Latest Trends in Japanese Business Firms' Behavior & Challenges in the Light of Enterprise Statistics

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Introduction

The Ministry of Economy, Trade and Industry (METI) publishes three important statistics on Japanese corporations' business behavior. The Basic Survey of Japanese Business Structure and Activities is a survey on Japanese companies' business diversification, globalized activities, and R&D, as well as their strategies to accommodate IT in their business structure. It contributes to industrial policy planning for strengthening Japanese business competitiveness as well as contributing added value to the industrial structure.

The Survey of Overseas Business Activity is one on Japanese business firms' global activities, including their overseas subsidiaries' activities in their host countries, and examines those activities' impact on the host country's economy as well as the global economy. This helps METI's trade policy practitioners to implement international trade policy for the benefits of both the Japanese economy and the global economy.

These are so-called statistics on economic structure and are useful for examining long-term trends, and by the nature of statistics the data are only available until 2021 or 2020 at this moment.

Meanwhile, METI publishes statistics on a quarterly basis on Japanese business firms' overseas subsidiaries activities which present more immediate facts up until the first quarter of 2023. This is called the Quarterly Survey on Japanese Overseas Subsidiaries Activities by which we can see how recent global political and economic developments impact on Japanese corporate behavior.

In this article, I would like to introduce some recent findings from these surveys and provide some observations on Japanese business firms' behavior.

Basic Survey of Japanese Business Structure & Activities 2022

This survey shows Japanese business achievements in FY 2021. Looking at sales and profits, the sales amount per company in all sectors increased 5.1% from FY 2020, corporate profits increased 40.9% and current profits increased 35.8%. In the manufacturing sector, the sales amount per company increased 8.9%, corporate profits 74.7% and current profits 46.7%. In the wholesale sector and retail sector, the increases were respectively, 3.0% and 1.7% in the sales amount, 39.2% and 8.8% in corporate profits, and 37.7% and 10.0% in current profits *(Chart 1)*.

These figures largely show that Japanese business performance has been steadily improving in FY 2021 from FY 2020 when the Covid pandemic's impact on business was most significant. It was seen, however, that there were somewhat significant differences in the speed of recovery among the sectors, with the wholesale and retail sectors' recovery slower than in the manufacturing sector. This is more clearly seen in the changes in operating profit margins and ordinary profit margins *(Chart 2)*.

In all sectors overall, the operating profit margin increased 1.1% point from FY 2020 and the ordinary profit margin increased 1.5% from FY 2020. The manufacturing sector saw 2.1% and 2.3% increases respectively. In the wholesale sector, 0.7% and 1.2% increases were seen, and in the retail sector they were 0.2% and 0.3%. The smaller business improvement in the retail sector compared to other sectors means consumer behavior has not significantly improved in response to a relative decline of the pandemic's impact on public health. Most consumers were still behaving with prudence due to the continuing pandemic at that time.

Looking at Japanese companies' corporate expenses, business expenses (the cost of sales plus sales expenditure and general administration cost) per company in all sectors overall increased 3.9% from FY 2020, while the cost of sales ratio decreased 0.7% point and the SGA (Selling, General and Administrative expenses) ratio decreased 0.4% point. In the manufacturing sector, business expenses per company increased 6.5%, while the cost of sales ratio decreased 1.0% and the SGA ratio decreased 1.1%.

