Peculiarities of Japan's Multinationalism: Facts and Theories

Introduction

A variety of theories have been advanced to explain the present trend of business firms toward multinational operations, a trend which was first noticed in the United States but is now spreading to other industrial countries. Several survey articles interpreting and categorizing these motley theories have been published recently. Among the most recent are one paper by John H. Dunning (1973),[1] which evaluates major theories in this growing field of literature and another by Thomas G. Parry (1973),[2] which discusses mainly the policy issues. A series of UN reports (1973-1974)[3] on multinational corporations focuses on the political questions involved, particularly those which arise on the side of the host countries of the Third World. The theoretical works so far written obviously revolve around the behaviour of Western multinationals, notably U.S. multinational corporations, with their Japanese counterparts being either treated as a special case or as mere newcomers who will inevitably follow the same path their Western predecessors had trod. True, some writers are more cautious, cautious enough to point out some differences in the industrial pattern of Japanese multinationals and

1 JOHN H. DUNNING, "The Determinants of International Production", *Oxford Economic Paper*, Vol. 25 (Nov. 1973), pp. 289-336.

2 THOMAS G. PARRY, "The International Firm and National Economic Policy: A Survey of Some Issues", *The Economic Journal*, Vol. 83, No. 332 (Dec. 1973), pp. 1201-1221.

3 UNITED NATIONS, *Multinational Corporations in World Development* (E. 73. II.A. 11); *The Impact of Multinational Corporations on Development and on International Relations*, 4 vol. (E. 74. II. A. 5, A. 6, A. 7, and A. 8); and *Summary of the Hearings before the Group of Eminent Persons to Study the Impact of Multinational Corporations on Development and on International Relations* (E. 74. II. A. 9).

to urge a further and more systematic analysis.[4] The purpose of this paper is to describe and interpret the uniqueness of Japan's emerging multinationalism and to consider the applicability of existing theories. The first section delineates the patterns and competitiveness of Japanese multinationals, by region and industry, and the second section evaluates the relevance of existing Western theories as applied to the Japanese case.

Patterns and Competitiveness

The Japanese government has recently begun to realize that direct foreign investment (DFI) is an important catalyst in implementing its ambitious plan to reorganize and upgrade Japan's economic structure while integrating its industrial activities with those of the rest of the world, supplementing the traditional route of trade. Japan now desires to transfer through DFI some of its traditional industries (particularly those which are less skill-intensive, resource-consuming, or pollution-prone) to developing or resource-rich countries and to encourage the development of modern, technology-intensive, and "clean" industries at home. Nevertheless, Japan's DFI activities throughout the postwar period have largely evolved in response to changing economic conditions in the world market. Among the important developments have been the rising protectionism against Japanese exports overseas, the eagerness of developing countries to attract foreign capital and technology, the so-called "chasing-up competition" from these countries against Japan's traditional industries, the soaring labor costs and rising social costs of industrial growth at home, and the recent changes in the value of the yen. The combination of these events rendered obsolete and even

4 For example, Dunning states: "The second line of research which needs pursuing is a more systematic analysis of the distinctiveness of [multinational enterprises (MEs)] and alternative forms of market penetration, by country and industry... Why is the broad industrial pattern of the Japanese MEs different from that of their U.S. and European counterparts?", *op. cit.*, p. 329. Raymond Vernon also observes: "... there are stages in the process of developing new theory when it pays to emphasize the inductive rather than the deductive phase of the cerebrating process. Though a considerable amount of observation has been done concerning the factors affecting the decisions of U.S. firms as they establish themselves overseas, much less has been done regarding the behaviour of European and Japanese firms". "A Program of Research on Foreign Direct Investment", in C. Fred Bergsten (ed.), *The Future of the International Economic Order: An Agenda for Research* (Lexington, Mass.; Lexington Books, 1973), p. 97.

deleterious to Japan the conventional approach of home-centered economic expansion (namely, importing raw materials, turning them into manufactures at home, and then exporting the latter back to the world). In short, overseas production has become a useful supplement to, as well as a desirable substitute for, Japan's trade. This new mode of commercial relations is reflected in the industrial and regional distributions of Japan's overseas investments, as shown in Tables 1 and 2.

TABLE 1

DISTRIBUTION OF JAPAN'S DIRECT FOREIGN INVESTMENT BY INDUSTRIAL SECTOR AND REGION

(in millions of U.S. dollars and percentage at the end of 1973)

Region	Extractive Sector	Manufacturing Sector	Commerce & Services
North America	272 (9.4)*	550 (18.7)	1,453 (43.1)
Europe	47 (1.6)	138 (4.7)	924 (27.4)
Latin America	204 (7.1)	932 (31.8)	479 (14.2)
Asia	692 (23.9)	1,096 (37.4)	400 (11.9)
Oceania	394 (13.7)	150 (5.1)	84 (2.5)
Middle East	1,158 (40.1)	26 (0.8)	9 (0.3)
Africa	119 (4.1)	41 (1.4)	22 (0.7)
Total	2,886 (100.0)	2,933 (100.0)	3,371 (100.0)

* Figures in parentheses show percentages.

SOURCE: Compiled from Japanese Ministry of International Trade and Industry, *Tsusho Hakusho* (White Paper on International Trade) 1974.

