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**Delayed, but Flourished? Preliminary analysis on FDI of the Japanese Companies
in Russia**

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Introduction

This paper aims to examine the recent development of economic activities of the Japanese companies in Russia. It is well known that Russian economy has been rapidly growing since the end of 1990s,¹ which encourages foreign direct investment (FDI) to the Russian market. Undoubtedly, enlarging domestic market is one of the most important factors to attract foreign companies. At the same time, it would be a necessary condition for FDI in the sense that it also depends on the various characteristics of foreign investors: the Japanese companies in general seem to be much more conservative to enter the emerging markets than the American and European competitors as it was the case in China as well as in Russia.

As a preliminary work to approach the Japanese companies in the Russian market, we will review the database 'Nikkei Telecom 21' from 2004 to 2008,² survey interview with the Japanese companies being involved in the Russian business (by author and others), annual questionnaire survey for FDI activities of the Japanese manufacturing enterprises

¹ The economic crisis after the fall 2008 has disrupted this trend. It hits the Russian economy harder than expected. According to various sources, it is predicted that it will shrink by 6.0–7.4% in 2009 (<http://www.banki.ru/>, accessed 6 May 2009).

² It is provided by the Nikkei Inc. that publishes various economic newspapers and journals such as the Nikkei, the Nikkei Business Daily, the Nikkei MJ (marketing journal), the Nikkei Finance (renewed as the Nikkei Veritas in March 2008). Nikkei is an abbreviation of *Nihon Keizai*, i.e., Japanese economy.

by the Japan Bank for International Cooperation (JBIC), press release materials of the respective companies and the official government statistics. This research is a first step to widen our view on FDI of the Japanese companies in Russia.

1 Russian market viewed from the Japanese economy: who is next after China?

This section explores the background of the Japanese economy that has been closely tied to the Russian market in recent years. Table 1 shows the trade trends of Japan and selected countries: although the share of international trade with Russia is still modest, both exports and imports have been rapidly increasing in the 2000s, in particular after 2004. More importantly, the exports to Russia exceeded the imports from it in 2006 and 2008 with a huge trade surplus in the last year, which means that Russia provides more profit-seeking opportunities for the Japanese companies. The table also tells us that the share of international trade with China, the biggest trade partner, is comparatively stable in recent times; the share of US has been drastically decreasing during the last decade, resulting in a loss of position as the biggest trade partner for Japan.

The statistics on the balance of payments and the international lending give us a more accurate picture of the FDI activities of the Japanese companies in Russia (see Figure 1). Both the flow of Japanese FDI and the cross-border lending to Russia have been rapidly growing after 2004: it could be said that the ‘Japan Money’ targeted this country around that time. Focusing on the advance into the Russian market, the number of the Japanese incorporations who have established overseas subsidiaries and/or representative offices in Russia has increased by three times from 60 entities in April 2001 to 181 entities in May 2009 (for the trend, see Figure 2).³

³ These figures mean the number of the corporate membership of ‘Japan Club’ in Moscow (managed by the Moscow office of Japan Association for Trade with Russia and NIS (ROTOBO)). According to the director, they more accurately reflect the number of

If we take a look at how the Japanese companies see Russia in terms of prosperity in the near future, they obviously acknowledge its growing importance as an emerging market. According to the result of questionnaire survey for FDI activities of the Japanese manufacturing enterprises by JBIC, Russia is regarded as a prospective market in a medium- (next three years) and long-term (next ten years) perspective. While China still maintains a lead in the market potentiality for medium-term business activities, the percentage of manufacturing enterprises favouring this country has decreased by one-third from 2003 to 2008 (See Figure 3). In contrast, Russia shows more economic attractiveness during the same period; over a quarter of surveyed enterprises are now considering Russia a prospective market for next three years. Moreover, as is shown in Figure 4, these enterprises give more expectation to it in a long-term perspective for next ten years. Russia with the percentage of the vote obtained approximately 40% is in the third place next to China which gave up the lead to India.