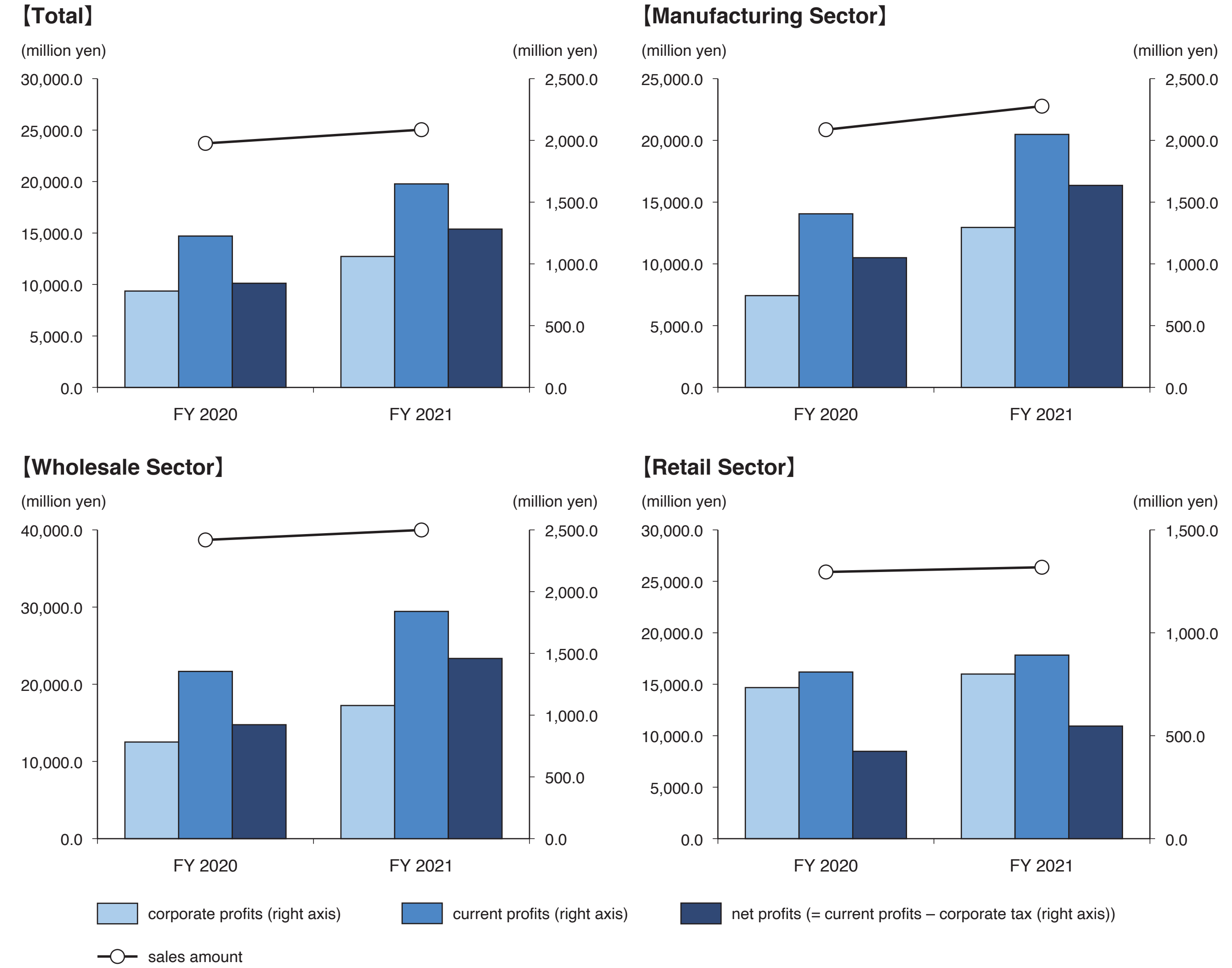
In the wholesale sector, business expenses per company increased 2.3%, and decreased 0.6% point for the cost of sales ratio and 0.2% for the SGA ratio. In the retail sector, these three were, respectively, a 1.5% increase and a 0.6% decrease and a 0.4% increase *(Chart 3)*.

Here, again, we see a relatively stagnant recovery, in particular in the retail sector, with its smallest figure in business expenses and increase of the SGA ratio meaning stagnant sales relative to sales administration costs.

Looking at value-added produced by Japanese business companies, value-added produced by all companies in total increased 7.8% from FY 2020 mainly due to the increase of corporate profits. Manufacturing companies' value-added increased 12.4% from FY 2020 and that of wholesale companies' increased 8.6%, both due to increased corporate profits, while retail

CHART 1

Sales amount, corporate profits, current profits & net profits per company in Japan, FY 2021

