5	8	30.8
	Product development for local needs	30	6.7	7	4.8	2	1.8	1	0.9	12	12.2	1	2	—	—	3	6.8	5	12.2	1	3.8
Infrastructure and systems	Developed local infrastructure	15	3.3	37	25.3	—	—	7	6.5	38	38.8	4	8.2	2	4.4	8	18.2	12	29.3	7	26.9
	Tax incentives for investment	78	17.4	36	24.7	4	3.6	25	23.1	3	3.1	—	—	4	8.9	1	2.3	2	4.9	6	23.1
	Stable policies to attract foreign capital	19	4.2	30	20.5	1	0.9	5	4.6	5	5.1	—	—	1	2.2	2	4.5	2	4.9	3	11.5
	Benefits from regional integration	5	1.1	13	8.9	—	—	4	3.7	—	—	—	—	3	6.7	1	2.3	1	2.4	3	11.5
	Stable political and social condition	19	4.2	58	39.7	3	2.7	22	20.4	36	36.7	1	2	1	2.2	6	13.6	6	14.6	10	38.5

FY 2003 Survey

		1		2		5		4		3		10		6		7		8		9	
		China		Thailand		India		Vietnam		U.S.		Russia		Indonesia		Korea		Taiwan		Malaysia	
Number of Respondent Companies		447	100	141	100	69	100	85	100	103	100	25	100	62	100	42	100	33	100	30	100
Production	Excellent human resources	108	24.2	26	18.4	21	30.4	30	35.3	25	24.3	1	4.0	3	4.8	9	21.4	6	18.2	5	16.7
	Inexpensive labor force	335	74.9	81	57.4	41	59.4	63	74.1	2	1.9	2	8.0	42	67.7	3	7.1	1	3.0	12	40.0
	Low-cost parts and raw materials	153	34.2	16	11.3	10	14.5	11	12.9	1	1.0	1	4.0	8	12.9	3	7.1	2	6.1	4	13.3
	Supply base for assembly manufacturers	128	28.6	48	34.0	17	24.6	12	14.1	27	26.2	1	4.0	17	27.4	2	4.8	5	15.2	7	23.3
	Industrial cluster	64	14.3	30	21.3	2	2.9	2	2.4	20	19.4	1	4.0	7	11.3	8	19.0	8	24.2	1	3.3
	Risk diversification	20	4.5	18	12.8	3	4.3	27	31.8	5	4.9	1	4.0	5	8.1	3	7.1	2	6.1	7	23.3
	Base for exports to Japan	100	22.4	28	19.9	7	10.1	21	24.7	—	—	—	—	9	14.5	1	2.4	1	3.0	7	23.3
	Base for export to the third countries	98	21.9	42	29.8	12	17.4	18	21.2	4	3.9	—	—	17	27.4	4	9.5	6	18.2	4	13.3
Sales	Present local market size	88	19.7	24	17.0	13	18.8	5	5.9	63	61.2	4	16.0	11	17.7	17	40.5	19	57.6	2	6.7
	Growth potential of the market	368	82.3	72	51.1	53	76.8	35	41.2	50	48.5	23	92.0	35	56.5	28	66.7	10	30.3	9	30.0
	Product development for local needs	35	7.8	9	6.4	2	2.9	1	1.2	17	16.5	—	—	2	3.2	4	9.5	2	6.1	2	6.7
Infrastructure and systems	Developed local infrastructure	42	9.4	33	23.4	2	2.9	4	4.7	37	35.9	1	4.0	4	6.5	15	35.7	6	18.2	8	26.7
	Tax incentives for investment	78	17.4	35	24.8	3	4.3	12	14.1	3	2.9	—	—	4	6.5	2	4.8	2	6.1	7	23.3
	Stable policies to attract foreign capital	20	4.5	21	14.9	1	1.4	6	7.1	6	5.8	—	—	2	3.2	3	7.1	1	3.0	7	23.3
	Benefits from regional integration	6	1.3	13	9.2	1	1.4	2	2.4	—	—	—	—	6	9.7	—	—	—	—	2	6.7
	Stable political and social condition	18	4.0	48	34.0	1	1.4	17	20.0	39	37.9	—	—	—	—	5	11.9	6	18.2	10	33.3

Note: The top 3 reasons are shaded for each country/region.