All these facts and data suggest that there was a momentous event for the Russian business of the Japanese companies around the year 2004. It is Toyota's decision to build a car assembly plant in St. Petersburg as the largest greenfield investment to Russia by a Japanese company that provided a spark for the Japanese business community to rush into this newly emerging market after China.⁴

2 Case of Toyota: Broadening our outlook

It is well known that Toyota is a conglomerate of both manufacturing (mainly

the Japanese companies that are operating in Russia than of those registered in the Russian state registry.

⁴ Although Toyota officially announced the project in April 2005, mass media had reported that it made a decision to advance into Russia in August 2004 (*The Nikkei*, 14 August 2004).

assemblers and suppliers) and non manufacturing (dealers, distributors, trading companies, financial institutions, etc.) enterprises; they are closely tied to one another through daily business activities and mutual stock holding under control of the Toyota Motor being at the top of the Toyota group. When the Toyota Motor goes abroad to build a new plant, not surprisingly all the group and affiliated companies are required to support it as follows: suppliers often build their own plants in the vicinity of assemble plants in order to provide high-quality car parts with reduced production and transportation costs, which is likely to contribute to more localization that regional/local governments always request from foreign companies; distributors (logistics) are expected to streamline an increasingly complex flow of goods and stabilize the overseas production anywhere in the world; in many cases, dealers and financial institutions are together providing various services for clients, which enables them to enjoy the high profit margins gained from car sales.

In the case of Russian business, the Toyota group has at least six overseas subsidiaries and two representative offices at the end of 2008 (see Figure 5). Other two affiliated companies are involved in the Russian business. Interestingly, Toyota obtained a banking licence in Russia, following Tokyo-Mitsubishi UFJ and Mizuho banks that are incomparably larger than the Toyota Financial Service in terms of capital and financial operations. Considering the difficulties to enter the financial market in this country⁵, it can be said that Toyota expects that financial services for consumer such as car note and insurance would yield large profits.

The case of Toyota helps us broaden our outlook on the FDI activities of the Japanese

⁵ According to the informal statement of Mizuho Corporate Bank who acquired the Russian subsidiary of Michinoku Bank, a local bank in the north region of Japan, that had obtained a Russian banking licence in 1999, 'we decided to buy 'time' by paying a premium to this deal.' (*The Nikkei Finance*, 13 October 2006).

companies in Russia. Now, we have to see what has been going on after the Toyota's project: not only do other major car makers such as Isuzu, Nissan and Mitsubishi build their own new plants, car suppliers and manufacturers of machinery start to pop up one after another (see Figure 6). Among them, Asahi Glass, the largest glass maker in the world, has invested in two plants more than twice the Toyota has invested in the assembling plant in St. Petersburg. As well as greenfield investment, brownfield investment is also ongoing: Trad and Daido Metal acquired the Russian car suppliers in Nizhegorod Oblast' respectively under the control of Oleg Deripaska's business group 'Bazovyy Element' (Press releases of Trad on 25 June 2007 and of Daido Metal on 3 August 2007). Service sectors such as transport operations and financial services are also developing to support the Japanese companies being involved in the Russian business. As Figure 6 clearly shows, most of these FDI projects launched after the Toyota's pronouncements on the new plant in St. Petersburg.

3 Key to the Japanese FDI in Russia: concluding remarks

It is undoubted that enlarging Russian domestic market is the most important factor for FDI of the Japanese companies. Some businessmen and experts who have been engaging in the Russian business supported this view as follows:

'Contrary to the East European countries where markets are relatively stable and are reaching the stage of maturity, here in Russia we are now seeing a visible growth: in fact, Russian market is crazy.' (Interview with the Toyota Motor, Russia on 20th February 2006, Moscow)

'Although Russian market is a lawless area, it is so lucrative that all good businesses make sure that we can always win big money. In my view, now it is the best time to enter this market.' (Interview with Suntory on 10th January 2007, Tokyo)