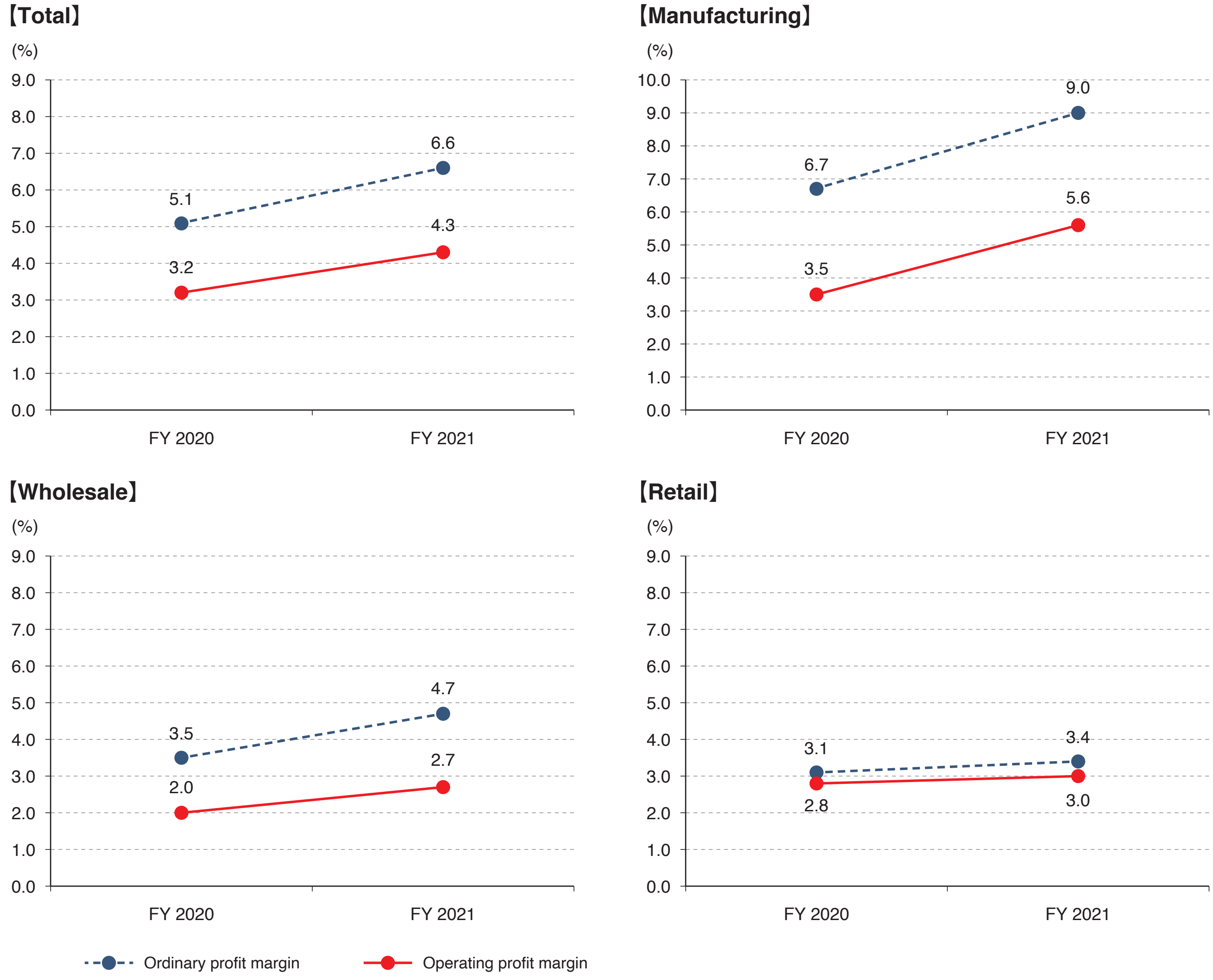


Source: METI

companies' value-added increased 4.3% due to higher employee salaries *(Table)*.

It is said of the Japanese economy that wages have never been raised during these past two decades. This statistical review of Japanese business companies endorses this statement. The labor share (proportion of labor costs to value-added) declined 2.7% points from FY 2020 as the rate of increase in total salary amounts was lower than the rate of increase in value-added. By sector, in the manufacturing sector it decreased 4.6% points and in the wholesale business sector by 3.1% points. Meanwhile, in the retail sector, it remained the same. Looking at labor productivity (value-added per one permanent employee), as the rate of increase in value-added exceeds the rate of increase in permanent employees, it increased 6.1% from FY 2020 in all sectors overall. By industrial sector, in

