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Japan's Balancing Act in Asia

How Political Tensions in Asia are Impacting Expansion Plans for Japanese Businesses Overseas

In September 2012 the Japanese government purchased three of the Senkaku Islands, a group of uninhabited islands known as the Diaoyu Islands in China and the Tiaoyutai Islands in Taiwan, from what they considered their private owner. The Islands have been part of a long running territorial dispute with Japan, China and Taiwan all asserting their claim over the land. So it was little surprise that this purchase was the cause of large scale, often violent protests in China, with anti-Japanese sentiment publicly displayed and Japanese businesses and goods vandalized and boycotted.

During the height of tensions, major Japanese companies such as Canon, Panasonic, Mitsumi and Lion Corporation temporarily suspended factory operations in China. Similarly, carmakers Toyota, Nissan and Honda also reduced production at factories by up to 50%.[1]

A recent Nikkei Inc. survey of 129 Japanese companies operating in China found that 70% were directly affected by the situation, some with violent instances. Around 72% of companies saw a decline in sales and 41% said customer growth suffered. 24% experienced issues in dealing with public institutions or state owned firms, while 80% still claim to be suffering from anti-Japanese sentiment in China.[2]

As the world's second largest economy with predicted year-on-year GDP growth at 7.5%, China cannot be ignored. It is still an important market that remains key to many Japanese companies and their global growth strategies. However on-going political and social tensions around the contested Islands, along with factors such as an economic slowdown, rising labour costs and workforce unrest, and an increasingly challenging legal and regulatory environment, has led many Japanese companies to seriously consider the impact of downsizing, or even in some instances winding up, their Chinese operations.

[1] http://www.japantimes.co.jp/news/2012/10/06/business/toyota-eyes-drastic-cuts-in-china-production/#.UhxmARswdN0
http://www.cnbc.com/id/49173868
[2] Nikkei Report: 'Senkaku ripples lingering', 2 September 2013

Japanese Companies Downsizing in China

Panasonic temporarily suspended work at three of its Chinese plants in September 2012 after one of their factories was set on fire. Protestors also damaged Panasonic factories in Qingdao and Suzhou, while employees began striking in Guangdong.

In September 2012, anti-Japanese protests resulted in Canon Inc. suspending operations at three out of its four plants – a laser printer factory and a digital camera factory in Guangdong and a copier plant in Jiangsu.[3]

One of Japan's largest consumer electronics retailer chains, Yamada Denki announced the closure of their Nanjing and Tianjin stores in June 2013 citing anti-Japanese sentiment and territorial tensions as causing a slowdown in sales; heated price wars; and "obstructive behaviour" by rival Chinese companies and product makers who refused to sell goods to Yamada Denki.[4] The Nanjing store had only operated for one year before closing, while in Tianjin operations began in June 2011.

Fast Retailing Co., owner of Asia's largest clothing retailer,[5] Uniqlo, currently produces 70% of its output in China, but would like to cut its production in the country to two-thirds, mainly to reduce costs. The process has already begun as the company moved parts of its apparel production in April 2013 to Vietnam, where wages can be half those in China.[6]

In October 2013, Japanese baby milk producer, Meiji suspended sales in the Chinese market citing that "...the rising costs of raw materials and increasingly fierce competition have made it *[sic]* difficult to make a stable profit in the market." While the company plans to return once market conditions improve, there is no indication of when that may be.[7]

Taking a Closer Look at the Reasons for Change

A study from the Japan External Trade Organization (JETRO), released in May 2013, revealed the biggest reasons for a potential downsizing or withdrawal of business from China were "country risk" (55% of respondents), "production cost" (38.5%) and "the legal system" (31.2%). Intellectual property rights and labour costs were also recognised as major business risks, with 69.8% of Japanese firms believing

[3] http://petapixel.com/2012/12/11/canon-to-target-chinese-market-amidst-lingering-anti-japanese-sentiment/
[4] http://ajw.asahi.com/article/economy/business/AJ201306120005
http://ajw.asahi.com/article/economy/business/AJ201304230070
[5] http://www.businessoffashion.com/tag/fast-retailing
[6] http://online.wsj.com/news/articles/SB10001424127887323798104578453073103566416
[7] http://www.japantoday.com/category/business/view/baby-milk-maker-meiji-suspends-china-sales

business risks in China to have increased (compared with 52.7% in FY2010).[8] While China continues to be the largest recipient of foreign direct investment in the developing world, this is generally slowing down as investors are increasingly faced with barriers to capitalise on their returns in the market.

