Japan's low levels of inward investment: the role of inhibitions on acquisitions

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In most countries, new foreign direct investment occurs predominantly by acquisitions. In Japan, by contrast, foreign investment occurs through greenfield establishments and/or joint ventures. This pattern occurs even though Japan's relatively unusual culture and institutions should make the demand for acquisitions high. Apparently, limitations on the supply of acquirable firms reduces foreign entry, and induces foreign firms to exploit their know-how through licensing. This article presents evidence that informal barriers to acquisitions, associated in particular with the presence of Japanese corporate groups — *keiretsu* — impede foreign direct investment in Japan.

The 1980s have seen a dramatic increase in global foreign direct investment (FDI) within the Triad (UNCTC, 1991). In particular, both Japanese and European firms have rapidly increased their holdings in the United States, while United States and Japanese investments in Western Europe have expanded considerably. Foreign direct investment into Japan, however, remains the weakest link, with flows much smaller than those into the United States and Europe, even when the relatively smaller size of the Japanese economy is accounted for (TCMD, 1992, p. 20, table I.4). The result is that foreign firms play an unusually small role in the Japanese economy. As noted by Edward M. Graham and Paul R. Krugman (1991, p. 33), compared with other major economies such as Germany, France and the United States, in which between 14 per cent and 26 per cent of industrial

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assets are controlled by foreigners, the 1 per cent share controlled by foreigners in Japan is miniscule. Other data indicate a similarly low share of FDI in Japanese employment, sales and domestic capital formation.

Should one be surprised at these low levels of FDI in Japan? What do they tell us about the nature of the Japanese market? The official Japanese interpretation is that foreigners can readily succeed in Japan, although it takes considerable effort. Indeed, publications of government agencies, such as JETRO (1989), proclaim the success of firms such as IBM, Texas Instruments, Procter and Gamble and Coca-Cola. According to the *Japan Economic Journal* (1990, p. 1), "As numerous examples of successful foreign ventures testify, [Japan] may not be an easy market, but it certainly is an open one".

But the success stories seem to be the exception rather than the rule. The relatively low FDI stock in Japan is partly the result of a history of official inhibitions on FDI. As Dennis Encarnation (1992) and Mark Mason (1992) described, inward FDI was heavily restricted for much of the post-war period. Officially, however, at least since the early 1980s, the Japanese market has been open to FDI.[1] Indeed, JETRO disseminates reports by the American Chamber of Commerce in Japan and by the European Business Community, which state that "government regulations are no longer an obstacle to foreign investment in Japan."[2]

Recent foreign direct investment in Japan

One might have expected that FDI would surge in the 1980s as firms compensated for their previous exclusion from Japan. According to the Ministry of Finance of Japan, which records notifications rather than actual transactions, the pace of inward FDI has accelerated. The Japan Economic Institute (1991, p. 3) reports that, between 1980 and 1990, the Ministry of

[1] In 1980, the Foreign Exchange and Foreign Trade Control Law allowed FDI in all but four industries (petroleum, leather, mining and agriculture). Notification of investments was still required, and the Government retained the right to object to any investment deemed a threat to national security or to "the smooth performance of the Japanese economy". Japan also retained the right to reject investments "from the viewpoint of reciprocity". Nonetheless, in principle, such objections were supposed to be rare. In 1992, the Diet enacted provisions to remove the Government's authority to block FDI deemed a threat to the smooth performance of the economy (Mason, forthcoming).

[2] The Government of the United States argued in the Structural Impediments Initiative talks that the notification process involved delays. In 1991, the Japanese Diet shifted to *ex post facto* reports. In March 1992, the Government of Japan actually passed a law that is designed to encourage FDI.

Finance was notified of $12.6 billion as additions to equity capital. This raised the total of post-war FDI from 8,826 cases valued at $3 billion at the end of 1980, to 42,900 cases valued at $15.5 billion at the end of 1990. Data of the Ministry of Finance, however, overstate FDI since they refer to notifications and not to actual investments and do not include loan repayments or liquidations of assets. In fact, in recent years, major withdrawals, particularly from minority-owned ventures, have been significant. These include the much-publicized sales of equity by General Motors, Chrysler, Honeywell, Avon and Southland Corporation (7-Eleven). According to estimates made by the United States Department of Commerce, using balance-of-payments data, reported by the Bank of Japan, the value of the total stock of inward FDI (valued at historical cost) in Japan at the end of 1989 was a mere $9.2 billion (to be sure, a threefold increase over the value in 1980), an amount that implied no increase in the global share of inward FDI of Japan over the decade.[3]

The estimates of the Bank of Japan understate FDI in Japan because they exclude reinvested earnings. An indication of the importance of this omission can be gleaned from the data reported by the United States, which is the largest foreign investor in Japan. (On a cumulative basis, data of the Ministry of Finance suggest that, as of March 1991, United States investors held 47 per cent of the total book value of reported FDI.) United States balance-of-payments data show a significant increase in the value of the FDI position of the United States in Japan, valued at historical cost. Between 1982 and 1990, for example, this position tripled from $6.4 billion to $21 billion. This represents a considerably faster rise than the twofold increase in the global stock of United States FDI valued at historical cost over the same period. However, the data also reveal that the growth was dominated by the activities of enterprises that were already in Japan. Valuation adjustments (which occur, for example, when a United States affiliate is sold to another United States owner), reinvested earnings and intercompany debt flows more than account for the growth. On balance, changes in equity capital were actually negative. Apparently, liquidations outweighed new injections of capital.[4] In sum, therefore, it appears that the foreign stake in Japan

[3] It is striking that just two acquisitions, one of MCA Inc. by Matsushita Electric Industrial Co. Ltd. in late 1990 ($6 billion) and of Columbia Pictures by Sony Corporation ($3.4 billion), are roughly equal to the entire value of the stock of inward FDI in Japan.

[4] New inflows of equity capital were not a major source of the overall growth of the United States FDI position worldwide. Between 1982 and 1990, only 4 per cent of the growth in the historical-cost position reflects net equity flows.

is growing, but primarily through the reinvested earnings of the firms already resident in Japan. New inflows have been offset by increased exit. As a result, compared with other economies, the overall FDI stock in Japan remains unusually low. In 1990, assets held by United States foreign affiliates in Japan accounted for 12.8 per cent of the total assets held by all United States foreign affiliates abroad. However, these data include United States minority stakes in firms such as Mazda, Mitsubishi Motors and Isuzu. Japan accounted for only 5.7 per cent of the assets in United States majority-owned foreign affiliates worldwide and only 5.5 per cent of the majority-owned manufacturing affiliates.