One feature seems unique — a heavy concentration of investments in commerce and services, accounting for as much as 36.7 per cent of the total amount of Japan's DFI (Table 1). The fact that 43.1 per cent of this category of investment is made in North America indicates the importance of that region for Japan's postwar economic development through trade. It was the United States in

particular that, by adopting a freer trade policy, allowed a phenomenal increase in imports from Japan, mostly income-elastic, high-value manufactures (such as automobiles, motor cycles, radios, and TV sets) that Japanese industry had succeeded in producing competitively, using technologies purchased mostly from the United States itself.[5] These Japanese exports, notably consumer durables, required the establishment of marketing networks, especially in advanced Western markets, to take care of inventories, advertising, sales promotion, and after-sale services. On the regional level, therefore, DFI in commerce and services accounts for 63.8 per cent of Japan's total investment in the United States and as much as 83.3 per cent of that in Europe (Table 2).[6]

TABLE 2

SECTORIAL DISTRIBUTION OF JAPAN'S DIRECT FOREIGN INVESTMENT WITHIN DIFFERENT REGIONS

(In percentage at the end of 1973)

Region	Extractive Sector	Manufacturing Sector	Commerce & Services	Total *
North America	11.9	24.2	63.8	100.0
Europe	4.2	12.4	83.3	100.0
Latin America	12.6	57.7	29.6	100.0
Asia	31.6	50.1	18.3	100.0
Oceania	62.7	23.9	13.4	100.0
Middle East	97.1	2.2	0.8	100.0
Africa	65.4	22.5	12.1	100.0

* Figures may not add up to 100.0 due to rounding.
SOURCE: Computed from Table 1.

5 For an analysis of Japan's postwar experience in assimilating foreign technologies and developing trade competitiveness, see TERUTOMO OZAWA, *Japan's Technological Challenge to the West, 1950-1974: Motivation and Accomplishment* (Cambridge, Mass.: The M.I.T. Press, 1974).

6 This high ratio for Europe exists not because Europe is a more important export market for Japan than the United States but because other categories of DFI in Europe are much smaller than in the United States.

As might well be expected of a country that lacked natural resources yet emphasized the development of resource-consuming heavy and chemical industries, stabilizing its supplies of overseas resources was Japan's primary goal in making its DFI in extractive industries. Here the economics is not a cost-pinching, short-term calculation but a security-primacy, long-term calculation. Japan's demand for and its dependence on overseas resources have increased enormously — so much so that the conventional trade mechanism, because it inevitably involves uncertainties, has become obviously inappropriate and thus a "develop-and-import" strategy through DFI has become a *sine qua non*, since it helps to secure, even if partially, the supply sources through their participation in ownership and management. Therefore, Japan's DFI shows a relatively high proportion of investments in extractive ventures as compared to its Western counterparts'. At the end of 1972, for example, the ratio of extractive investments was 36.8 per cent for Japan, 35.7 per cent for the United States, 7.2 per cent for Britain, and 5.3 per cent for West Germany.[7]

Many products whose output had expanded phenomenally during the postwar period were either derived from petroleum as raw material or were petroleum-using in the method of production or in the mode of consumption. Consequently, Japan's DFI in extractive sectors came to be heavily concentrated in the Middle East (about 40 per cent of the total, as shown in Table 1).

What has been quite drastically unique about Japan's DFI, however, has been the migration of Japan's manufacturing industry to neighboring Asian countries and Latin America, notably Brazil, which started to occur in significant magnitude in the late 1960s and the early 1970s. As shown in Table 1, Asian countries account for 37.4 per cent of Japan's DFI in manufacturing. Japanese ventures in this region are not only supplying local markets but, and increasingly, exporting to third-markets, particularly to advanced Western countries, as well as back to Japan. The manufacturing activities transferred to this region are mostly those labor-intensive, low-technology sectors in which Japan used to enjoy decisive trade advantages but in which it can no longer compete internationally if their production is to be continued at home. For example, as much

7 Japanese Ministry of International Trade and Industry, *Wagakuni Kigyo no Kaigai Jigyo Katsudo* (Overseas Business Activities of Our National Enterprises), 1974, p. 84.

as 40.2 per cent of Japan's manufacturing ventures in Asia are accounted for by textiles and 14.6 per cent by electric appliances — both are Japan's traditional export industries. Hong Kong, Taiwan, South Korea, and Singapore are most actively used as production bases by Japanese companies in their triangular or circular trade strategy. As high as 70.3 per cent of the total sales of Japanese ventures in Hong Kong are exported either to "third countries" (69.9 per cent) or back to Japan (0.4 per cent); in Taiwan, 52.1 per cent is exported (42.7 per cent to "third countries" and 9.4 per cent back to Japan); in South Korea, 47.7 per cent exported (34.4 per cent to "third countries" and 13.3 per cent back to Japan); and in Singapore, 37.1 per cent exported (32.2 per cent to "third countries" and 4.9 per cent back to Japan). And this trend toward triangular trade is definitely on the rise; the ratio of exports to total sales for Japanese manufacturing ventures in Asia as a whole rose from 26.3 per cent in 1971 to 36.7 per cent in 1973.[8]

This newly evolving triangular trade system enjoys not only low-cost production in developing countries but, and more importantly, the marketing networks spun extensively by Japanese firms, notably trading companies, in the world market. The global marketing channels Japan established initially for its own exports are thus evolving into an outlet for exports produced in developing countries with Japanese capital and technology. With the foregoing analysis in mind, it is interesting to observe the differences that have emerged between Japan's DFI patterns in the advanced West and those in the developing regions (Table 2); the ratio of DFI in commerce and services is comparatively high in North America and Europe, whereas in contrast it is the ratio of DFI in manufacturing that is relatively high in Asia and Latin America. Although Japan's manufacturing DFI in Latin America is aimed mostly at relatively large local markets, it may become export-oriented once the host countries adopt a more outward-looking development strategy, one emphasizing exports rather than import substitution, as Brazil has done so successfully in the recent past.