Tightened Regulatory Environment for Foreign Firms

China is known to be phasing out the preferential tax and treatment it once offered to foreign businesses. Stricter regulations for foreign financial institutions were announced in August 2013, compared to an easing of regulations for local firms.

Lack of Transparency

In a recent survey conducted by anti-corruption watchdog, Transparency International, 100 top multinationals from 16 emerging economies provided insight that indicated China was the least transparent economy amongst all the BRICS (Brazil, Russia, India, China and South Africa) markets.[9] The lack of clarity on procedure and decision-making by local authorities means it is often difficult for companies to operate in China. Further, daily reports on corruption and bribery scandals in China are highlighting the difficulties that foreign firms face in upholding corporate governance standards.

Economic Sanctions Resulting from Sino-Japanese Disputes

In late September 2012, Chinese media reports suggested that economic sanctions on Japan were being considered by the Chinese government in response to Sino-Japanese territorial disputes.[10] While never implemented, it has been noted by various law firms that Japanese companies face much more meticulous and frequent customs checks on goods coming from Japan, which is negatively impacting their operations in China.

Rising Chinese Wages

The initial lure of low Chinese wages attracted more than 14,000 Japanese companies to set up small-scale production factories across the country. However, with some studies projecting Chinese wages and benefits rising between 15% and 20% a year, labour forces in other Asian countries are now appearing to be more attractive options.

While still significantly less than in Japan, in December 2012 the average monthly wage in Shanghai was reported to be US$449, compared to US$301 in Manila, US$345 in Bangkok, US$148 in Ho Chi Minh City, US$74 in Phnom Penh and US$53 in Myanmar.[11]

Labour Unrest

Foreign enterprises frequently experience labour unrest which can manifest itself in strikes and sometimes violent disturbances. With China's economic growth comes a better informed, workers' rights manifesto, along with greater demand for better conditions and salaries.

8 http://www.jetro.go.jp/en/news/releases/20130328200-news
9 http://www.reuters.com/article/2013/10/17/companies-transparency-idUSL3N0I536W20131017
10 http://blogs.wsj.com/chinarealtime/2012/09/17/whats-at-stake-in-china-japan-spat-345-billion-to-start/
11 http://www.jetro.go.jp/en/reports/survey/pdf/2013_05_01_biz.pdf

Risks in Downsizing

Operational and Property Risk

Any downsizing operation presents a risk to company employees and assets. Once lay off plans are submitted they can quickly spread to workers and can result in chaos. As we have seen in China, factory sit-ins, personal injury, death threats, and even kidnapping or hostage-taking are increasingly common physical security risks that company managers face when announcing lay-offs. More cases are being seen in which violence is threatened or used to 'test' management willingness to offer additional compensation. Further, damage to company property, sabotage, Intellectual Property (IP) theft and robbery have been commonly known to occur when announcing staff lay-offs in China.

December 2012

1,000 workers at South Korea-owned mobile phone parts producer Dongguan Samkwang Science & Technology held a strike over low salaries and poor working conditions. The strike turned violent as armed police and security guards' attempted to suppress the protestors.

Around 3,000 workers held a strike over redundancy payments at the Hong Kong-owned Wong's Electronics Co factory in Shenzhen.[12]

January 2013

Complaints over bonuses and forced overtime led 1,000 workers to strike at a Foxconn factory in Beijing.[13]

June 2013

Chip Starnes, the president of US-based medical products manufacturer Specialty Medical Supplies, was held captive by Chinese workers at the company's Beijing plant following rumours that the plant would be closed and operations would be moved to India in order to lower production costs. The president was released after six days in the factory.[14]

Supplier Risk

Suppliers have also been known to blockade factory gates and refuse to allow anyone to leave until they are paid and to also harass staff outside of company premises.