CHART 2
Operating profit margin & ordinary profit margin



Source: METI

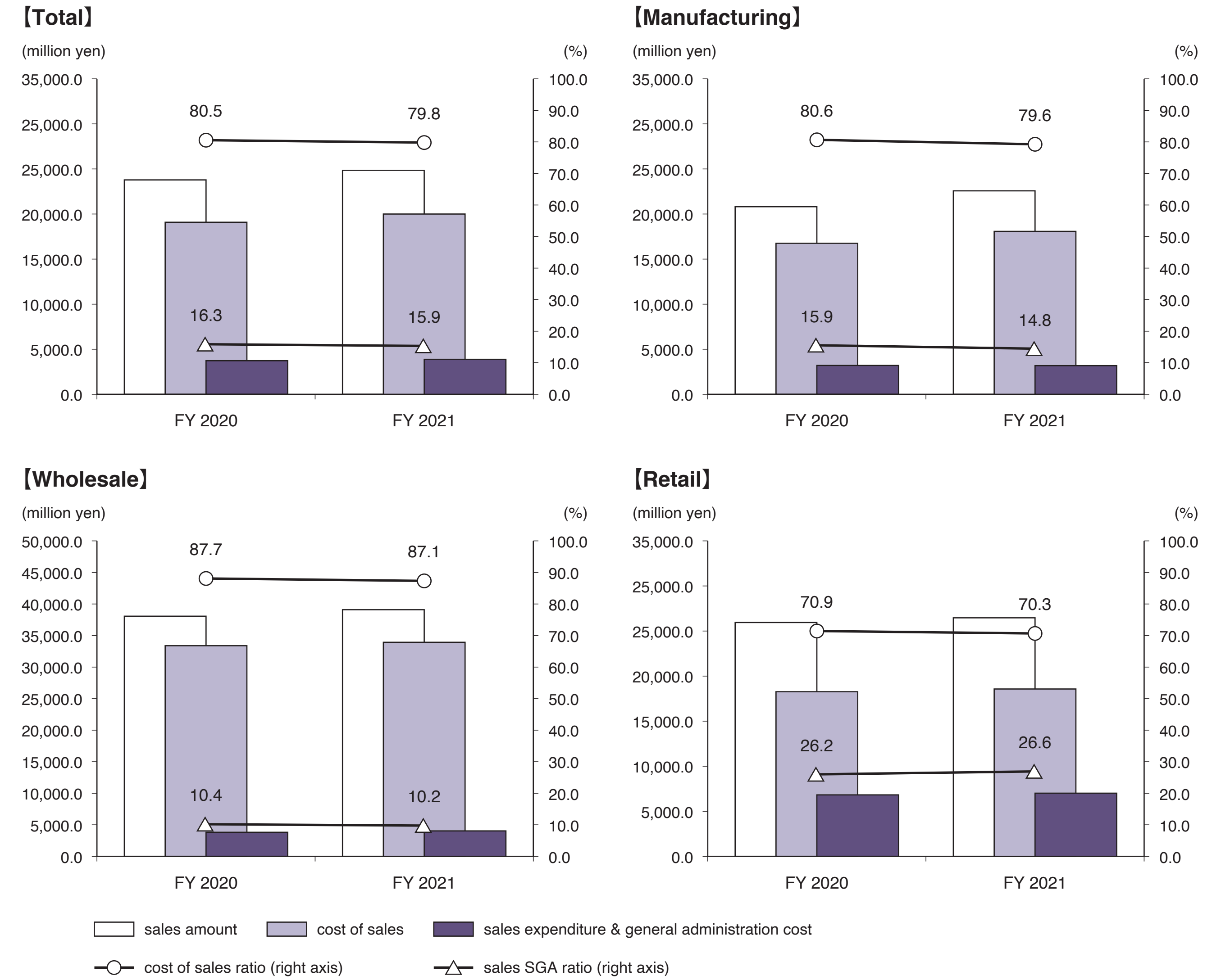
manufacturing it increased 10.9%, in the wholesale sector it increased 8.6%, and in the retail sector it increased 2.6% *(Chart 4)*. In spite of a rise of labor productivity, this was not reflected in wages; instead, the share of wages to total value-added decreased. Meanwhile, as this survey shows, Japanese companies' corporate profits increased steadily in FY 2021, showing a stable recovery from the pandemic crisis. We can now see that those increased corporate profits were not spent on wage increases.

On the other hand, the capital adequacy ratio per firm increased 0.2% point from FY 2020 in the manufacturing sector and increased 1.5% points in the retail sector, while in the wholesale sector it declined 0.9% point. Thus, except for the wholesale sector, their increased corporate profits were spent on improving their balance sheets, with an increased capital adequacy ratio.

The number of subsidiaries is a good indicator of a company's business strategy. In particular, the number of overseas subsidiaries

CHART 3

Business expenses per company, cost of sales, sales expenditure & general administration cost, cost of sales ratio, sales SGA ratio



Source: METI

implies how much a company is active in its business globalization. This statistical review shows that the number of subsidiaries in the manufacturing sector increased 0.9% from FY 2020, with a 0.2% increase in domestic subsidiaries and a 1.4% increase in overseas subsidiaries. Meanwhile, in the wholesale sector the number decreased 0.8% with both domestic and overseas ones declining, and in the retail sector it decreased 1.8% with both also declining. The decrease in subsidiary numbers in the wholesale and retail sectors can be explained by the pandemic’s lingering impact in FY 2021 on business strategy, namely making firms less active in expanding their business. However, the manufacturing sector, which picked up faster than the other two sectors even during the