This article argues that the difficulties of acquiring existing Japanese firms help explain the low level of FDI in Japan. Indeed, the distribution system and other unusual entry barriers to the Japanese market suggest that the demand for acquisitions by foreigners contemplating FDI should be unusually high. In fact, however, most foreign entry into Japan occurs through greenfield operations. Obstacles to acquisition on the supply side, therefore, dominate entry patterns. The low levels of FDI in Japan reflect the need to rely on greenfield entry in a market in which entry barriers would normally induce entry through acquisition. One of the major barriers to foreign acquisitions of Japanese firms are the stock cross-holdings of Japanese corporate groups. Statistically significant evidence suggests, indeed, that *keiretsu* linkages inhibit FDI in Japan. The final section of the paper considers some implications of this finding.

The demand for acquisitions

Foreign firms may face higher market-entry costs than their domestic counterparts. Some of these simply reflect a lack of familiarity with the domestic economy. Others may be permanent and reflect official and/or private discrimination against foreign-owned firms. Much of FDI theory rests on the recognition of these disadvantages and the insight that, to compete abroad, a firm must have compensating advantages in the form of specialized product, process or marketing assets. But establishing a majority-owned foreign operation is not necessarily the optimal means of exploiting firm-specific assets. One alternative is to service the foreign market through exports. If foreign production is advantageous (for example, because of trade barriers, transportation or production costs or the benefits of market proximity), licensing, franchising and joint ventures could be more attractive alternatives to majority-owned FDI. Of course, these methods of market entry could be complementary. However, it is instructive to consider the factors that determine choices between them, since it helps to evaluate the characteristics of FDI in Japan.

Foreign direct investment versus licensing

Consider first the choice between FDI and licensing without equity. Licensing has the advantage of saving the firm the costs of manufacture and market entry. On the other hand, licensing requires formulating and monitoring a contract relating to the foreign use of the specific assets of the licensing firm. As Edward John Ray (1989, p. 59) pointed out, the licensor faces risks of opportunistic behaviour by the licensee and difficulties of assessing the value of the assets being licensed. In addition, where specific assets of a firm are not easily reduced to a formula or a blueprint, the licensee faces the risk that the know-how will not be readily assimilated. Foreign direct investment, by contrast, allows a firm to internalize these contracting, informational and transference difficulties, although it requires incurring the costs associated with foreign entry and operation. As Ray noted, the desire to invest directly is positively related to these licensing-contract costs and negatively related to the market-entry and operating costs of the investing firm. A reliance on licensing suggests the dominance of entry and marketing costs over contracting costs.

The propensity to license could also rise with the presence of domestic monopolies.[5] Foreign firms could prefer to take advantage of domestic monopoly power of a local firm rather than enter into head-to-head competition with it. Indeed, a domestic firm with existing market power may be prepared to pay more for a licence than firms that are forced to compete.

The Government of Japan has historically induced foreign firms to grant licences by placing severe restrictions on FDI. Officially, the Ministry of International Trade and Industry (MITI) is no longer engaged in such activities. Nonetheless, it is clear that, by comparison with other nations, a disproportionate amount of United States know-how continues to be exploited in Japan through licensing rather than through export sales or FDI. In 1990, for example, the $1.2 billion earned by United States companies from royalties and licence fees from Japan accounted for 35 per cent of United States receipts from royalties and fees from unaffiliated foreigners worldwide.[6] By

[5] I thank Kenneth Froot for this point.

[6] In 1990, Japanese firms earned only $185 million in payments from unaffiliated United States firms for royalties and license fees. This is less than one sixth of the corresponding receipts from unaffiliated Japanese firms earned by United States firms.

contrast, in 1990, United States receipts from Japan from foreign affiliates in the form of income and royalties and licence fees were only 5.5 per cent of total United States receipts from affiliates world-wide. Indeed, United States earnings from royalties and licence fees from unaffiliated Japanese firms were 33 per cent of all United States receipts from their foreign affiliates in Japan in the form of income and royalty fees. By contrast, worldwide, total United States receipts from payments of royalties and fees by unaffiliated foreigners amounted to just 5.2 per cent of total United States receipts (income plus royalties) from affiliates.

Over the 1980s, as restrictions on FDI were removed, the role of licensing might have been expected to diminish. Yet, in 1980, the amount of $354 million paid by unaffiliated Japanese firms to the United States in the form of fees and royalties was equal to 40 per cent of FDI income — considerably smaller than the corresponding ratio of 61 per cent in 1990. In 1980, Japan accounted for 30 per cent of all United States income from fees and royalties; in 1990 its share was 35 per cent. To be sure, more research is required to determine how much of the rapid growth in Japanese fees and royalties reflects recent licensing and how much simply reflects a historical legacy.

Joint ventures

Consider next the choice between minority positions in joint ventures and majority-owned FDI. Joint ventures represent a compromise between licensing and full control. Joint ventures may be more advantageous to foreign firms than licensing, since they permit a foreign firm to exploit its specific assets while economizing on the costs of operation in a foreign environment and avoiding some of the contract costs associated with licensing. They may be more advantageous to the domestic firm in ensuring an effective transfer of the specific foreign assets. Joint ventures, none the less, retain the risks associated with the loss of know-how to foreign partners and with the lack of complete operating control. Both partners in joint ventures may fear the creation of formidable future competitors. In general, one would expect joint ventures to predominate over FDI in those cases in which operating in a foreign environment presents unusually large problems for foreign-owned firms, either because of entry barriers and/or because of operating difficulties (for example, nationalistic discrimination against foreign-owned firms). Indeed, often sanctioned by law, joint ventures predominate in FDI in developing countries following protectionist policies. Joint ventures could also be a means of collusion when ventures have monopoly potential.

Generally, however, United States firms prefer to invest abroad in majority-owned ventures. In 1990, majority-owned companies accounted for about 78 per cent of the FDI assets of United States firms. By contrast, only 34 per cent of the FDI assets in Japan and only 26 per cent of the assets in manufacturing were in majority-owned companies. Indeed, there is a relationship between countries that have generally discriminated against FDI and the share of majority-owned firms in FDI assets. While in developed countries that ratio averaged 76 per cent, the conspicuous outliers are the Republic of Korea (18 per cent), India (14 per cent) and Japan (34 per cent).

There is evidence, however, that the United States FDI position in Japan is becoming more concentrated in majority-owned firms. In 1977, for example, majority-owned United States affiliates accounted for only 16 per cent of the assets of United States-affiliated firms in Japan. One source of that shift is the actual decline in the activity associated with minority-interest United States affiliates in the country. Indeed, as reported in table 1, employment and sales (adjusted for exchange rates and inflation) in minority-interest United States affiliates in Japan actually declined by 28 per cent and 36 per cent, respectively, between 1977 and 1990. The second source of the shift is the rapid growth in real assets (increasing by 91 per cent) and real employment (increasing by 70 per cent) of majority-owned ventures. Thus, while the United States stake in majority-owned affiliates in Japan remains unusually small, it is a growing component of the overall United States FDI position.