The rate of return on sales of Japan's overseas ventures, recently surveyed by Japan's Ministry of International Trade and Industry (MITI), is shown in Table 3. Interestingly enough, the developing regions (Asia, Latin America, and Africa, excepting the Middle

8 *Ibid.*, pp. 44-46.

East) are more profitable markets for Japanese ventures than are the industrially advanced regions (North America and Europe). This pattern is more pronounced for Japan's manufacturing ventures. Indeed, this aspect of Japan's multinational operations is unique. For the typical Western, particularly U.S., multinationals in the manufacturing and financial sectors, the developing countries are, it is said, less important either as markets or as centers of profits than are the advanced countries.[9] One may then wonder, why are Japanese manufacturing ventures more profitable in the developing countries than in the advanced countries?

TABLE 3

RATE OF RETURN ON SALES OF JAPAN'S OVERSEAS VENTURES *
(in percentages)

Region	Fiscal 1970 (a)	Fiscal 1972 (b)
North America	0.9	0.4
Europe	0.7	0.6
Latin America	3.8	8.4
Asia	4.5	6.0
Oceania	0.8	0.4
Middle East	−0.3	−1.7
Africa	8.1	3.0

* The rate of return on sales for fiscal 1970 is based on Japan's overseas ventures in all sectors which responded to the survey, while the rate of return for fiscal 1972 sectors is based on those in manufacturing only.

SOURCES: (a) MITI, *Nihon Kigyo no Kokusaiteki Tenkai* (International Expansion of Japanese Enterprises) 1973. The rate of response to a MITI survey from which the above figures are derived was 51.4%.

(b) MITI, *Wagakuni Kigyo no Kaigai Jigyo Katsudo* (Overseas Business Activities of Our National Enterprises) 1974. The rate of response was 50.5%.

As we saw earlier, a majority of Japan's manufacturing investments are located in Asia and Latin America. There are two basic motives for this type of industrial transfer: one is to circumvent the import substitution policy of the host country; the other is to

9 For this prevailing view, see PETER F. DRUCKER, "Multinationals and Developing Countries: Myths and Realities", *Foreign Affairs*, Vol. 53, No. 1 (Oct. 1974), pp. 121-134. He stresses this point by stating: "... the major manufacturing, distributive and financial companies of the developed world would barely notice it, were the sales in and the profits from the developing countries suddenly to disappear."

set up a production base to utilize low manufacturing costs overseas. The former motive was predominant throughout the 1950s and during the early 1960s and was generally observable in Japan's DFI in Latin America; the latter gained in importance beginning in the mid-1960s, particularly following each of the currency realignments in 1971 and 1973, and explains, on the whole, Japan's manufacturing ventures in Asia. No doubt the revaluation of the yen boosted both the interest of Japanese firms in overseas production and their capacity to engage in it, since the revaluation not only weakened their export price advantage but also facilitated the purchase of foreign assets in appreciated currency.

Japanese ventures in developing countries enjoy a variety of advantages. First, there are few local competitors to speak of. Obviously, the less industrially developed the host country, the less the local competition. Though there may be some competition from Western manufacturers similarly operating in the host country, they tend to operate, by and large, either in less labor-intensive industries or in different industrial sectors, so they rarely offer serious competition. Moreover, the host country may even discourage local competition among investing foreign interests, lest their scale economies be jeopardized; this is often the case with the production of automobiles, steel, and chemicals. Secondly, especially in Asia, the Japanese are most eagerly taking advantage of low-cost labor and of other financial advantages offered by host countries, such as tax holidays and freedom from duties on imported capital goods and materials. They may even enjoy the preferential tariffs recently conferred by their own country and others on the importation of manufactures from the developing countries.[10]

Thus, Japanese manufacturing ventures, increasingly organized for triangular trade, benefit greatly from the economic policies of developing countries, which emphasize the development of export-oriented, labor-intensive industries. Under the triangular trade arrangement, Japanese industry is able to retain its trade com-

10 How Japanese enterprises are taking advantage of the special production conditions of the developing countries is discussed in TERUTOMO OZAWA, "Multinationalism, Japanese Style", *Columbia Journal of World Business*, Vol. VII, No. 6 (Nov.-Dec. 1972), pp. 33-42, and also in TERUTOMO OZAWA, *Labor Resource Oriented Migration of Japanese Industries to Taiwan, Singapore, and South Korea*, World Bank Economics Staff Working Paper, No. 134, August 1972.

petitiveness, which used to be derived from the use of its domestic resources but comes now from the employment of low-cost foreign resources, notably labor.