Reputational and Strategic Risk

In China the importance of developing and maintaining institutional relations with a wide range of stakeholders and demonstrating long term commitment to the country's social and economic growth is utmost to growing businesses, meaning that any company looking to downsize or exit needs to do so very cautiously. During periods of transition,

12 http://www.rfa.org/english/news/china/strike-12272012140921.html
13 http://thenextweb.com/asia/2013/01/14/workers-strike-over-low-wages-at-foxconn-supplier-in-china/
14 http://libcom.org/blog/workers-struggles-east-asia-december-2012-january-2013-09022013
http://globaltorchlight.com/2013/06/28/recent-incident-highlights-chinas-growing-labour-unrest/
http://www.reuters.com/article/2013/06/27/us-china-labour-dispute-idUSBRE95Q08B20130627

numerous companies have been accused of abusing China and its people as their practices have been misrepresented by government, media and grass-roots organisations. Such reputational damage can lead to concrete business setbacks, ranging from difficulties extending a license or failing partnerships to a consumer backlash.

With so many investors looking to enter the Chinese market, local authorities are facing a backlog of process and paperwork. As such, companies looking to downsize or even exit the country are certainly not a priority. In fact, local authorities, concerned with reduction in tax revenues and unemployment, tend to be uncooperative and difficult throughout the process, making the process drag on and become very costly.

Moving into Alternative Markets

Recent research findings from the Japanese Bank for International Cooperation showed that India, Indonesia, Thailand and Vietnam all joined China as the top five countries attracting the most business interest from Japanese manufacturers in between 2011 and 2012.[15] These countries all offer major market growth potential and an inexpensive labour market. Other factors attracting foreign investors to these countries include the abundant availability of raw materials, the stage of their economic development and local population demographics – which all point towards an expanding future middle class with potential opportunities available across multiple industry and business sectors. In addition, emerging markets such as Cambodia, Mongolia and Myanmar have also received increased business interest from Japan and other foreign investors, and are all providing an appealing alternative to the potentially volatile and increasingly uncertain business environment in China.

While each of these emerging markets presents their own specific risks and opportunities, it is apparent that the investment climate in these countries is improving and the opportunities available are showing good potential. Alongside this, the push for Japanese foreign investment is being supported by recently renewed foreign policies and government guidance to banking institutions. Across the board, the general mood amongst Japanese companies looking to realise their expansion plans overseas is one of timeliness and valuable strategic fit. However, as Japanese investors look to transition in and out of various Asian markets it is vital they conduct comprehensive due diligence and risk assessments to effectively plan and approach any exists and entries. Such action will not only help companies manage and mitigate any risks – making market exit or entry as smooth as possible – but will also ensure that the value of their investments remain intact.

About FTI Consulting

FTI Consulting is a global business advisory firm dedicated to helping organisations protect and enhance enterprise value in an increasingly complex legal, regulatory and economic environment. With more than 4,000 employees located in 24 countries, FTI Consulting professionals work closely with clients to anticipate, illuminate and overcome complex business challenges in areas such as investigations, litigation, mergers and acquisitions, regulatory issues, reputation management, strategic communications and restructuring.

The Global Risk and Investigations practice of FTI Consulting is a leading provider of comprehensive business risk solutions including reputational due diligence and other business intelligence, fraud and corporate investigations, data forensics and electronic evidence recovery, brand protection, the strategic management of intellectual property and crisis containment services in Asia.

Our team of seasoned professionals is drawn from backgrounds in senior law enforcement, regulatory compliance, academic and economic research, information technology and investigative journalism. We provide clients with critical information, insight and timely solutions for informed decision making.

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[15] Japan Bank for International Cooperation press release: http://www.jbic.go.jp/en/about/press/2010/1203-01/index.html