Investment in wholesale trade

As emphasized in particular by Encarnation (1992), United States majority-owned investment in Japan has been heavily directed towards wholesale trade. Valued at historical cost, world-wide United States investment in wholesale trade accounted for just 11 per cent of the United States global FDI position in 1990. A similar valuation of the United States position in Japan indicates that wholesale trade has an 18 per cent share in the United States position. Similarly, the value of assets in majority-owned affiliates involved in wholesale trade account for 18 per cent of all assets held by majority-owned United States Japanese affiliates. By contrast, only 10 per cent of majority-owned affiliate assets worldwide are in wholesale

Table 1. United States foreign direct investment: majority-owned and minority-interest affiliates, Japan vs. developed countries, 1977 and 1990
(Percentage)

JAPAN

Item	1977			1990			Percentage change 1977-1990		
	Employment	Sales	Assets	Employment	Sales	Assets	Employment	Real sales[a]	Real assets[a]
Majority-owned	16.8	25.5	16.1	32.4	37.4	33.8	70.4	12.3	91.4
Minority-owned	83.2	74.5	83.9	67.6	62.6	66.1	-28.1	-35.8	-28.4
Total (billion dollars)	389 123	51.9	41.8	344 300	113.4	108.3	-11.5	-23.5	-9.2

DEVELOPED COUNTRIES

Item	1977			1990		
	Employment	Sales	Assets	Employment	Sales	Assets
Majority-owned	76.7	75.4	71.3	75.1	77.5	76.2
Minority-owned	23.3	24.6	28.7	24.9	22.5	23.8
Total (billion dollars)	4 980 691	449.0	359.6	4 308 500	871.1	843.2

Sources: IMF, *International Financial Statistics*, various issues; United States Department of Commerce, National Trade Data Bank; United States Department of Commerce (1981).

[a] Adjusted for inflation and exchange-rate changes. The consumer price index in Japan rose by 54 per cent during 1977-1990. In 1977, $1 = ¥268.5 and in 1990 $1 = ¥144.8.

trade. It is also the case that, unlike other forms of investment in Japan, United States FDI in wholesale trade is predominantly majority-owned. Indeed, 49 per cent of all United States assets in wholesale trade were, in 1990, in majority-owned firms. These data are strongly suggestive of either unusual profit opportunities in this industry or of the importance of such investment for making sales.

In sum, the continued dependence on licensing, the heavy reliance on minority-interest ventures and the relatively large investments in majority-owned wholesale trade ventures support the argument that the marketing and distribution of foreign products in Japan is unusually difficult, or that current inflows have been too small to offset the impact of earlier policies. (The data on United States licensing and wholesale trade investment could also indicate a lack of competition.)

A study conducted by the United States International Trade Commission (1990) singled out:

- Legal restrictions on retailing, wholesaling and investment as limiting entry. These include a weak enforcement of the anti-monopoly law of Japan, the Large Retail Store Law, which limits expansion of large retailers, as well as other regulations and entry fees.
- Business practices that are used by manufacturers to exert vertical control over distribution channels and to reduce horizontal competition.
- The high costs associated with setting up independent distribution systems (land rent, warehousing, transportation), partly as a result of government tax and land-use policies.
- Social customs that emphasize long-term relations that result in less willingness by purchasers to switch suppliers or retailers.

Greenfield versus acquisitions

Once the decision to invest has been made, a firm has the choice of either starting a greenfield operation or of acquiring an existing operation. In equilibrium, one would expect to see firms priced at their replacement cost, that is, for Tobin's Q — the ratio of the firms market value to its replacement costs — to equal unity. However, when Q=1 for domestic entrants, foreigners should be prepared to pay more than domestic firms for existing firms if their costs of entry are systematically higher. Indeed, except in cases where the specific assets can only be transferred to new ventures, one would expect to see that acquisition is more common as a means of entry in FDI than it is in domestic investment. In general, the foreign preference for acquisitions over greenfield investments depends on the disadvantages faced by foreigners in establishing domestic operations. The more costly it is for foreigners, as compared with domestic firms, to enter new markets, the higher the demand for acquisition over greenfield entry.

In terms of our theoretical analysis, the evidence on licensing, joint ventures and investment in majority-owned wholesale trade operations is strongly suggestive of unusual barriers to entry, operation and marketing in Japan. *This evidence suggests that,* ceteris paribus, *foreign demand for acquiring existing Japanese firms as a means of entry should be unusually high. Ex post,* however, the share of entry accounted for by foreign acquisitions also reflects the relative supply of acquirable assets to foreigners. This supply is related to the overall level of economic development. In addition, however, it reflects the market for corporate control in general, as well as official and unofficial discrimination against foreigners. Indeed, it will be argued below that all factors limiting the supply of acquirable assets have played a role in constraining FDI in Japan.

The supply of acquirable assets to foreigners

Data gathered by the Japan Economic Institute (1990) show that the number of mergers and acquisitions in Japan is actually quite similar to that in the United States, but the typical Japanese deal appears to be smaller (table 2). However, this finding could simply reflect a bias in the samples, since the Japanese data, which are based on reports to the Fair Trade Commission, are comprehensive while the United States data may not be. In both countries, mergers-and-acquisitions activity has increased rapidly in recent years. Although mega-deals appear to be rarer in Japan, they are not unknown. In fact, the Mitsui Bank merger with Taiyo Bank in 1990 was actually the largest in the world in terms of market capitalization.[7]

Hostile takeovers

The more striking differences between Japan and the United States, however, relate to the feasibility of hostile takeovers and of takeovers involving foreign firms. In part, hostile takeovers are rare because the Japanese concept of a firm places less emphasis on the role of stockholders and more emphasis on the rights of other stakeholders, in particular, employees and management. According to the Japan Economic Institute (1990, p. 13), the Japanese word for "takeover bid" (*nottori*) can also mean "hijack". Moreover, the loyalty felt by employees and management to large firms in a system (often characterized by lifetime employment) stands in the way of even friendly mergers in which companies lose their identity.

[7] Holloway (1990, p. 41).