TABLE

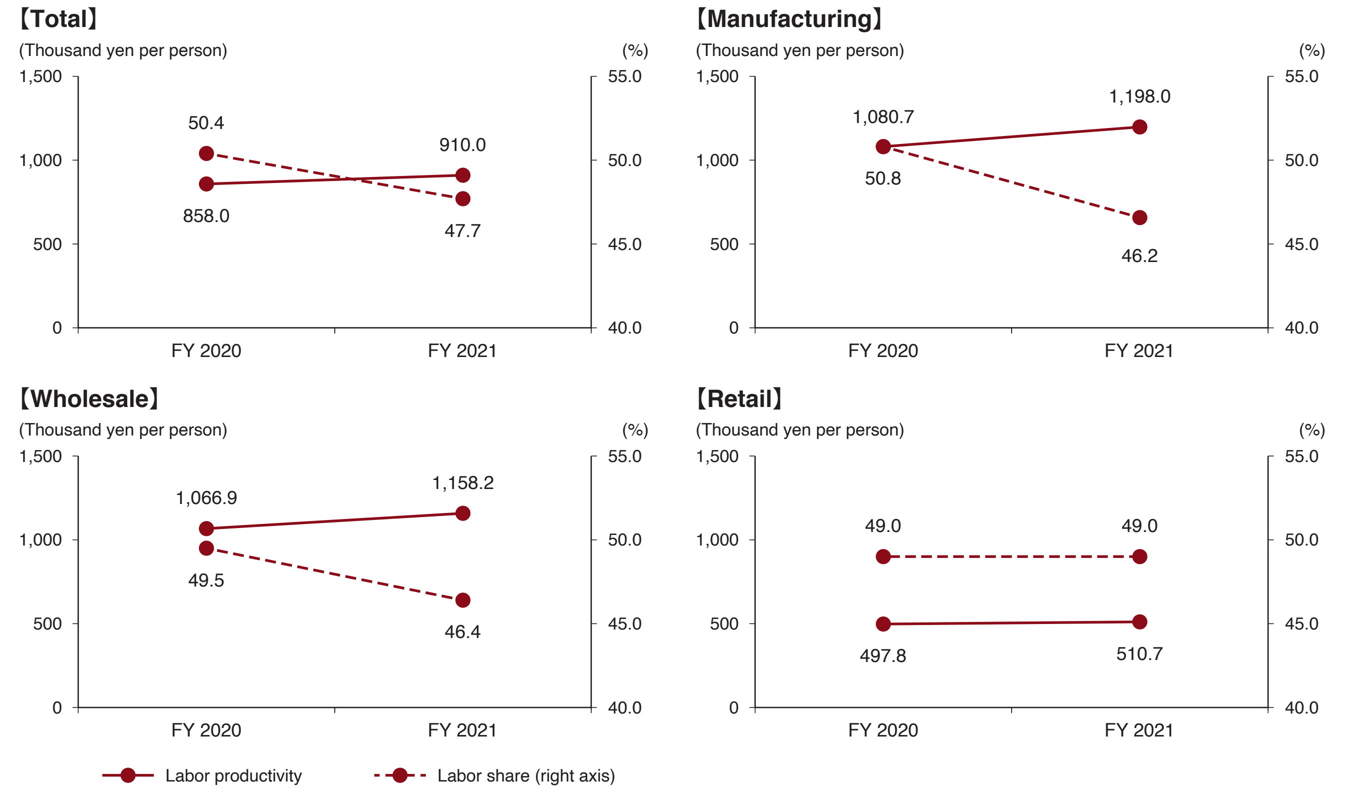
Contribution of various items of value-added to the total

	Total (million yen)				Manufacturing (million yen)				Wholesale (million yen)				Retail (million yen)			
	2020 FY	2021 FY	Change from the previous year	Contribution %	2020 FY	2021 FY	Change from the previous year	Contribution %	2020 FY	2021 FY	Change from the previous year	Contribution %	2020 FY	2021 FY	Change from the previous year	Contribution %
Total value added	117,475,034	126,643,183	7.8	–	55,131,786	61,986,275	12.4	–	15,582,704	16,917,790	8.6	–	15,843,324	16,521,724	4.3	–
Corporate profits	19,999,342	28,170,383	40.9	7.0	8,744,455	15,366,314	75.7	12.0	3,873,162	5,302,779	36.9	9.2	2,263,827	2,452,475	8.3	1.2
Salary amount	59,220,337	60,441,955	2.1	1.0	28,027,678	28,664,362	2.3	1.2	7,719,891	7,850,041	1.7	0.8	7,770,904	8,093,331	4.1	2.0
Depreciation costs	15,636,254	15,742,276	0.7	0.1	9,068,919	8,986,257	▲0.9	▲0.1	1,157,414	1,082,377	▲6.5	▲0.5	1,297,485	1,254,069	▲3.3	▲0.3
Welfare expenses	10,785,199	10,118,317	▲6.2	▲0.6	5,782,868	5,410,535	▲6.4	▲0.7	1,429,649	1,278,596	▲10.6	▲1.0	1,121,641	1,096,617	▲2.2	▲0.2
Rent of real estate and other assets	8,331,005	8,563,286	2.8	0.2	2,140,762	2,146,141	0.3	0.0	1,085,664	1,051,232	▲3.2	▲0.2	3,029,777	3,259,855	7.6	1.5
Tax	3,502,897	3,606,966	3.0	0.1	1,367,104	1,412,666	3.3	0.1	316,924	352,765	11.3	0.2	359,690	365,377	1.6	0.0

Source: METI

CHART 4

Labor productivity & labor share



Source: METI

pandemic, took a more active business strategy for expansion, in particular globally.