On the other hand, Japanese manufacturers directly producing in advanced countries, such as the United States, are in the main those who produce technology-based and highly-differentiated products (such as color TV, synthetic leather, and miniature bearings) and those who manufacture peculiarly Japanese products (such as soy sauce and other ethnic food products). While the latter type of investment is not likely to expand significantly simply because both the number of such products and the demands for them are limited, the former type of investment may continue to grow in the future as the Japanese themselves come up with technological innovations and as market acceptance of their product brands develops. These technology-based Japanese manufacturers, typically represented by Sony, Panasonic, and Hitachi, have long been the export-oriented users of technologies essentially developed in the West, although in recent years they themselves have begun to introduce their own innovations. These companies initially concentrated their efforts on exporting to Western markets. It was only after they began to be confronted by protectionism in these markets in the late 1960s and the early 1970s that they decided to manufacture locally. In essence, they are resorting to a defensive type of investment in order to retain control over markets they once served through exporting. Unlike their U.S. counterparts, these Japanese ventures rarely have a decisive technological lead over the local companies in the West. Stiff competition, therefore, operates against Japanese entrants, and the profitability of their operations remains low.

Relevance of Western Theories

Now that we have examined the over-all patterns and characteristics of Japan's DFI, let us review, in this section, the major theories advanced by Western economists to explain the behaviour of Western multinationals and consider how relevant each of these theories is as applied to the behaviour of Japanese multinationals. Necessary theoretical modifications will be discussed.

(a) *Industrial Organization Approach*

One well-accepted theory emphasizes industrial organization. To explain the pattern of "horizontal" foreign investment (namely, investment designed to produce the same line of products across national boundaries), Stephen Hymer, Charles Kindleberger, and Richard Caves, among others, emphasized that DFI occurs in industries characterized by oligopolistic market structures in both home and host countries.[11] The products involved in overseas production, these theorists believe, are therefore either distinct in their technical make-up or highly differentiated in their market acceptability, and are produced by a group of a few relatively large firms. This oligopolistic market is, by definition, composed of individual firms each of whom enjoys monopolistic profits through possessing and controlling some type of firm-specific, rent-yielding attributes (for example, either a superior technology or greater knowledge about production, marketing, and management). The basic assumption here is that the firm that invests for direct production in a foreign market is, all other things being equal, at a disadvantage compared to local firms because of its unfamiliarity with local market conditions (that is, it must incur higher information costs than do its local counterparts). The argument goes, therefore, that some special advantage possessed by the investing foreign firm must be great enough to offset the higher information costs of its alien status if it is to operate competitively in a foreign market. This approach helps explain why the firm bypasses the capital markets, the traditional conduit through which debt capital moves "anonymously" (that is, devoid of managerial controls) from a low-rate-of-return country to a high-rate-of-return country, and why the firm prefers to retain direct control over the production and marketing of its own products through direct investment (securing equity ownership) rather than to depend on other means of serving the foreign market (exporting or licensing a foreign firm, for example).

Moreover, this explanation of DFI also helps us understand why an investing firm prefers to own its foreign subsidiary outright or as nearly so as possible. The firm is understandably reluctant to

11 Stephen Hymer, "The International Operations of National Firms: a Study in Direct Investment", unpublished doctoral dissertation, M.I.T., 1960; Charles P. Kindleberger, *American Business Abroad* (New Haven: Yale University Press, 1969); and Richard E. Caves, "International Corporations: The Industrial Economics of Foreign Investment", *Economica*, 1971, Vol. 38.

share with local interests the quasi-rents resulting from its advantages.[12] If its advantages are built on some technical knowledge internal to the firm, the need for quality controls and other engineering supervision may also make the firm wary of losing control of management.[13] The desire for managerial control may even be stronger if a firm's advantage is based only on a differentiated "product image" it has carefully cultivated over a long period of time, as is the case with soft drinks and convenient foodstuffs.

According to this view, there would be no direct foreign investment in a perfectly competitive market, since, as Kindleberger has pointed out, there ought to be some type of "market imperfections" in the market for DFI to take place:

> For direct investment to thrive there must be some imperfection in markets for goods or factors, including among the latter technology, or some interference in competition by government or by firms, which separates markets...
>
> That product differentiation breeds direct investment is indicated by its prevalence in branded products such as pharmaceuticals, cosmetics, soft drinks, and specialty foodstuffs, and in concentrated industries such as automobiles, tires, chemicals, electrical appliances, electronic components, farm machinery, office equipment. It does not occur in standardized goods produced by competitive industries such as textiles, clothing, flour milling, and distribution (except for Sears, Roebuck in Latin America).[14]

Raymond Vernon has similarly observed:

> ... multinational enterprises are not identified with the manufacture of such standardized products as steel bars and rods, gray cloth, or plywood; but they are identified with products whose specifications are in flux. The dichotomy is not all that clear, of course. A few seemingly standardized products, such as automobiles, appear to enlarge their scale economies of production or distribution with such regularity and persistence that the advantages of the multinational enterprises are maintained.[15]

12 Richard N. Cooper, *The Economics of Interdependence* (New York: Council on Foreign Relations, 1968), p. 88.

13 Jack Baranson, "Technology Transfer through the International Firm", *The American Economic Review*, Papers & Proceedings, Vol. LX, No. 2 (May 1970), p. 437.

14 Charles P. Kindleberger, *Op. cit.*, pp. 13-14.

15 Raymond Vernon, "Future of the Multinational Enterprise", in C. P. Kindleberger (ed.), *The International Corporation* (Cambridge, Mass.: The M.I.T. Press, 1970), p. 383.