Table 2. United States and Japanese merger-and-acquisition activity, 1981-1988[a]

	Number		Value (Billion dollars)		Average Value (Billion dollars)		Number of large deals	
Year	United States	Japan	United States	Japan	United States	Japan	$100 mil plus United States	¥50 bil plus Japan
1981	2395	1815	82.6	10.1	34.49	5.58	113	50
1982	2346	919	53.8	13.3	22.93	14.50	116	47
1983	2533	1722	73.1	8.9	28.86	5.14	138	63
1984	2543	1886	122.2	10.4	48.05	5.52	200	81
1985	3001	1920	179.8	15.0	59.91	7.80	270	79
1986	3336	2083	173.1	27.2	51.89	13.06	346	112
1987	2032	2299	163.7	24.0	80.56	10.42	301	131
1988		2364		27.2		11.49		

Sources: Japan Economic Institute (1990).

[a] The dollar values of Japanese deals were calculated using current exchange rates from IMF, *International Financial Statistics*, various issues; Japanese data are for fiscal years. ¥50 billion = $220 million, $210 million and $346 million in 1980, 1985 and 1987, respectively.

In part, however, hostile takeovers are more difficult because many Japanese firms have large percentages of their stock held either by stable shareholders (such as insurance companies and trust and pension funds), who have close relations with the management of the company, or by *keiretsu* members (that is, members of a corporate group characterized by extensive cross-shareholdings). In many cases, these two groups account for two thirds of all outstanding shares of a company and can, therefore, prevent hostile takeovers.

This practice of cross-shareholdings was originally a response to the prohibition on holding companies that was implemented in Japan in the early 1950s to prevent the reconstitution of the large pre-war *zaibatsu* conglomerates. Despite these strictures, the three former *zaibatsu* groups — Mitsubishi, Mitsui and Sumitomo — and other large groups of diverse companies (horizontal *keiretsu*) centred on major banks, have developed more subtle mechanisms of collaboration, a feature of which is extensive cross-holdings of stock. In addition, other groups, centred on such large manufacturing companies as Nippon Steel and Toyota (vertical *keiretsu*), have developed close links that involve an exchange of equity. For the six largest horizontal groups, the average percentage of stock of a group held by other group members ranged from 7 per cent to 14.3 per cent in 1963 and had risen to between 12.2 per cent and 26.9 per cent in 1988 (fiscal year).

None the less, hostile takeovers are not unknown in Japan. For example, Aaron Viner (1987, pp. 70-71) noted that Takami Takahashi (president of the Minebea ball bearing company) has masterminded takeovers in both Japan and the United States. Minebea was also the object of a takeover attempt by foreigners, who acquired stocks through convertible bonds and warrants that are traded anonymously in the Euromarket. However, a foreign participant in the effort, Charles Knapp (a Los Angeles financier), "could not find a single Japanese bank or securities house to help in any capacity with his bid" (Viner, p. 90), and Takahasi successfully fought off the bid by merging his company with another and thereby diluting Knapp's stake (Viner, p. 90).

Some suggest that, recently, possibilities for hostile mergers have increased. In part, this reflects increased experience of Japanese firms with acquisitions abroad. In addition, Japanese courts that formerly frowned upon hostile takeovers have modified their stance in recent rulings. In a particularly noteworthy case in 1989 (Shuwa versus Chujitsuya), the court found that efforts to dilute Shuwa's shares by an exchange of stocks at low prices between two targets was unfair. This was the first time a court declared anti-takeover practices unfair.

In addition, Japan has seen a nascent debate over shareholders' rights, sparked in part by the ill-fated efforts of T. Boone Pickens, who tried to claim a seat on the board of Koito Manufacturing Company.[8]

Foreign acquisitions

The other striking difference from the United States relates to the treatment of foreign investors by Japan. As mentioned above (Encarnation, 1992, chapter 2), FDI in Japan was severely restricted during the 1950s and

[8] According to the Japan Economic Institute (1991a), on 13 June 1991 a study group of that Ministry of International Trade and Industry urged the Ministry to promote mergers and acquisitions through various regulatory and legal changes. However, the report also called on the Ministry of International Trade and Industry to provide legal aid to firms facing hostile buyouts.

1960s. By 1973, however, Japan was officially complying with the OECD Code of Liberalisation of Capital Movements. It is noteworthy, however, that, although the official policy was that Japan was open, less formal policies undermined this commitment.

Mason (1992, pp. 205-207) described how a revision of the Commercial Code of Japan in 1966 made it easier for Japanese firms to issue shares to third parties of their choice. He detailed how firms belonging to industrial groups took advantage of these regulations over the following decade to insulate themselves from foreign companies. In addition, in 1971, an amendment of the Securities Exchange Law introduced a system of notification of takeover bids. As described by Viner (1987, p. 69), in 1972 the Bendix Corporation made a tender offer for some of the equity in the small firm Jidosha Kiki. This created concerns, and there was a deliberate effort to prevent foreign firms from initiating takeovers of domestic companies. According to Viner, to render foreign takeovers virtually impossible, "hundreds of corporations (with unofficial Ministry of Finance encouragement) which were not members of *keiretsu* systematically expanded their mutual shareholdings. Companies within *keiretsu* increased mutual shareholding to the legal limit. As a direct result ... the total percentage of shares held by corporations rose 12.7 percent in just one year, 1971/2" (p. 88). Indeed, Viner observed that:

> "the redistribution was so effective that between 1978-84, the number of foreign acquisitions of Japanese companies numbered just 20. Of these only two were of substantial size (BOC takeover of Osaka Gas and Banyu-Merck)."

In general, foreign firms contemplating Japanese acquisitions do not enjoy national treatment. As noted by *The Economist* (12 August 1989), as of mid-1989, takeover bids from foreigners had to be carried out through a domestic securities house, which gave the Ministry of Finance 10 days notice of its intentions— "i.e., enough time to organize a rescue operation to be mounted to keep the target in Japanese hands" (p. 68). If a foreign firm managed to clear that obstacle, it was allowed just 20 to 30 days to complete the acquisition. Japanese firms were not subject to these rules.

Recent data confirm that foreign involvement in mergers-and-acquisitions activity within Japan, though increasing, remains rare. According to data collected by Yamaichi Securities (table 3), between 1985 and 1989, foreign purchases of Japanese firms were in the range of about 20 per year;

however, these data include purchases outside of Japan. By contrast, there was a dramatic increase in Japanese purchases of foreign firms and Japanese purchases of Japanese firms. Data on foreign sellers collected by Merrill Lynch (table 4) confirm the paucity of sales to foreign firms of Japanese companies; these averaged about 3 per year. By comparison, averages were 52, 15, 14 and 6 per year for British, German, French and Swiss firms, respectively.