'Russia will be the biggest market in Europe in the future... In principle, Japanese companies go anywhere if they expect to make a big profit.' (Interview with the Moscow office of ROTOBO on 19th May 2009, Moscow)

Interestingly, answering to the 2008 questionnaire survey by JBIC, the Japanese manufacturing enterprises ranked the Russian region at the top place in terms of profitability (JBIC, *Survey Report on the Overseas Business Activities of the Japanese Manufacturing Enterprises in 2008*, November 2008, page 25). This means that they earned much higher profits than expected in Russia or the highest unexpected profits there than in the rest of the world including China and US.⁶

On the other hand, we have to be in mind that a massive flow of FDI would have a great impact on the further investment activities. First, although it sounds contradictory, St. Petersburg may be losing its attractiveness of the market for FDI due to raising prices of real estates and shortage of labour forces caused by a rapid inflow of FDI in recent years. In fact, Bridgestone, a top producer of car tyres, seemed to give up the new plant project in St. Petersburg and Toyota officially announced to freeze the project of building a second plant next to the operating plant. According to the director of ROTOBO, now Kaluga and Yaroslavl' are more advantageous where a couple of the Japanese major manufacturers such as Mitsubishi Motor, Yokohama Tire and Komatsu are constructing their new plants on the basis of greenfield investment (Interview with the Moscow office of ROTOBO on 19th May 2009, Moscow).

Second, recent trend of the Japanese FDI in Russia reveals the characteristic behaviour of the Japanese companies in emerging markets: overseas business operations are often

⁶ Note that JBIC asked the surveyed enterprises to answer to this question with respect to subjective evaluation on the profitability, not its actual increase or decrease.

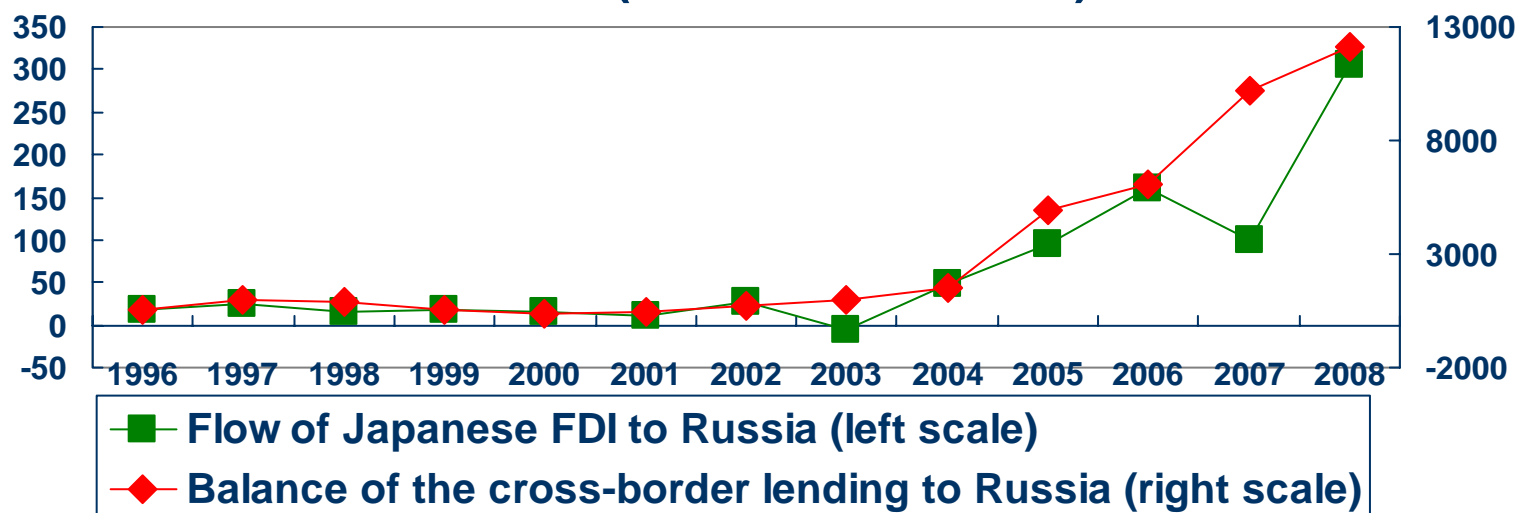
heating up after the symbolic FDI project, i.e., Toyota's car plant in St. Petersburg in this case. However, this would cause less deliberate or 'unwilling' FDI projects of late comers without elaborated feasibility studies. Suzuki's new plant project in St. Petersburg that has been almost cancelled would be a typical failure pattern due to a hasty judgement.