**Appended Table 6 Promising Countries/Regions for Overseas Business Operations
-Details of Issues**

FY 2004 Survey

	1		2		3		4		5		6		7		8		9		10		
	China		Thailand		India		Vietnam		U.S.		Russia		Indonesia		Korea		Taiwan		Malaysia		
	Number of companies	Ratio	Number of companies	Ratio	Number of companies	Ratio	Number of companies	Ratio	Number of companies	Ratio	Number of companies	Ratio	Number of companies	Ratio	Number of companies	Ratio	Number of companies	Ratio	Number of companies	Ratio	
Number of Respondent Companies	423	100	102	100	95	100	82	100	74	100	42	100	38	100	28	100	27	100	18	100	
Laws and taxation systems	Under-development of local legal system	124	29.3	2	2	28	29.5	33	40.2	—	—	16	38.1	4	10.5	1	3.6	2	7.4	1	5.6
	Unclear operation of local legal system	268	63.4	8	7.8	23	24.2	30	36.6	—	—	15	35.7	8	21.1	—	—	1	3.7	1	5.6
	Complex local tax collection systems	78	18.4	8	7.8	7	7.4	8	9.8	—	—	4	9.5	7	18.4	—	—	—	—	2	11.1
	Unclear operation of taxation system	163	38.5	8	7.8	10	10.5	17	20.7	—	—	5	11.9	9	23.7	2	7.1	3	11.1	1	5.6
	Increase in tax burden	83	19.6	17	16.7	8	8.4	6	7.3	13	17.6	2	4.8	4	10.5	4	14.3	5	18.5	2	11.1
Administration, overall	Restrictions on foreign capital	137	32.4	11	10.8	15	15.8	19	23.2	—	—	7	16.7	4	10.5	2	7.1	—	—	3	16.7
	Complex and vague investment permit procedures	87	20.6	9	8.8	14	14.7	9	11	1	1.4	8	19	4	10.5	—	—	—	—	2	11.1
	Difficulty in obtaining immigration or working visas	4	0.9	2	2	2	2.1	—	—	13	17.6	4	9.5	1	2.6	1	3.6	—	—	—	—
	Insufficient protection of intellectual property rights	220	52	5	4.9	16	16.8	16	19.5	1	1.4	7	16.7	4	10.5	7	25	5	18.5	1	5.6
	Local restrictions on currency exchange and remittance	176	41.6	8	7.8	11	11.6	15	18.3	1	1.4	7	16.7	1	2.6	2	7.1	4	14.8	3	16.7
	Import restrictions	39	9.2	5	4.9	13	13.7	2	2.4	2	2.7	4	9.5	—	—	1	3.6	3	11.1	—	—
	Anti-dumping measures	15	3.5	4	3.9	—	—	—	—	16	21.6	—	—	—	—	—	—	—	—	—	—
Labor problems	Difficulty in securing local personnel (management level)	120	28.4	28	27.5	12	12.6	22	26.8	12	16.2	6	14.3	11	28.9	3	10.7	4	14.8	3	16.7
	Increase in labor costs	137	32.4	41	40.2	6	6.3	7	8.5	24	32.4	5	11.9	7	18.4	9	32.1	11	40.7	10	55.6
	Local labor problems	71	16.8	13	12.7	17	17.9	11	13.4	17	23	6	14.3	8	21.1	12	42.9	3	11.1	3	16.7
General problems	Intense local competition	177	41.8	46	45.1	18	18.9	11	13.4	51	68.9	9	21.4	12	31.6	18	64.3	18	66.7	4	22.2
	Difficulty in collecting receivables	181	42.8	2	2	16	16.8	9	11	—	—	10	23.8	1	2.6	2	7.1	2	7.4	—	—
	Difficulty in local financial access	41	9.7	4	3.9	4	4.2	4	4.9	—	—	6	14.3	1	2.6	3	10.7	1	3.7	1	5.6
	Under-development of local supporting industries	42	9.9	6	5.9	19	20	20	24.4	2	2.7	8	19	4	10.5	1	3.6	—	—	1	5.6
	Instability of local currency and price	31	7.3	4	3.9	9	9.5	9	11	—	—	10	23.8	9	23.7	—	—	1	3.7	—	—
	Under-development of infrastructure	166	39.2	9	8.8	41	43.2	27	32.9	—	—	7	16.7	8	21.1	1	3.6	1	3.7	1	5.6
	Unstable local security and social conditions	40	9.5	4	3.9	32	33.7	3	3.7	2	2.7	19	45.2	22	57.9	4	14.3	4	14.8	1	5.6
Insufficient information on investment climate	14	3.3	2	2	33	34.7	25	30.5	—	—	18	42.9	3	7.9	2	7.1	1	3.7	—	—	