Acquisition versus greenfield entry

It was established earlier that, *ceteris paribus*, one would expect that, in general, the foreign demand for entry via acquisition would tend to be high. Indeed, this is confirmed by the data compiled by James W. Vaupel and Joan P. Curhan (1973) on the ways used by affiliates of United States-owned manufacturing firms to enter foreign markets between 1900 and 1968 (table 5). More specifically, on average, they found that direct acquisitions dominated newly formed ventures in entries into foreign markets of subsidiaries in which United States firms had at least a 5 per cent stake. In countries in which acquisitions are made relatively easily (such as Canada and the United Kingdom), only 35 per cent of entries involved newly estab-

Table 3. Number of mergers and acquisitions involving Japanese firms, 1981-1990

Year	Japanese firms acquire Japanese firms	Japanese firms acquire foreign firms	Foreign firms acquire Japanese firms	Total
1981	122	48	6	176
1985	163	100	26	289
1986	226	204	21	451
1987	219	228	22	469
1988	223	315	17	555
1989	240	405	15	660
1990	293	440	18	751

Source: Yamaichi Securities Co., Ltd. as cited by Japan Economic Institute (1991b).

Table 4. Foreign sellers[a]: number of transactions, by country, 1982-1991

Country of seller	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	Ten-year Cumulative
Australia	6	3	6	7	7	5	4	13	19	10	80
Austria	1	1	-	-	-	-	1	-	-	1	4
Belgium	2	1	3	3	6	2	1	1	2	4	25
Canada	30	35	24	42	54	31	32	41	41	49	379
Denmark	-	1	2	-	-	2	-	1	2	1	9
Finland	-	1	-	-	-	1	-	-	2	1	5
France	8	8	15	16	12	9	14	16	21	18	137
Germany	12	13	13	15	13	11	12	17	25	16	147
Greece	1	-	-	-	-	-	-	-	2	1	4
Ireland	-	-	-	-	2	1	1	-	3	1	8
Italy	2	6	6	13	4	10	7	15	10	6	79
Japan	3	3	7	7	2	-	1	2	4	3	32
Luxembourg	1	-	-	-	-	-	-	-	-	-	1
Netherlands	3	8	3	7	5	7	5	4	11	17	70
New Zealand	-	-	2	1	-	1	-	3	7	3	17
Norway	-	-	1	-	-	1	2	-	1	3	8
Portugal	-	-	-	-	-	-	-	1	1	-	2
Spain	-	3	6	3	4	2	2	3	5	2	30
Sweden	-	1	3	3	2	5	2	8	7	2	33
Switzerland	10	11	3	5	5	2	2	7	7	3	55
Turkey	-	-	-	1	-	-	-	1	1	-	3
United Kingdom	30	39	45	44	50	41	48	71	80	72	520

Sources: Mergstat Review 1991; Merrill Lynch Business Brokerage and Valuation. Shaumberg, Illinois.

[a] Foreign sellers reflect nationality of ownership, not necessarily location of company. Transactions measures reflect announced transactions only and include acquisitions of both controlling and minority interest in a company.

lished operations. In France and Germany, newly established ventures accounted for 39 per cent and 42 per cent of all new entries, respectively. Weighted by the number of firms entering, newly formed entrants accounted for 43 per cent of all new entries in the whole sample.

As might be expected, entry into developing countries (in which the supply of acquirable assets is limited) is more dependent on new ventures. The share of new ventures has also been high in some less-developed indus-

Table 5. Percentage breakdown of number of manufacturing foreign affiliates of United States-based companies, by foreign affiliate's method of entry into foreign country[a]

Country	Newly formed	Reorganization	Acquired directly	Number of firms
Australia	47.0	2.1	50.0	236
Austria	59.0	0.0	41.0	22
Belgium	49.0	0.0	51.0	103
Canada	35.0	2.8	62.0	703
Denmark	48.0	0.0	52.0	29
Finland	60.0	0.0	40.0	5
France	39.0	3.5	57.0	286
Germany	42.0	2.3	56.0	259
Greece	78.0	0.0	22.0	23
Ireland	45.0	3.2	52.0	31
Italy	50.0	0.5	50.0	200
Japan	64.0	0.7	35.0	142
Luxembourg	49.0	0.0	51.0	
Netherlands	53.0	1.1	46.0	91
New Zealand	58.0	2.3	30.0	44
Norway	50.0	0.0	50.0	18
Portugal	81.0	0.0	19.0	21
Spain	43.0	0.8	57.0	129
Sweden	62.0	0.0	38.0	39
Switzerland	48.0	0.0	52.0	25
Turkey	86.0	0.0	14.0	14
United Kingdom	35.0	3.3	62.0	452
Weighted average	43.3	2.1	54.5	

Time period when United States firms entered into the Japanese market

	Pre-1946	1946-1957	1958-1967
Percentage of total	6.4	16.7	76.9

Source: Vaupel and Curhan (1973, chapter 4, p. 256).

[a] Data cover foreign affiliates formed between 1900-1968. The study covers approximately 40 per cent of the total number of all foreign manufacturing affiliates of United States companies and approximately 70 per cent of the value of United States manufacturing investment in foreign affiliates. Data include minority-interest and majority-owned affiliates.

trialized countries, such as Turkey (86 per cent were new establishments); Portugal (81 per cent) and Greece (78 per cent). Furthermore, data on entry into the United States between 1981 and 1990 indicate, as in the earlier cases of Canada and the United Kingdom, a high dependence on acquisitions rather than greenfield operations. For these years, acquisitions accounted for 79 per cent of all entries (table 6). While Japanese firms have tended to prefer greenfield entry and plant expansions, more so than firms from other countries, they have not been reluctant to engage in acquisitions. In 1989, for example, 56 per cent of Japanese FDI involved acquisitions, and 11 per cent involved purchases of real estate.

Historically, uniquely among developed countries, entry into Japan also involved a relatively large number of greenfield investments. For the entire sample, the ratio was 64 per cent. For the period 1957 to 1968, the ratio was 68 per cent. Thus, while a priori reasoning suggests that the demand for acquisitions as a mode of entry should be high in the case of Japan, *ex post* acquisitions appear to be unusually low. The foreign-direct-investment entry data confirm that there are obstacles on the supply side.

The twenty-fourth *Survey of Foreign Affiliates in Japan*, undertaken by MITI in 1991, provides an even more overwhelming impression of the degree to which entry into majority-owned firms in Japan has occurred through greenfield operations. As reported in table 7, only 7 per cent of the firms in which foreigners have more than a 50 per cent equity stake started through the acquisition of Japanese firms. Some 49 per cent started with new establishments, and the remainder began as joint ventures.