Yet, as we have seen earlier, a vast majority of Japan's overseas ventures in manufacturing are located in neighboring Asian countries and in Latin America. Especially in the former, these ventures, set up, in the main, by small- and medium-sized companies, produce mostly standardized, low-technology products. These are therefore relatively small-scale operations, so there is not much possibility of scale economies in production or of product differentiation.

To be sure, there is an emerging pattern of overseas investment by large Japanese companies which fits the Hymer-Kindleberger-Caves model. These ventures are, however, located in advanced countries, especially in the United States, and are in high-technology sectors that require firm-specific advantages. This type of direct investment, however, accounts for still only a small segment of Japan's DFI in manufacturing.

The competitiveness of a vast majority of Japan's manufacturing ventures, therefore, originates in the backward industrial environment of the host countries of the Third World, a condition that gives quasi-advantages to those Japanese firms which have gained business experience in a more advanced market environment at home or elsewhere. In this respect, this type of investment can still be interpreted as meeting a part of the theoretical requirement mentioned above that stresses the existence of some market imperfection for DFI to transcend the normal channel of trade. Yet the Hymer-Kindleberger-Caves model is postulated on the oligopolistic market structure of a particular industry in *both* the home and host countries. On the other hand, those market imperfections which give advantages to Japanese ventures in Asia and Latin America have to do, by and large, with the underdeveloped market structures of the host countries rather than with the oligopolistic characteristics of business internal to the investing Japanese firms. Besides, the "markets" of the host countries, being still underdeveloped, hardly exhibit any meaningful characteristics which can be conveniently classified as oligopolistic. (Indeed, by definition, oligopoly is a state of market conditions which develops in industrialized market economies.)

When these trends are placed in perspective, an important question arises: If most Japanese manufacturing ventures in developing countries derive their quasi-advantages rather from the economic weaknesses (backwardness) of the host country than from their own firm-specific advantages, aren't their so-called advantages really of

a transient nature — much less enduring than the oligopolistic advantages inherent in the individual firms, especially given the fact that their DFI itself contributes to the economic development of the host countries? The answer seems to be yes. There is, however, one type of advantage accruing to Japanese firms which may be relatively lasting: the world-wide marketing networks of Japanese companies, set up initially to foster Japan's exports but now increasingly used to market products manufactured in its offshore-production bases. Even though small Japanese firms themselves may lack marketing capacities, their overseas ventures are in many cases either assisted indirectly or participated in directly by trading companies as joint-venture partners. Thus access to the export market is assured whenever it is needed. In contrast, lack of marketing skills and lack of networks in world markets are among the crucial weaknesses of developing countries in undertaking, by themselves, the production and export of standardized goods, even when they have a strong basis for developing a comparative advantage.

Pondering this question leads us to the realization that the very nature of this type of Japanese venture is likely to conflict with local interests, since these ventures are largely in those industries which the developing countries, once having acquired basic skills and capital, desire to manage and are capable of managing on their own. Under these circumstances, the outcry against Japanese economic domination is bound to be heard. As a consequence, the Japanese are often forced — if not in the early stages of their advance into a developing country then in the later stages when they have demonstrated successful operations — to form joint ventures and to transfer a great share of ownership to the local interests. Local protest of this nature has occurred most vociferously in Thailand. Japanese industries, constantly in search of countries which still offer favorable manufacturing conditions, may migrate from one Asian country to another. A pattern of transmigration has already appeared: Taiwan, Hong Kong, Singapore, and South Korea, once most eager to attract labor-intensive, low-technology industries, are now more selective in hosting Japanese ventures; hence, Japanese companies have begun to move to other countries, such as Malaysia, Indonesia, and the Philippines, which have recently emerged as attractive offshore-production bases.

Let us go back to our discussion of Western theories. There is another interesting development in the industrial organization approach. John K. Galbraith recently emphasized the organizational and motivational characteristics of oligopolistic modern corporations.[16] His approach supplements the Hymer-Kindleberger-Caves model, which interprets direct investment as a market behaviour, predetermined by the oligopolistic structure of industry rather than molded by any internal psychological drive of the individual firms. This type of analysis is largely in line with the neoclassical economic approach which identifies a firm's behaviour with the particular type of market structure in which it operates.

Galbraith interprets overseas investment essentially as the rational behaviour of big oligopolistic corporations nurtured in an advanced capitalist economy like that of the United States. In a mature stage of capitalism what he calls "a technostructure" comes into existence. The technostructure is "a complex of scientists, engineers, and technicians" in the fields of management, marketing, and production, hired by a big corporation. It is a planning system built on "collective intelligence" and on "the authority of organization". According to Galbraith, this modern efficiency-oriented business organization strives to eliminate uncertainties in the market, first at home and then overseas, as its span of operation expands:

> [The function of the multinational corporation] is, simply, the accommodation of the technostructure to the peculiar uncertainties of international trade. It transcends the market internationally as it does nationally... By re-creating itself in other countries the technostructure, in effect, follows its product to those countries.[17]

Galbraith thus brings in the unique organizational form of the modern corporation as an additional factor to explain overseas investments. The existence of an oligopolistic market is simply a necessary but not a sufficient condition for direct investment to occur; the firms in such a market must reach a mature stage of organization to form a technostructure. And the United States arrived first at such a stage:

> Here, it follows, is the explanation of the eminence of American corporations in transnational operations. It is not because they are American. Where foreign firms have developed large and powerful

16 John K. Galbraith, *Economics and The Public Purposes* (Boston: Houghton Mifflin Co., 1973).

17 *Ibid.*, p. 167.