From this statistical review of Japanese companies we can see that the manufacturing industry of Japan was relatively inactive on the domestic front but more active globally. It can probably be assumed that the industry is increasingly eager to earn revenue from global business.

Let's move on to the second statistical survey of Japanese business, the Survey of Overseas Business Activity, which gives a detailed and holistic picture of Japanese companies' recent overseas business strategy and activity.

Survey of Overseas Business Activity 2022

With the eagerness of Japanese manufacturing companies to enhance overseas production, the ratio of Japanese manufacturing overseas subsidiaries' production to all Japanese corporations' production has been increasing steadily since FY 2012 and reached 25.8%, a 2.2% point rise from FY 2020, in particular with a rise in this ratio in the transportation and general machinery sectors *(Chart 5)*. This high ratio makes a significant contrast to the low ratio of the internal FDI stock amount to nominal GDP in Japan, which was 5.2% in 2021.

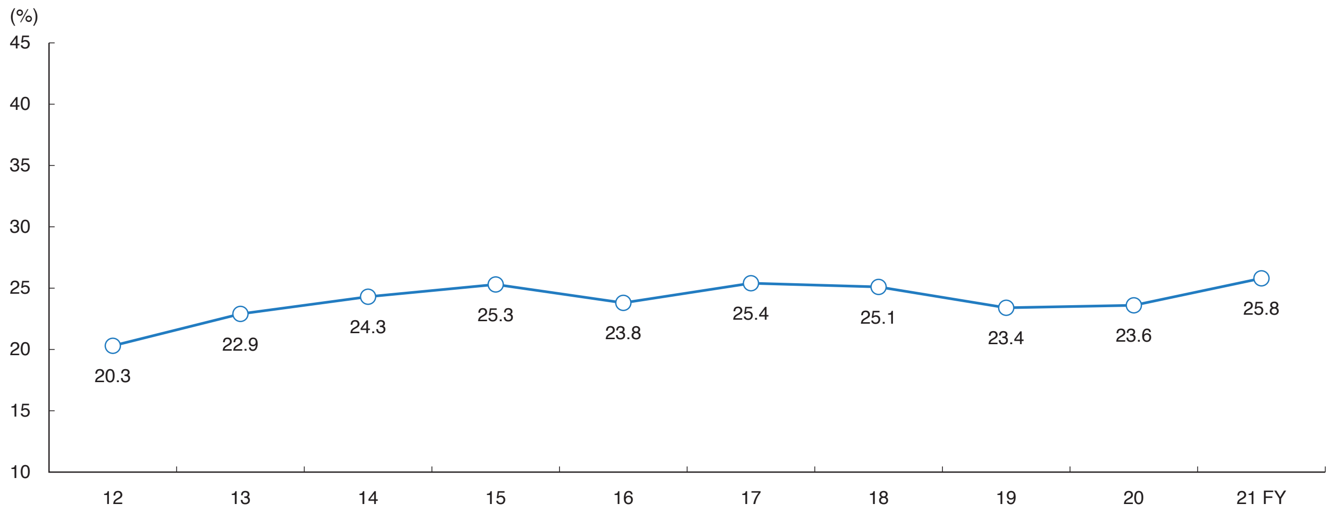
On the fundamental business indicators, such as sales amount and current profits, both significantly increased among Japanese overseas subsidiaries in FY 2021. The total sales amount of all Japanese overseas subsidiaries reached 303.2 trillion yen in FY 2021, a 25.9% increase from FY 2020, with a robust increase both in the manufacturing and non-manufacturing sectors and also in all regions of the world. Likewise, the current profits of all Japanese overseas subsidiaries totaled 17.1 trillion yen, a 72.9% increase from FY 2020 with rises in both sectors as well as in all regions. As a result, the ordinary profit margin was 6.8 %, a 2.0% point rise from the previous year. Thus, Japanese companies' global business activities went well in FY 2021 in spite of the lingering impact of the pandemic on public health and the economy.

Looking at the ratio of the Japanese manufacturing industry's overseas subsidiaries' sales in the surrounding regions of the host country to their total sales in FY 2021, it was 92.9% in North America, 82.7% in Europe and 79.2% in Asia.

Meanwhile, the ratio of their parts and components procurement to the total of those procurements by region in FY 2021 was 74.9% in Asia, 66.1% in North America and 65.3% in Europe. This points to close business relations between those subsidiaries and the local economy of the host country and its surrounding nations.