The *ex-post* data on the share of new entry taking the form of greenfield operations can be used to explore whether there is a relationship between the overall quantity of FDI and the mode of entry. These regressions are reported in table 8. Regression 1 shows that the level of assets in majority-controlled United States affiliates in Japan is 141 logarithmic percentage points lower than one would expect on the basis of Japanese population and per capita purchasing power parity GDP. Despite the large standard errors of the equation, the coefficient on the Japanese dummy is almost significant. However, as shown in regression 2, when the variable GREEN is inserted in the regression, it confirms that there is a negative association between greenfield operations and FDI that is significant at the 90 per cent level. The addition of this variable has a large impact on the Japanese dummy variable — it is reduced by 60 logarithmic percentage points. As might be expected, the measure of tariff and non-tariff barriers is not significant in explaining

Table 6. Foreign direct investment in the United States: method of investment by source country, 1989[a]
(Percentage)

Method	All countries	Canada	France	Germany	Japan	Netherlands	Switzerland	United Kingdom
Mergers and acquisitions	79.21	86.85	90.53	86.72	56.20	99.07	91.68	97.53
Equity increases	3.98	0.51	0.00	0.00	5.45	0.00	8.11	0.02
Joint ventures	3.13	4.33	1.50	0.00	6.47	0.00	0.21	0.66
New plants	4.94	4.47	6.32	5.24	10.23	0.18	0.00	1.20
Plant expansion	3.57	0.89	0.00	7.94	9.28	0.00	0.00	0.29
Real estate	4.59	2.94	1.44	0.00	11.34	0.74	0.00	0.24
Other	0.57	0.00	0.21	0.10	1.03	0.00	0.00	0.04
Total value known (Million dollars)	74 715.4	3 691.3	3 324.8	2 381	22 977.7	3 824.1	4 306.8	24 955.1

Source: United States Department of Commerce (1991).

[a] The data include only investments for which the value of the transaction is known. Foreign direct investment is defined as ownership of 10 per cent or more of a company.

overall FDI (equations 4 and 5). It is, however, more significant in manufacturing (equations 6 and 7) and confirms that trade barriers can induce FDI. These regressions, which explain assets in majority-controlled manufacturing FDI, also suggest the importance of mergers and acquisitions for FDI. In this case, the dummy variable on Japan in equation 6 run without GREEN is -103 logarithmic percentage points. However, when GREEN is introduced into the regressions, the coefficient of the Japanese dummy falls to only -16 logarithmic percentage points. The coefficient on the greenfield variable, which is almost significantly different from zero, confirms the negative relationship between reliance on greenfield investment as a mode of entry and overall FDI. *Ex post*, therefore, the supply of acquirable assets appears to be an important factor in encouraging FDI. Conversely, the lack of such supplies inhibits FDI.

Keiretsu, foreign direct investment and mergers in Japan

Few issues in United States-Japan relations are more controversial than the *keiretsu* relationships among Japanese firms. For many firms in the United States, *keiretsu* are the best example of the invisible barriers that

Table 7. Majority-owned foreign direct investment in Japan: percentage of firms, by industry and method of entry, 1991

Industry	Creation of joint venture	Creation of new company (Greenfield)	Capital participation (M&A activity)	Total number of firms that responded
Total investment	43.7	49.3	7.1	1,234
Manufacturing	51.0	40.3	8.7	576
Manufacturing except oil	51.5	40.7	8.2	562
Food processing	52.4	33.3	14.3	21
Textiles	57.1	42.9	0.0	7
Wood products	42.9	57.1	0.0	7
Pulp and paper	20.0	80.0	0.0	5
Publishing and printing	33.3	66.7	0.0	12
Chemicals	62.3	29.8	7.9	114
Pharmaceuticals	44.4	44.4	11.1	45
Oil	50.0	21.4	28.6	14
Rubber	50.0	41.7	8.3	12
Leather	50.0	50.0	0.0	2
Clay and ceramics	50.0	50.0	0.0	14
Steel and iron	0.0	0.0	0.0	0
Non-ferrous metals	35.7	50.0	14.3	14
Processed steel	40.0	50.0	10.0	10
General machinery	52.4	37.8	9.8	82
Electric machinery	50.5	45.9	3.7	109
Transportation machinery	59.1	22.7	18.2	22
Precision machinery	38.3	51.7	10.0	60
Weapons	0.0	0.0	0.0	0
Other manufactured	61.5	26.9	11.5	26
Commerce	38.0	56.0	6.0	502
Oil sales	0.0	0.0	0.0	0
Services	34.3	61.1	4.6	108
Other	35.4	60.4	4.2	48
Oil related services	50.0	21.4	28.6	14

Source: Ministry of International Trade and Industry (1991). The survey was sent to all business enterprises that had a foreign capital ratio of 50 per cent or more as of 31 March 1991. The survey was received by 2,463 companies, of which 1,276 responded.

Table 8. Foreign direct investment in OECD countries, 1990
[t-statistics in parenthesis]

FDI	ln(POP)	ln(GDP/C)	BAR	JPN	GREEN	Corr. R^2	Standard error
1 ln(MAJDFI)	0.84	3.05		-1.4		0.70	0.94
	[5.00]	[5.87]		[1.32]			
2 ln(MAJDFI)	0.81	2.4		-0.81	-0.032	0.78	0.88
	[5.10]	[4.00]		[0.77]	[1.90]		
3 ln(MAJDFI)	0.76	2.24			-0.036	0.74	0.88
	[5.30]	[4.00]			[2.20]		
4 ln(MAJDFI)	0.86	3.06	0.02	-1.26		0.69	0.95
	[5.00]	[5.83]	[0.79]	[1.15]			
5 ln(MAJDFI)	0.82	2.44	0.01	-0.074	-0.03	0.65	0.90
	[5.05]	[3.95]	[0.54]	[0.69]	[1.72]		
6 ln(MAJMAN)	0.94	4.85	0.07	-1.03		0.65	1.49
	[3.63]	[5.92]	[1.89]	[0.61]			
7 ln(MAJMAN)	0.88	3.79	0.06	-0.16	-0.05	0.70	1.39
	[3.53]	[4.01]	[1.69]	[0.10]	[1.89]		

Sources: (1) United States Department of Commerce, Bureau of Economic Analysis.
(2) OECD Main Economic Indicators.
(3) Saxonhouse and Stern (1989).
(4) Vaupel and Curhan (1973).

Notes: Constant term not reported.
MAJDFI(1) = Assets of United States majority-owned affiliates.
MAJMAN(1) = Assets of United States majority-owned affiliates in manufacturing.
POP(2) = Population in 1990.
GDP/C(2) = 1991 purchasing power parity per capita gross domestic product.
BAR(3) = Sum of tariff rates and tariff equivalents of non-tariff barriers.
JPN = Dummy = 1 for Japan.
GREEN = Percentage of United States FDI entries in greenfield establishments.

make United States-Japan investment and trade unfair. Japanese investors can buy any United States firm they choose, but it is almost impossible for United States investors to obtain control of most major Japanese firms because of substantial cross-holdings of stock held by *keiretsu* members. Similarly, Japanese exporters can readily sell their goods in the United

States, but United States exporters find that there are extraordinary barriers created in Japan by the close links between suppliers and assemblers and between manufacturers and distributors. Some believe that these asymmetries in access make free trade with Japan undesirable and, thus, advocate managed trade. Others are calling for anti-trust measures and changes in rules that will make *keiretsu* relationships more transparent and Japanese markets more open to foreign exporters and investors.