FY 2003 Survey

	1		2		5		4		3		10		6		7		8		9		
	China		Thailand		India		Vietnam		U.S.		Russia		Indonesia		Korea		Taiwan		Malaysia		
	Number of companies	Ratio	Number of companies	Ratio	Number of companies	Ratio	Number of companies	Ratio	Number of companies	Ratio	Number of companies	Ratio	Number of companies	Ratio	Number of companies	Ratio	Number of companies	Ratio	Number of companies	Ratio	
Number of Respondent Companies	427	100	106	100	60	100	71	100	78	100	22	100	52	100	31	100	24	100	21	100	
Laws and taxation systems	Under-development of local legal system	128	30.0	4	3.8	15	25.0	26	36.6	—	—	6	27.3	8	15.4	—	—	2	8.3	—	—
	Unclear operation of local legal system	280	65.6	10	9.4	17	28.3	28	39.4	—	—	12	54.5	13	25.0	1	3.2	—	—	—	—
	Complex local tax collection systems	103	24.1	9	8.5	9	15.0	4	5.6	1	1.3	1	4.5	5	9.6	—	—	—	—	—	—
	Unclear operation of taxation system	175	41.0	10	9.4	12	20.0	12	16.9	—	—	5	22.7	5	9.6	2	6.5	1	4.2	—	—
	Increase in tax burden	67	15.7	15	14.2	5	8.3	5	7.0	9	11.5	—	—	4	7.7	2	6.5	1	4.2	4	19.0
Administration in general	Restrictions on foreign capital	141	33.0	12	11.3	8	13.3	19	26.8	—	—	3	13.6	1	1.9	3	9.7	—	—	5	23.8
	Complex and vague investment permit procedures	115	26.9	8	7.5	10	16.7	18	25.4	1	1.3	1	4.5	4	7.7	1	3.2	—	—	—	—
	Difficulty in obtaining working visa	15	3.5	5	4.7	4	6.7	1	1.4	11	14.1	1	4.5	4	7.7	—	—	—	—	1	4.8
	Insufficient protection of intellectual property rights	197	46.1	11	10.4	10	16.7	14	19.7	—	—	2	9.1	10	19.2	5	16.1	5	20.8	—	—
	Local restrictions on currency exchange and remittance	175	41.0	4	3.8	9	15.0	10	14.1	1	1.3	1	4.5	1	1.9	4	12.9	3	12.5	4	19.0
	Import restrictions	70	16.4	5	4.7	7	11.7	11	15.5	—	—	1	4.5	3	5.8	1	3.2	—	—	—	—
	Anti-dumping measures	19	4.4	1	0.9	1	1.7	1	1.4	10	12.8	—	—	1	1.9	2	6.5	—	—	—	—
Labor problems	Difficulty in securing local personnel (management level)	111	26.0	39	36.8	7	11.7	25	35.2	9	11.5	2	9.1	12	23.1	3	9.7	3	12.5	2	9.5
	Increase in labor costs	85	19.9	31	29.2	6	10.0	3	4.2	25	32.1	—	—	10	19.2	11	35.5	6	25.0	5	23.8
	Local Labor problems	60	14.1	12	11.3	16	26.7	8	11.3	12	15.4	1	4.5	20	38.5	8	25.8	2	8.3	3	14.3
General problems	Intense local competition	159	37.2	47	44.3	13	21.7	6	8.5	57	73.1	4	18.2	14	26.9	22	71.0	14	58.3	10	47.6
	Request for technology transfer and performance	34	8.0	6	5.7	5	8.3	4	5.6	2	2.6	—	—	3	5.8	2	6.5	—	—	1	4.8
	Difficulty in collecting receivables	176	41.2	2	1.9	9	15.0	7	9.9	—	—	4	18.2	1	1.9	2	6.5	—	—	—	—
	Difficulty in local financial access	38	8.9	3	2.8	2	3.3	8	11.3	—	—	—	—	3	5.8	—	—	—	—	2	9.5
	Under-development of local supporting industries	54	12.6	5	4.7	13	21.7	20	28.2	1	1.3	1	4.5	11	21.2	—	—	—	—	2	9.5
	Instability of local currency and price	17	4.0	6	5.7	5	8.3	5	7.0	—	—	5	22.7	17	32.7	2	6.5	—	—	1	4.8
	Under-development of infrastructure	67	15.7	9	8.5	27	45.0	33	46.5	—	—	4	18.2	13	25.0	—	—	—	—	1	4.8
	Unstable local political and social conditions	47	11.0	3	2.8	11	18.3	5	7.0	1	1.3	7	31.8	28	53.8	2	6.5	—	—	—	—
Insufficient information on investment climate	21	4.9	4	3.8	13	21.7	27	38.0	—	—	7	31.8	3	5.8	2	6.5	1	4.2	—	—	

Note: The top 3 problems are shaded for each country/region

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