

Japanese business

Gaijin at the gates

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Illustration by Claudio Munoz



Japan is courting foreign investors, not for their money but for their ideas

SEIYU, a Japanese discount retailer, this week forecast its sixth straight annual loss. But its chief executive did not bow in contrition as other Japanese bosses might have. Instead, Ed Kolodzieski gushed about the firm's bright future, his southern American twang a testament to his former role as an executive at Wal-Mart, which owns a majority of the Japanese firm. Despite Seiyu's terrible performance, its American parent is pouring in money to modernise its stores.

That is just how Japan wants it. The government is trying hard to attract foreign direct investment (FDI). It has revamped the commercial code, made it easier for foreign firms to buy Japanese ones and set up a whole bureaucracy to win over hesitant investors. Yet this enthusiasm underscores an oddity: why should a country that has an excess of capital seek out foreign money?

The answer is not for the cash, but for the people and ideas that come with it. Japan hopes foreigners can reform companies, introduce competition and shake up old industry structures in ways that domestic firms cannot. "It is important that we have more new players in the Japanese economy, with new ideas and new business models," says Nobuyuki Nagashima of JETRO, a government agency that used to promote Japanese exports, but which now has an additional mandate to attract foreign investment.

The notion that gaiatsu, or "foreign pressure", can spur reform has a long history in Japan. In 1853 the "black ships" of America's Commodore Perry forced the Japanese market open at gunpoint, helping to unwind centuries-old feudal traditions. More recently, if less flamboyantly, foreign firms have disrupted the Japanese market by creating competition.

For example, Renault's Carlos Ghosn restored a near-bankrupt Nissan to health by drastically cutting suppliers and staff (though it has faltered lately). The arrival of Starbucks forced other coffee-shop chains to improve. Foreign insurers unleashed a bevy of new products that have been aped by domestic rivals. And foreign private-equity funds have fixed and flipped many foundering firms.

But Japan's embrace of foreign investment has been less successful than these examples suggest. Although Japan's inward FDI doubled between 2000 and 2005, it still amounted to only 2.4% of national output, far less than in other big economies. In America the comparable figure is 15%, and in Germany, France and Britain it is between 30% and 40%. This means that foreign firms' share of the economy is far smaller than in other countries (see chart).

Japan lags so far behind for both economic and cultural reasons. Consumer spending is sluggish, wages and prices are falling and the population is shrinking. "Japan is a somewhat saturated market already—the incentive for foreign investment is not that high," explains Frances Cheung, an economist at Standard Chartered, an investment bank. Nor can Japan compete as a regional export hub with the likes of Singapore and Shanghai. The tax code makes life difficult for foreign firms and red tape abounds. As a result, Japan is losing the race to attract global capital, says Seiji Adachi of Deutsche Bank.

Cultural factors are an even bigger hurdle. Many companies resist foreign takeovers for fear that the new owners will restructure too harshly, slashing jobs and spurning suppliers of long standing. In fact, restructuring is hard, which makes takeovers less attractive. Foreign investors say they struggle to find managerial talent. People tend to work their way up the hierarchy in a single firm for their whole careers, leaving few managers in the labour market.

All told, foreign companies often find that investing in Japan involves too much effort for too little profit.

Yet garnering FDI is critical for Japan's future. In manufacturing, labour productivity at the Japanese affiliates of foreign firms is as much as 60% higher than it is at domestic firms; in services firms it is 80% higher, according to the Organisation for Economic Co-operation and Development. Thanks to its declining population, Japan will have to increase productivity dramatically to maintain living standards. Yet productivity is lower than in many other countries and by some measures is falling further behind.

Furthermore, acquisitions by foreign buyers have tended to increase the overall value of Japanese firms. Three years after an international takeover, profits have increased by 35% on average, according to ABeam Consulting, and the overall value of firms acquired by foreigners has increased nearly twice as much as those bought by domestic competitors.

Foreign firms can bring competition to Japan where local ones might not because they do not feel bound by existing approaches or business relationships, notes Nicholas Benes of JTP, a firm that advises on mergers and acquisitions. They are also often the most efficient in their industries. Steven Vogel of the University of California at Berkeley has found that foreign-owned firms are more likely to restructure than Japanese ones. And the investment reaches economically stagnant corners of the countryside, not just the relatively prosperous big cities.

Heang Chhor, the head of the Tokyo office of McKinsey, a consultancy, believes there is good reason to invest: trillions of yen will be spent over the next decade by the elderly on everything from holidays to health care. In 2025 the country will still account for at least 10% of global output.

This is what attracted Wal-Mart in 2002, when it bought its stake in Seiyu. So far, it has had scant success: Seiyu's share price has fallen by three-quarters since Wal-Mart invested, thanks to the same inefficiencies that afflict most Japanese retailers. So the American firm is trying to change the very way the Japanese business operates, particularly by introducing Wal-Mart's advanced IT system, called



RetailLink, which analyses store performance and customer trends.

“Seiyu is bogged down in old customs that are wasteful,” explained Toru Noda, the company's chief operating officer, when it revealed more losses this week. Wal-Mart brings proven skills in managing big supermarkets, he said. “It is what we would like to learn to do.”