In the recent Structural Impediments Initiative between Japan and the United States, particular attention was paid to the role of *keiretsu*. The Government of the United States argued that *keiretsu* linkages made foreign entry into Japan especially difficult. The Structural Impediments Initiative talks ended with an agreement by the Government of Japan to strengthen the monitoring of transactions among *keiretsu* firms by the Fair Trade Commission and to take steps to eliminate any restraints on competition that might arise from their business practices. The United States called for, among other things, streamlining rules for mergers and acquisitions, stronger rights of shareholders, and disclosure requirements against management. However, the relevance of *keiretsu* remains hotly contested.

Japanese defend *keiretsu* with two diametrically opposed arguments (Yoshitomi, 1991). One argument is that *keiretsu* do not actually have significant economic effects. Foreign concerns about *keiretsu* simply reflect "misunderstandings". *Keiretsu* are really no different from arrangements in other countries, such as vertical integration, conglomerates and close links between firms and banks. There is no need for new policies because the Japanese economy is highly competitive. If firms actually made decisions based on *keiretsu* loyalties, rather than on economic grounds, they would lose money and soon be driven from the market. Often cited in support of this view is evidence gathered by the Japanese Fair Trade Commission, which indicated that intra-group transactions account for only a small share of total transactions by *keiretsu* members, as well as evidence that keiretsu firms are not particularly profitable (Yoshitomi, 1990, p. 13).

The other argument is that *keiretsu* linkages are very important — indeed they are the heart of Japanese success. It is no coincidence that the best firms in Japan are typically members of *keiretsu*. *Keiretsu* provide members with benefits through sharing risk and information. Close links between assemblers and suppliers enhance the transfer of technology. *Keiretsu* linkages are more efficient than vertical integration, because they permit reliable supply while preserving corporate flexibility. Stockcrossholding permits *keiretsu* managers to concentrate on long-term investment decisions. It frees them from pressures of the stock market and fears of takeovers, which have made United States managers short-sighted (Yoshitomi, 1990, p. 12).

Those who make that second argument acknowledge that *keiretsu* create problems for new foreign entrants, but they still defend *keiretsu* on efficiency grounds. According to their view, Japan is confronted with a painful dilemma. If it becomes more open, it will be less efficient. In other words, those who want Japan to become more open are asking it to be less successful.

In Robert Lawrence (1991), these views were evaluated by examining Japanese trade, using a model developed by Peter Petri (1992). Trade by industry was explained on the basis of such variables as factor-intensity, tariffs, transportation costs and concentration. In addition, variables were used drawn from data developed by Dodwell Marketing Associates, which measured the share of sales accounted for by firms belonging to *keiretsu*, by industry. Statistically significant evidence that *keiretsu* were associated with reduced imports was found. The analysis of Japanese exports, however, gave mixed results. The vertical *keiretsu* of major producers and suppliers in a single industry had a positive effect on exports, although it was not statistically significant. However, *keiretsu* of firms drawn from the former *zaibatsu* groups and those from other horizontal groups had no beneficial effect on exports. It was concluded that the results provided some support for the claim that *vertical* ties enhance efficiency. On the other hand, no support was found for claims that horizontal *keiretsu* improve performance, and it was therefore concluded that the efficiency benefits from cross-holdings may be exaggerated.

This work on *keiretsu* can now be expanded to explore, in a preliminary fashion, the relationship between *keiretsu* and the activities of majority-owned foreign affiliates in Japan. The dependent variable is the share of industry sales in 1991 accounted for by majority-owned foreign affiliates, as indicated by the data collected for the twenty-fifth annual survey of MITI. The independent variables are taken from the Petri model. In particular, variables have been used that measure concentration (Herfindahl Index) and technological intensity (share of scientists and engineers in sectoral employment). Foreign direct investment is expected to be positively associated with both variables. A variable was added to indicate capital intensity and the share of industry sales by *keiretsu* firms in 1987. In a second specification, that variable was separated into the share in sales of firms in horizontal and in vertical *keiretsu*. The results, reported in table 9, suggest that, indeed, *keiretsu* are negatively associated with FDI. As indicated in equation 1, the *keiretsu* variable is statistically significant and negatively signed. The coefficients on concentration and technological intensity are both positive. When separate variables measuring vertical and horizontal *keiretsu* are introduced, they are insignificant and with negative coefficients. While not significantly different from each other, the coefficient of horizontal *keiretsu* is larger than that of vertical *keiretsu*. This suggests that each percentage increase in sales by horizontal *keiretsu* firms is associated with a relatively larger restraining impact than a percentage increase by firms in vertical *keiretsu*.

It should be stressed that the data sample is inordinately small. Observations are available for only ten industries. In addition, one cannot be sure that the classification schemes used for measuring sales by industry are all consistent. Moreover, questions have been raised about the classification scheme used by Dodwell. None the less, there is no reason to believe that the data are particularly biased towards finding significantly negative relationships between *keiretsu* and foreign sales by industry.

To be sure, it is quite possible that *keiretsu* and low FDI are both correlated with an omitted variable that has a causal link with both. However, this variable must operate separately from the effects of both capital intensity and concentration, which were controlled for in the regressions. One argument worth considering, for example, is that *keiretsu* enjoy a lower cost of capital, have lower hurdle rates of return and can, therefore, outbid foreigners interested in acquiring Japanese companies. It may also be the case that, if exports and FDI are complements, the difficulties experienced by foreign firms in entering industries in which *keiretsu* predominate help to explain the finding in Lawrence (1991) that *keiretsu* have a negative impact on imports.