> technostructures, as in the case of Philips, Shell, Unilever, Nestlé, Volkswagen, they have exploited transnational operations as vigorously as any American firm. But the United States, befitting its higher level of industrial development, has the most advanced planning system. Accordingly it has far more corporations that are prepared for transnational operations than any other country. What has been called the American challenge is not American; it is the challenge of the modern planning system. This, because of size of country, absence of adverse feudal tradition, legal system, geography, resources and much else, has reached its highest development in the United States.[18]

Several Japanese corporations perhaps have already grown large enough to form a technostructure. One can easily list Japan's big companies — Nippon Steel, Toyota, Nissan Motor, Mitsubishi Heavy Industries, and many others including trading companies — as technostructures in the Galbraithian sense. Indeed, the trading companies, which are actually nothing but planning complexes of "collective intelligence", are the spearheads of Japan's multinationals. In 1973, for example, the first seven of Japan's top ten overseas investors were trading companies. Many Japanese manufacturing ventures in Asia and Latin America were, as pointed out earlier, established by small- and medium-sized companies or what may be described as "pre-technostructural" organizations. But, as we have seen above, they can secure assistance from the trading companies. Moreover, the Japanese government itself (notably MITI), which is perhaps the world's most efficient technostructure for economic planning, is now actively engaged in planning, assisting, and guiding Japan's overseas investments. The much-publicized concept of "Japan, Inc." itself reflects the existence of macro-economic technostructure in the Japanese economy. Thus the Galbraithian theory has interesting implications for our analysis of Japan's multinationalism not only as an organization theory of the way modern corporations are organized but also as a theory of the way an economy itself is organized. The sudden emergence of Japan's multinationalism is not so much a result of the development of technostructures in its individual corporations as a product of its entire economy, which

18 *Ibid.*, pp. 169-170.

strives to adapt itself to rapidly changing world economic environments, a dynamic adaptive process planned and implemented through a close collaboration between industry and government.

(b) *The Product Cycle Approach*

The postwar industrial world has been characterized by the appearance of new products in rapid succession, some of these products developing into new industries on their own. Synthetic materials and electronics products are prime examples. Many of these innovations originated in the United States. In fact, a 1970 OECD study shows that U.S. firms are credited with about 60 per cent of the 110 significant innovations introduced in the world economy since 1945.[19] These innovations, once successfully introduced in the United States, quickly spread to the rest of the world, first to European countries and Japan and then gradually to developing countries in Latin America and Asia. As a result, world trade in new products flourished, but with shifting patterns of comparative advantage as innovations spread from one industrial center to another. This dynamic trade pattern is captured in the so-called product cycle theory of trade.[20]

Since new products are bound to be imitated by and produced in other countries, innovating firms may decide to move into foreign markets in order to retain control of new products by establishing

19 Organization for Economic Cooperation and Development (OECD), *Gaps in Technology. Analytical Report* (Paris, 1970), p. 198.

20 The product cycle theory postulates that new products or processes (notably, high-income products and labor-saving processes) are likely to be first introduced in the United States, since the United States enjoys a large affluent market with the world's highest standard of living, plus a relatively abundant supply of technological and entrepreneurial resources, including scientists, engineers, and daring businessmen. Thus the U.S. firm which innovates a new product can exploit its monopolistic position first at home and then in the markets of other industrialized countries with similar demand structures. Yet as the market for the product develops overseas as a result of the very success of the firm's exporting, and as the technology to produce the new product is perfected and standardized, firms in those other countries are motivated to produce for their own markets — and may even export later on. They enjoy a variety of local advantages, including their familiar knowledge of the local markets and lower labor costs which become a predominant cost factor in the maturity stage of the product cycle. The foreign producers may even succeed in exporting the product back to the United States. For this view, see Raymond Vernon, "International Investment and International Trade in the Product Life Cycle", *The Quarterly Journal of Economics*, Vol. LXXX (May 1966), pp. 190-207.

their own production facilities, either wholly- or jointly-owned. In Professor Vernon's words:

> An enterprise innovates in response to the conditions in its home market. For a time, it exports on the basis of its innovational lead. Eventually, overseas demand expands, competitors appear, and costs grow important. The enterprise asks whether it can prolong its innovational lead or salvage what it has been exporting. At that point, its decision turns on a number of considerations, many of them quite like the considerations involved in setting up a branch plant in the home market.[21]

According to this view, overseas production of a new product is essentially of a defensive nature; it is an alternative to the export of a new product and helps to preserve to the firm the fleeting advantage embodied in the new product. The firm is compelled to set up production abroad as a defensive reaction to the threat of foreign competition; the firm's action is in this view a passive behaviour, in contrast to the aggressive nature of the action implied in the Galbraithian model of the technostructure (which posits an aggressive effort of the efficient planning system to triumph over both domestic and overseas markets). Many American, as well as some European, overseas investments may be explained by the product cycle approach.

Yet the product cycle model does not directly apply to the case of Japan's manufacturing ventures overseas. Japanese industry, having been, for the most part, an interceptor of Western technologies throughout the postwar period, has not introduced any significant innovations which would invite massive imitations overseas as envisaged in the model. This theory, then, needs to be analyzed from the view-point of the followers rather than that of the innovators; thus far the latter approach has been the main theoretical construct used.