Remittance of money acquired by overseas subsidiaries, including dividends and royalties to Japanese investors, amounted to 5.5 trillion yen, a 32.1% increase from FY 2020. The increase was observed everywhere in the world and thus implies that earning profits from overseas subsidiaries' activities is now a common

CHART 5
Changes of overseas subsidiaries production ratio to total



Source: METI

business strategy for Japanese corporations. In this light, we see Japanese manufacturing overseas subsidiaries' investment in production facilities and equipment increased as well, reaching 3.7 trillion yen, a 14% increase from FY 2020, which made the proportion of those manufacturing overseas subsidiaries' investment in production facilities and equipment to total investment by the Japanese headquarters and their overseas subsidiaries 20.8%, a 1.4% point rise from the previous year.

R&D expenditures by these Japanese manufacturing overseas subsidiaries amounted to 907.5 billion yen, a 27.7 % increase from FY 2020. This increase was also observed everywhere in the world. Investment in facilities and equipment or R&D expenditures are long-term policies for expanding business activities and they prove as well that Japanese manufacturing corporations are now trying to use their overseas subsidiaries as the principal source of revenues.

Looking at the location of Japanese companies' overseas subsidiaries, at the end of FY 2021 overseas subsidiaries totaled 25,325, of which manufacturing ones were 10,902 (43% of the total) and non-manufacturing ones were 14,423 (57%), and the percentage of subsidiaries in Asia was 67.7%. Among Asian nations, the percentage of subsidiaries in ASEAN 10 nations to the total was 29.4%, a 0.6% point rise from FY 2020, while those in China accounted for 28.8%, a 0.3% point decline from the previous year *(Chart 6)*.

Looking at only the newly established Japanese overseas subsidiaries in FY 2021, there were 169 companies, a decrease of 31 companies from the previous year. In terms of location, the proportion of the new subsidiaries in North America and Europe increased, while the proportion of those in other regions decreased.

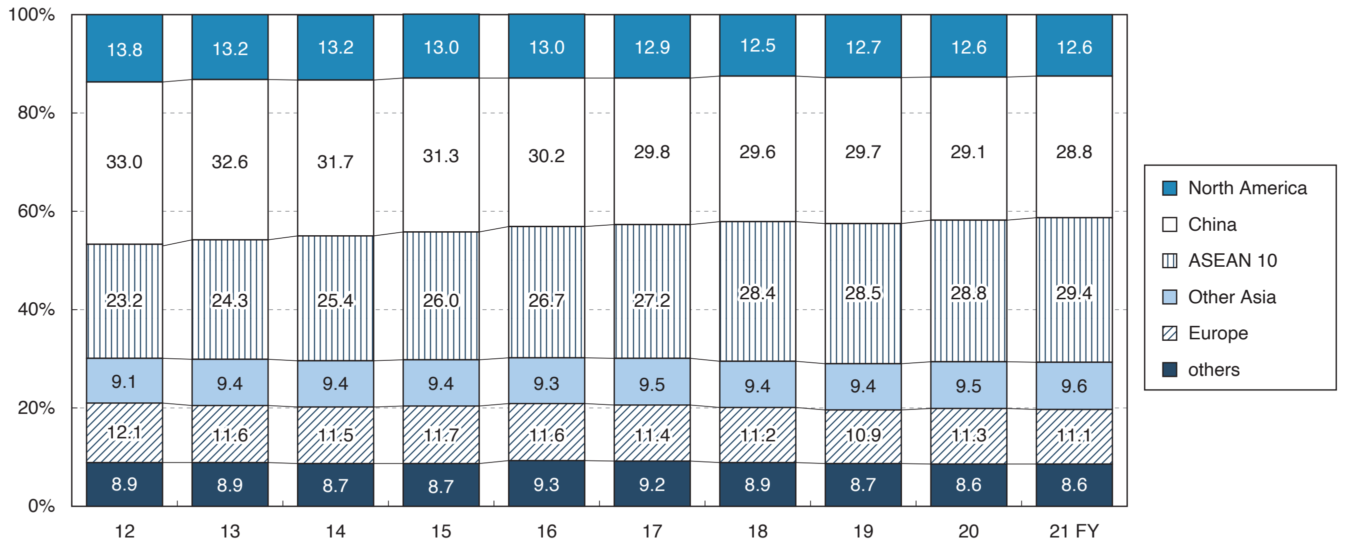
In terms of employees working for these Japanese subsidiaries, at the end of FY 2021 it was 5,690,000, a 1.2% increase from FY 2020, of whom around 4,200,000 were employed in manufacturing and 1,500,000 in non-manufacturing. By region, there were 840,000 working in North America, a 9.9% increase from FY 2020, and 640,000 in Europe, a 1.7% increase, while employees in Asian subsidiaries were 3,780,000, a 0.5 % decline from FY 2020, with a decrease in China and an increase in the ASEAN 10 nations.