Table 1 Trade trends of Japan and the selected countries

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Exports:											
Exports to Russia (billion yen)	128	55	61	87	118	204	337	495	<u>821</u>	1265	<u>1714</u>
Export share (Russia)	0.3%	0.1%	0.1%	0.2%	0.2%	0.4%	0.6%	0.8%	1.1%	1.5%	2.1%
Export share (China)	11.0%	10.9%	12.0%	13.5%	15.7%	18.5%	19.3%	19.5%	20.0%	20.7%	21.1%
Export share (US)	30.5%	30.7%	29.7%	30.0%	28.5%	24.6%	22.4%	22.5%	22.5%	20.1%	17.5%
Imports:											
Imports from Russia (billion yen)	378	429	494	468	410	490	617	683	<u>774</u>	1242	<u>1389</u>
Import share (Russia)	1.0%	1.2%	1.2%	1.1%	1.0%	1.1%	1.3%	1.2%	1.1%	1.7%	1.8%
Import share (China)	13.8%	14.4%	15.0%	17.0%	18.7%	20.0%	21.1%	21.3%	20.7%	20.8%	19.0%
Import share (US)	23.9%	21.7%	19.0%	18.1%	17.1%	15.4%	13.7%	12.4%	11.7%	11.4%	10.2%

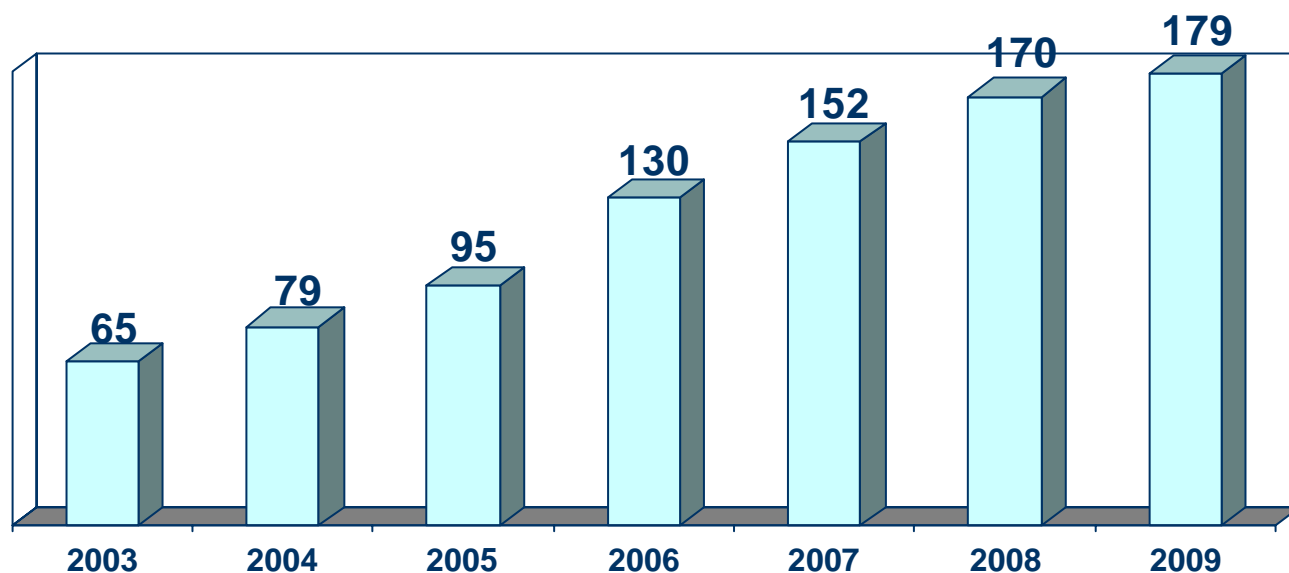
(Sources) Ministry of Finance, Trade Statistics of Japan (<http://www.customs.go.jp/>, accessed 12 May 2009) and Japan's Balance of Payments (<http://www.mof.go.jp/>, accessed 12 May 2009).