Finally, the data have also been used to explore whether the existence of *keiretsu* constitutes a barrier to domestic mergers and acquisitions. Indeed, while *keiretsu* may inhibit mergers outside the group, they may actually help to promote such activities between members. Data on mergers and acquisitions, most of which were relatively small, reported to the Japan Free Trade Commission for nine industries over the period 1988 and 1989, showed that mergers-and-acquisitions activity is more prevalent in technology-intensive industries (table 9, equations 3 and 4). However, no effects associated with the *keiretsu* variables could be found. Apparently,

Table 9. Foreign direct investment sales and mergers and acquisitions by industry

[t-statistics in parenthesis]

Per cent SALES	CAPINT	HERF	TECH	KRETS	VERT9	HORIZ8	Corr. R^2
1 Per cent SALESMOF	0.03	0.002	0.42	-0.09			0.77
	[0.39]	[1.79]	[2.31]	[3.45]			
2 Per cent SALESMOF	0.097	0.002	0.327		-0.08	-0.12	0.79
	[1.11]	[2.24]	[1.75]		[3.29]	[3.31]	
3 JPNMERG	-15.34	-0.15	113.85	6.82			0.17
	[0.65]	[0.53]	[1.89]	[0.90]			
4 JPNMERG	-28.17	-0.23	123.82		6.19	13.04	0.03
	[0.87]	[0.71]	[1.86]		[0.75]	[1.04]	

Sources: (1) Japanese Ministry of Finance, "Corporate business statistical annual report", and Ministry of International Trade and Industry.
(2) Japan Economic Institute (1990).
(3) Petri (1992).
(4) Dodwell Marketing Consultants (1986).

Notes: Constant term not reported.
Percentage SALESMOF = Share of foreign affiliates in industry sales, FY1991.
JPNMERG(2) = Value of mergers and acquisitions, by industry, 1984-1988.
CAPINT(3) = Capital intensity.
HERF(3) = Herfindahl index.
TECH(3) = Technology intensity.
KRETS(4) = Percentage sales by all *keiretsu*.
VERT9(4) = Percentage sales by vertical *keiretsu*.
HORIZ8(4) = Percentage sales by horizontal *keiretsu*.

keiretsu do not inhibit domestic mergers-and-acquisitions activity. Indeed, the coefficients of the *keiretsu* variables are positive (although not statistically significant). The effects of *keiretsu* appear to operate on FDI, but not on domestic mergers-and-acquisitions activity.

Conclusions and policy implications

During the 1980s, inward FDI in Japan grew primarily through the reinvested earnings of existing firms. In fact, foreign withdrawals, particularly of minority-interest positions, have outweighed new equity capital investments. Apparently, the high values on the Tokyo stock market during the late 1980s not only discouraged new entrants, but also encouraged existing foreign participants to liquidate some of their positions.

Several features of foreign activity in Japan support the anecdotal accounts of barriers to foreign entry and operation. These include the high share of United States receipts from Japan that take the form of licence payments from unaffiliated Japanese firms, the high share of FDI accounted for by joint ventures, and the high share of majority-owned FDI in wholesale trade. Given these entry barriers, one would expect the *ex ante* demand for acquisitions as a mode of entering Japan to be relatively high.

Mergers and acquisitions in Japan, even under friendly conditions, are difficult. Acquisitions involving foreign firms and/or hostile takeovers are rare. In other developed countries, by contrast, the majority of FDI entries occur through acquisitions. However, in Japan a disproportionate share of entries involves joint ventures and greenfield operations. The estimated relationship between the mode of entry (that is, greenfield versus acquisition) and the level of FDI internationally helps to explain the low levels of FDI in Japan.

The expansion of stock cross-holdings among *keiretsu* members and other Japanese firms during the 1970s was an explicit device to prevent foreigners from buying Japanese companies. It appears to have worked. The presence of *keiretsu*, whether of a horizontal or vertical type, is associated with particularly low levels of FDI. Market entry could be hindered by practices that are explicitly collusive (situations in which long-term relationships are the norm), by difficulties associated with making acquisitions of *keiretsu*-related firms because of stock cross-holdings, or by inherent cost-of-capital advantages enjoyed by *keiretsu* members. Additional research is needed to determine the precise mechanism that brings about this negative association. While one cannot be clear on which mechanism precisely is at work, the results represent additional evidence refuting the claim that *keiretsu* linkages are economically insignificant. Although *keiretsu* do not appear to discourage domestic merger-and-acquisitions activity, they are associated with less FDI.

Is the environment for FDI in Japan changing? The 1992 recession in Japan, combined with significant declines in stock and land prices, could herald a change in the environment for merger-and-acquisitions activity in Japan in general, and for acquisitions of Japanese firms by foreign companies in particular. Foreigners are likely to find deals more attractive as prices fall. *The Economist* (25 April 1992) noted that though present economic conditions will require considerable restructuring through mergers, most deals are likely to occur between firms within the same *keiretsu*. It added, however, that

> "Japanese banks are increasingly unwilling to play their traditional role of arranging marriages with healthier Japanese companies. Many just want to get their money back as soon as possible, even if that means selling to a foreign company." (p. 85).

None the less, *The Economist* also noted that "there is still a huge cultural divide that deters many outsiders from acquisitions in Japan." (p. 85). The major differences in the ease with which foreigners can acquire domestic companies in Japan and in other developed economies are likely to persist for the time being.

As the world economy becomes increasingly integrated, institutional differences, such as those that exist between Japan and other countries, are coming under particular scrutiny. On the one hand, there is a view that pluralism and diversity are beneficial to the global economy and that, as long as border barriers are removed, a high degree of national sovereignty is warranted. Certainly, since no global investment code exists, Japanese practices do not represent a violation of its international legal obligations. On the other hand, there is a growing recognition that globalization requires mechanisms for deeper integration than that achieved by the removal of border barriers and the adherence to the formal legal obligations of national treatment. As the preparation for the single European market has made clear, at certain times, this may require harmonization; at other times, mutual recognition may suffice. None the less, efforts to negotiate measures to reconcile institutional differences are likely to continue.

A cost-benefit analysis of these institutional practices is beyond the scope of this article. Foreign direct investment will generally confer benefits on both the host and home countries. The relatively closed Japanese market for corporate control reduces foreign profits. It also reduces domestic competition and may reduce technology transfer to Japan. However, restrictions on FDI could also increase Japanese welfare (and reduce foreign welfare) if it shifts rents from foreign to Japanese-owned firms by forcing foreign firms to license their products, rather than to enter the Japanese market directly.

Increasingly, firms recognize that effective global strategies require a major presence in each region of the Triad (UNCTC, 1991). Since access to

Japan is more difficult than access to the United States or Europe, Japanese firms could gain a strategic advantage. Indeed, in the long run, firms headquartered in Japan could therefore become more competitive than those headquartered in the European Community or the United States. As Japanese companies become more important rivals and as they avail themselves of the opportunities to invest in other nations, these asymmetries in market access between Japan and other countries are likely to become an increasing source of friction. It is unclear whether the asymmetries will be closed by a Japanese convergence towards foreign practices, or by restraints that seek to give Japanese firms investing abroad access that is equivalent to that granted foreign firms in Japan. It is hard, however, to imagine that the current asymmetries will be maintained. ■

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