These figures of location changes and employment changes of Japanese subsidiaries can be understood as a sign of Japanese companies' responses to increased geopolitical risks in the Asian region, in particular in China. They seem to have started moving subsidiaries from high-risk regions to safer ones. In FY 2021, the Ukraine war had not yet begun but the US-China struggle for global hegemony had intensified and the risk of supply chain disruption in Asia was increasing. In this light, Europe was safer than Asia.

We will see a clearer picture of this risk-averse behavior by looking at the last statistical survey covered in this article, namely the Quarterly Survey on Japanese Overseas Subsidiaries Activities.

CHART 6

Changes of overseas subsidiaries' region location structure



Source: METI

Quarterly Survey on Japanese Overseas Subsidiaries Activities, 1st Qtr of 2023

This survey is a quarterly version of the Survey of Overseas Business Activity, and as quarter-based statistics it can provide more recent statistics on overseas subsidiaries' activities. The latest version of this survey is for the first quarter (January-March) of 2023.

Total sales of all sectors were 41.3 trillion yen in this quarter, a 1.3% decline from the same quarter one year ago and showing a decrease for two consecutive quarters. Sector wise, the decline in chemicals and electric machinery mainly caused this overall decline. By region, while sales in the United States and Europe significantly increased in this quarter from the same quarter in 2022, the decline in China (24.0%) and that in South Korea (16.8%) were principally the causes of the overall decline.

As for Japanese overseas subsidiaries' investment in production facilities and equipment, it totaled 1.16 trillion yen, an increase of 4.4% from the same quarter in 2022 and rising for the third consecutive quarter due to a robust performance in transportation machinery and electric machinery. By region, there were significant increases in the US (16.2%), Thailand (34.8%) and India (39.5%), while there was a significant decrease in China (15.7%) and this was a decline for the second straight quarter. In the case of Thailand, the increase continued for the seventh consecutive quarter and in India for the third consecutive quarter.

Concerning employment, the data showed 4,155,000 in total, a decrease of 1.3% from the same quarter in 2022, declining for the second straight quarter. By sector, employment in electric machinery and general purpose machinery decreased. By region, whereas in the US and Europe employment increased 5.0% and 0.2% respectively in this quarter, there were declines in China, Thailand and Vietnam of 6.3%, 2.1% and 2.7% respectively.

Looking at these figures, the decline in sales, investment in facilities and equipment, and employment in China is noteworthy, meaning that we can clearly see Japanese companies adopting risk-averse behavior with regard to China. In particular, in the data on investment, we can see that they are diverting resources from China to Thailand and India. Investment is a leading indicator of future business strategy, rather than sales and employment, and changes reflect business behavior. We will probably see in the future an increase in sales and employment in other Asian nations or in other ASEAN 10 nations following this change of investment data. With the significant weight of China in total global Japanese overseas subsidiaries' business activities among these three indicators, namely 24.1% (sales), 18.8% (investment) and 23.0% (employment) in 2022, this change in business behavior would create a drastic change in the weight of locations.

Conclusion

Japanese companies' business strategies are today highly globalization-oriented ones through which they are trying to earn money from their overseas subsidiaries. Under globalization with little economic or geopolitical risk, these strategies have gone well. At this moment, however, geopolitical risks have been significantly increasing and they could be an impediment to this business model. The statistical surveys discussed do not reflect the impact of the Ukraine war but only the risks inherent in China's aggressive foreign policy that has been continuing for several years. The Ukraine war could create further risks for business since it has been the source of the energy and food crisis today, and this could cause global inflation resulting in a global recession. Thus the impact of geopolitical risks like the continuing Ukraine war could be much more serious than those already reflected in these statistical surveys, and we will see their impact a little later in those surveys.

Policies today should be evidence-based, but to achieve this we need data that fully reflects immediate reality. Otherwise, policy practitioners cannot make relevant decisions based on evidence and cannot properly mitigate risks. We will need to take advantage of big data available immediately through the use of IT.

In particular, we need to have more data and information on geopolitical risks that reflect immediate reality. If such risks can be made known before they actually materialize, it would have enormous benefits for business and policymakers could examine these possible risks and think about multiple strategies to cope with them. In formulating such strategies, they would become more skilled and experienced in handling risks and this could make them avoid being always risk-averse, and more like navigators carefully avoiding collisions with icebergs by analyzing the full picture in advance.

A risky world is the new normal today. We will need risk analysis for survival, and the use of more evidence-based risk analysis would enhance the need for data made available on time. Living in the world of big data, this is not necessarily a challenge. JS

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