Figure 1 Flow and balance of 'Japan Money' in Russia (million US dollar)



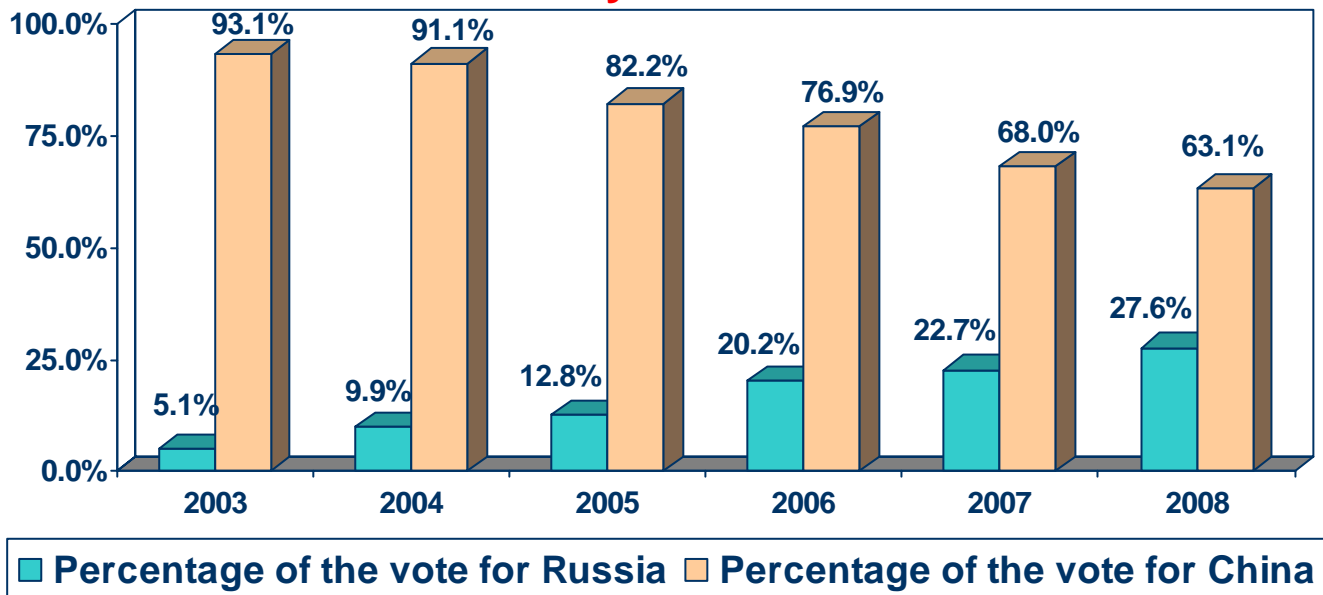
(Sources) The Bank of Japan, Japan's International Finance based on the BIS (<http://www.boj.or.jp/>, accessed 19 May 2009) and Japan External Trade Organization, FDI Statistics of Japan (<http://www.jetro.go.jp/indexj.html>, accessed 19 May 2009).