The question which must be asked is: Under what circumstances would the followers, who develop advantages in the mature stage of product cycle because of their lower production costs in their own market, also be induced to opt for overseas production? There are two sets of possible circumstances and thus two broadly different

21 Raymond Vernon, *Manager in The International Economy* (Englewood Cliffs, N.J., Prentice-Hall, 1972), p. 208.

investment patterns. First, the followers may be interested in transferring production to other countries where either production costs are already much lower than at home or are expected to drop soon. This type of overseas-production may be induced by rapidly rising production costs at home; this situation reduces and eventually eliminates the followers' cost advantages. It may also be induced by the offer on the part of a host country of a favorable production environment, an offer made to attract foreign manufacturers who seek low production costs, particularly those of labor. Both situations may combine to induce the manufacturers to move to overseas-production by exerting "push" and "pull" effects. This type of overseas investment can be explained within the framework of the Heckscher-Ohlin factor endowments theory.

A second set of circumstances may arise when the followers themselves have made substantial improvements in the new products and have succeeded in differentiating their products through the development of their brand names. In this case, their motives and investment behaviour can be explained by the industrial organization approach we have discussed earlier — that is, as a market behaviour of oligopolistic firms. Or, and more important, such firms, if their technological capacity advances through the process of learning-by-doing until they eventually attain technological independence, may quickly pass through the stage of being followers and become innovators themselves. But so long as their technological maturity is attained mainly as a result of exporting to some foreign markets (which are economically more advanced than their home market) — rather than "in response to the conditions in [their] home market", they may naturally be interested in setting up plants in such advanced markets if their exports are threatened by protectionism. Once having established direct production, they are also most likely to capitalize on the innovation-conducive atmosphere and technological resources of advanced markets, the market conditions they cannot enjoy at home.

As we have discussed earlier, Japan's manufacturing ventures in Asia are on the whole a product of the first set of circumstances. They have been attracted primarily by lower production costs, notably those of labor. In contrast, Japan's manufacturing ventures in the United States, though still limited in number, are mostly a result of the second set of circumstances, that is, oligopolistic maneuvering and innovation-seeking investments. The latter

behaviour is of a particular interest since it signals a new stage of Japan's industrial offensive in the United States. Some technologically mature Japanese firms, notably some in electronic consumer goods, are setting up shop directly in the U.S. market with an eye to exploiting technology resources. Even some Japanese textile firms are putting up textiles mills of their own in the United States for the purpose of quickly monitoring the rapidly changing fashion market for high-value, fashion-oriented lines of products. Clearly, these manufacturers have graduated from the stage of being outside interceptors of innovations originating in the United States and have moved right into the center of the world's most innovation-conducive market in order to continue to improve their technological capacities. These Japanese firms are obviously in what may be called a "post-product-cycle" stage of industrial offensive.[22]

(c) *A Monetary Account*

All the foregoing models focus on the "real" aspect (market and products) and say nothing about the "money" aspect of the phenomenon of direct foreign investment, if we borrow the Keynesian terms of a dichotomy of economic activities used in macroeconomic analysis.

Breaking loose from the dominance of the real-sector models in the literature, Robert Z. Aliber presents a monetary account of overseas production.[23] He agrees on the basic theoretical contention that the investing foreign firm must have some sort of advantages over the local firms, but argues that these advantages manifest in the real sector are neutralized by the exchange rate:

> The popular explanations for the dominance of the U.S. firms in direct foreign investment include the superiority of U.S. management techniques and the larger U.S. government-financed research and development. Some of these advantages are internal to firms; to some extent comparable advantages might be purchased by foreign firms. Other advantages are external to the firm and inherent to the U.S. economic environment. These advantages, comparable to advantages that other countries might have in the form of lower wage costs, should be neutralized by the exchange rate. These popular explanations for direct investment are inconclusive. A satisfactory explanation must account for advantages that U.S. firms have which cannot be acquired on comparable terms by their foreign competitors and which are not neutralized by the exchange rate.[24]

22 Some examples of the post-product-cycle activities of Japanese firms in the United States are described in Terutomo Ozawa, *Japan's Technological Challenge..., Op. cit.*, Chap. 6. See also Yoshi Tsurumi, "The Strategic Framework for Japanese Investments in the United States", *The Columbia Journal of World Business*, Vol. VIII, No. 3 (Winter 1973), pp. 19-25.

23 Robert Z. Aliber, "A Theory of Direct Foreign Investment", in C. P. Kindleberger (ed.), *The International Corporation* (Cambridge, Mass.: The M.I.T. Press, 1970), pp. 17-34.

According to Aliber, the existence of different national currencies with different exchange risks is the key factor in explaining the pattern of DFI since it assigns different capitalization ratios even for the same stream of expected earnings between the home-country firms and the host-country firms. In his words:

> This difference in capitalization rates results because the market attached different capitalization rates to income streams denominated in different currencies. Source-country firms are likely to be those in countries where the capitalization rates are high; host-country firms are those in countries where capitalization rates are low. The differences in capitalization rates select which country will be the host country and which the source country.[25]

Stated differently, to cover the exchange risk or to reflect the currency premium involved, the expected income streams of the source-country firms ought to be discounted at a higher rate when denominated in the host-country currency (that is, a weaker currency) than when denominated in their own home currency (that is, a stronger currency). Therefore, "if the market applied the host-country capitalization rate to the income stream received by the source-country firm, there would be no incentive for foreign investment".[26]