Figure 2 Number of the corporate member of 'Japan Club' in Russia (in April in every year)



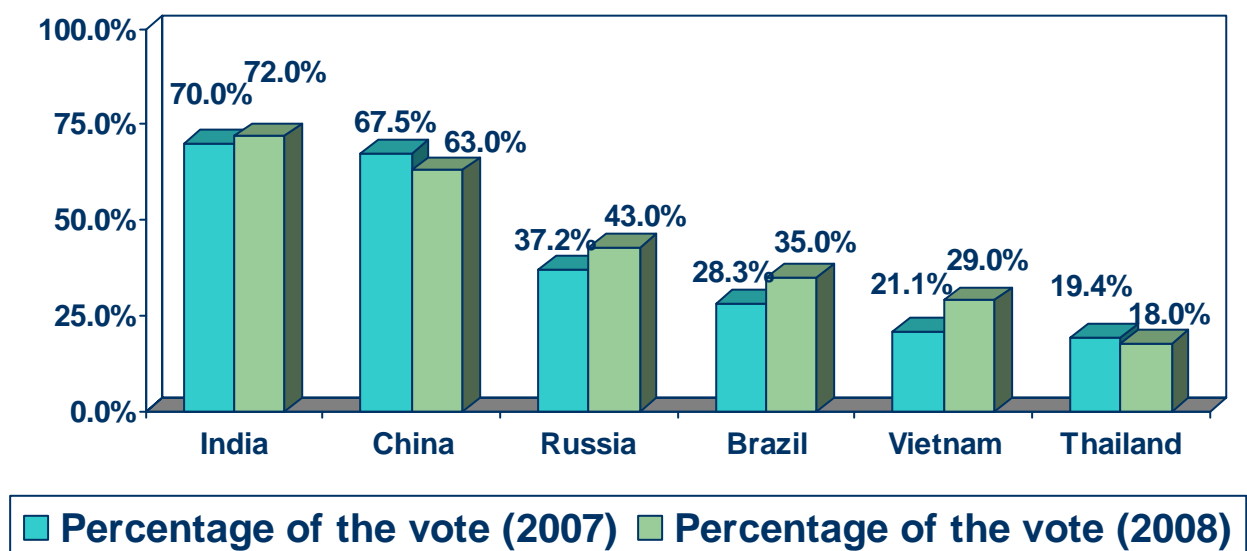
(Source) Internal materials provided by the Moscow office of Japan Association for Trade with Russia and NIS

Figure 3 Where is prospective market for next 3 years?