At this point, it is worth contrasting, as Aliber did, the differences between his explanation of the source-country firm's advantage and the monopolistic competitive advantage stressed in the Hymer-Kindleberger-Caves approach, since this comparison not only clarifies Aliber's model but also has some interesting implications for our analysis of Japan's DFI.[27] Kindleberger, illustrating a monopolistic

24 *Ibid.*, p. 18.
25 *Ibid.*, p. 28.
26 *Ibid.*, p. 30.
27 *Ibid.*, p. 28 (in a footnote).

advantage, ascribes the difference in capitalized value to differences in the income stream rather than to those in the capitalization ratio: Given the equation C=I/R, where C is the value of a capital asset, I the stream of income expected from C, and R the rate of return on investment (that is, the capitalization ratio), Kindleberger contends: "I is higher for the foreigner than for the local entrepreneur because of some advantage in goods markets such as a differentiated production or assured outlets or marketing skill".[28] In contrast, Aliber, by treating I as the same for both the source-country and host-country firms (in the absence, that is, of real-sector advantages on the part of the source-country firms, argues that R ought to be higher for the former because of the currency premium. His argument then necessarily implies that C should be smaller for the source-country firms than for the host country firms. Aliber states:

> The market is subject to a bias, in that host-country equities are subject to the currency premium, while source-country equities are not. Because of this bias, financial intermediaries in the source country may issue liabilities and use the proceeds to acquire the securities in the host country. The larger the currency premium, the greater the disadvantage for host-country firms.[29]

Thus Aliber identifies the source of the unique advantage of the source-country firms (and the disadvantage of the host-country firms) with the exchange risk associated with their currencies. This monetary approach is supplementary to the real-sector models discussed earlier, since it emphasizes the country-specific advantage embodied in the premium currency instead of the firm-specific advantage internal to a particular individual firm.

An eclectic synthesis of both the real- and money-sector approaches, therefore, provides a convenient analytical framework for Japan's multinationalism. As we have noted earlier, the advantages accruing to Japan's manufacturing ventures located in developing countries are not so much firm-specific as derived from the underdeveloped market conditions of the host countries. Japanese ventures are attracted particularly by low labor costs and relatively high rates of profit. This means, in terms of the equation C=I/R, that the stream of income expected by Japanese ventures, I, is relatively high

28 C. P. Kindleberger, *Op. cit.*, pp. 24-25.
29 R. Z. Aliber, *Op. cit.*, p. 30.

because of low production costs and a lack of competition. Moreover, the increased volume of Japan's DFI subsequent to the revaluations of the yen was no doubt encouraged by the accompanying changes in the exchange rate favorable to Japanese investors; that is, the value of capital assets acquired in foreign markets, C, dropped, since Japanese investors were able to invest with the appreciated yen, and the capitalization ratio for Japanese ventures increased as a result of a premium given to the yen. This newly created advantage was an additional inducement to Japan's DFI in both the advanced and developing regions, following the currency appreciation.

One factor is uniquely important for Japanese ventures. Not only may I and R be higher for Japanese ventures than for the local firms, but also, more importantly, I (therefore R) is expected to increase for Japanese overseas ventures as compared to their own domestic operations. Production conditions at home have grown less and less favorable in the recent past because of the inflationary spiral of wages and prices of both consumer goods and industrial resources. Thus at home I declines, while C rises, making overseas investment more attractive. Consequently, some Japanese firms, which at present scarcely possess advantages large enough to operate profitably in a foreign market, may be induced to move to overseas if there is some hope of gaining advantages in the near future. This seems to be the case with many of the Japanese manufacturing ventures recently set up in the United States and Europe. Even though they have no decisive advantages over the local firms now, they opt for direct investment in advanced markets in the belief that their production costs at home will soon catch up with or even exceed those in the host countries. As a result, their operations tend to be small to minimize the risk of possible miscalculations.

Conclusions

One major difference in the behaviour of Western and Japanese multinationals which seems to emerge from our preceding analysis is that the Japanese are influenced greatly by the macroeconomic factors of their own economy as well as by those of the host countries. Among the significant factors, both internal and external, are the great dependence of their economy on foreign markets, both for export and import (particularly of natural resources), the rising

environmental costs of industrialization at home, the phenomenal increase in the prices of domestic industrial inputs (notably, land and labor), the aspirations of developing countries to industrialize and their eagerness to attract Japanese capital and technology, and the rising protectionism against Japanese exports in the world market. Thus Japanese multinationals are responding to, and taking advantage of, both the needs of their own economy and the new requirements of foreign markets. Japan's manufacturing ventures in Asia, in particular, are the best example of this adaptive behaviour; they are making the best use of economic differences between their own economy (which is perhaps over-industrialized in terms of its physical resources, and in which the marginal social benefit of industrialization has quickly diminished, while the marginal social cost has soared) and those of the host countries (which are still in the early stages of development and in which, therefore, the opposite pattern of the appraisal of social benefit and cost prevails).

Overall, the overseas expansion of Japanese industry is in relative harmony with its national interest; it is, in fact, encouraged and assisted by the government. This is, indeed, in sharp contrast to the situation of U.S. multinationals who are under heavy attack from their labor unions and related interest groups. Although there are some exceptions in individual cases, the trend of Japan's DFI, on the whole, reflects more the adaptive behaviour of the entire Japanese economy to changing world economic conditions than the random market behaviours of its individual firms.

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