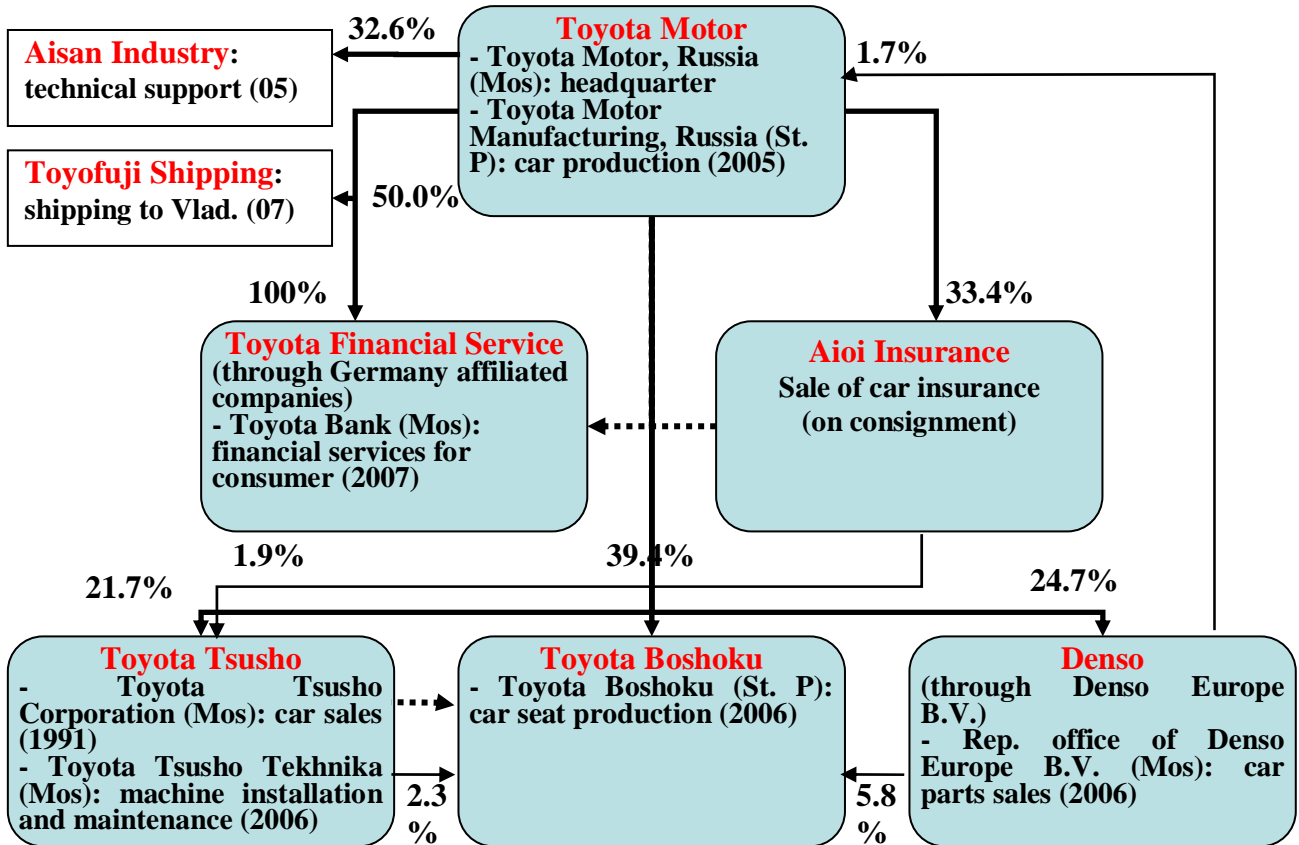
(Sources) The Japan Bank for International Cooperation, *Survey Report on the Overseas Business Activities of the Japanese Manufacturing Enterprises in 2007*, November 2007, page 29 and in 2008, November 2008, page 32.

Figure 4 Where is prospective market for next 10 years?



(Source) The Japan Bank for International Cooperation, *Survey Report on the Overseas Business Activities of the Japanese Manufacturing Enterprises in 2008*, November 2008, page 32.

Figure 5 Toyota group in Russia



(Note) Solid and dashed arrows denote the capital ties and business relations, respectively. Figures mean the share of stock holding.

(Sources) Newspaper and magazine articles, official press releases and IR information.

Figure 6 Selected FDI activities and projects of the Japanese companies in Russia

Manufacturers of machinery and heavy-equipment Komatsu (1998; 2010), Mori Seiki & Mitsui (2007) etc.	Assemblers Toyota (2007), Isuzu (2006; 2008), Nissan (2009), Mitsubishi (2011) , Suzuki?	Dealers Toyota Tsusho (1991), Nissan (2003), Honda (2004), Mitsui (2008?)
	Suppliers Asahi Glass (1997; 2005), Toyota Boshoku (2007), Daido Metal (2007), IHI (2009), Trad (2010), Yokohama Tire (2011)	
Distributors (logistics) NYK Line (2004; 2006), Kintetsu Express (2005), Mitsui (2006), Nippon Express (2006), Mitsubishi (2006), Yusen Air & Sea (2007)		
Financial institutions Tokyo-Mitsubishi UFJ (2006), Mizuho (2006 [1999]), Toyota Financial Service (2007)		

(Note) Blue and red areas denote manufacture and non manufacture sectors, respectively.

(Sources) Newspaper and magazine articles, official press releases and IR information.