

The Pattern of Japanese Foreign Direct Investment in the UK

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1. Preface

Many Japanese multinational enterprises (MNEs) are active in foreign direct investment (FDI). Simply put, an MNE can be any firm which operates in more than one country. With such a broad definition, FDI can be considered to occur if a firm has an interest in having some degree of control over the management of a firm in another country and then exercises that interest. FDI is therefore quite different from portfolio management (indirect investment). For the most part, MNEs as we know them today developed and expanded following World War II, initially in the US and European countries and later spreading to some Asian countries such as Japan. It is those post-war MNEs that are responsible for the majority of occurrences of FDI.

The principle reason for current interest in the analysis of FDI relates to recognition of the large influence FDI has on both home and host countries. Positive influences of FDI on the host economy include increases in local employment, technology transfer, and transfer of management skills, all of which are considered favourable for the host country. As for negative influences, some aspects of the local economy appear to be controlled by MNEs and infant industries in the host country may, as a consequence, suffer the loss of chance of growth. If the government of the host country highly evaluates the positive influences, the government may and will have some welcome policies toward FDI. However, the host government may instead have a closed-door policy toward FDI if the negative influences are seen as threatening. Of interest, then, is to determine what the variables are that cause a government to perceive FDI as favourable or unfavourable.

Another important point of discussion is how the MNEs select their location for FDI. In that MNEs may choose a specific location for their FDI, one topic for consideration is the identification of factors affecting a firm's decision to invest into one country or another. These two issues, governmental attitudes towards

MNEs and firms' expectations of FDI, are therefore interrelated.

In this paper, consideration will first be given to selected theories accounting for FDI by MNEs. Next, the history of Japanese FDI in the UK is presented, with recognition given to the fact that the UK has been recipient of the greatest amount of Japanese FDI among European countries. Following these historical summaries, the characteristics of Japanese FDI in the UK are identified and discussed. For purposes of illustration and explication, a somewhat detailed overview of conditions of the Japanese auto industry in the UK are provided. Finally, determinants of Japanese FDI will be proposed and discussed within the framework of the theories of MNEs.

2. Theories of Foreign Direct Investment (FDI) by Multinational Enterprises (MNEs)

Increasingly since the 1960s, there has been substantial analysis of FDI. Reasons for such interest in FDI's have been: (1) the post-second world war expansion of US-based MNEs and their FDI activities, and (2) the recognition of influence of MNEs and FDI on the economies of both the home and host countries. Most studies on FDI and MNEs attempt to identify the causes of the MNEs' involvement in FDI. Generally speaking, when a firm attempts to enter a host market, the firm needs some specific advantages in order to offset its own lack of advantage within the unfamiliar host market, as has been explained by Stephen Hymer (1960). Competitors existent in the host market are assumed to have superior knowledge about the host market, which is their own territory of business. In order to enhance their competitive standing, the investing firms generally try to obtain such knowledge in the host country. As mentioned by Kindleberger (1969), the advantages that can be brought to the host market include research and development (R&D) skills and knowledge, product-related knowledge, management-related knowledge, and other forms of knowledge or experience which may not be available within the host market. MNEs therefore are given a chance to enter the host market because they are seen to have advantages which are welcomed by existing firms in the host market. Such advantages are generally referred to, in the Hymer-Kindleberger theory, as firm-specific advantages. However, even though a firm has a particular firm-specific advantage, that alone is not sufficient explanation to account for the existence of FDI. A company also has the alternative to engage in licensing, rather than FDI. Thus the Hymer-Kindleberger theory provides necessary but not sufficient criteria for the occurrence of FDI.

Another explanation for FDI is what is known as the PLC (product life-cycle) model, which was introduced by Vernon (1966). According to that theory, every product has its own life-cycle which can be seen to exhibit three stages: (1) the new product stage, (2) the matured product stage, and (3) the standardised product stage. In the stage of the new product, generally the new products are invented or created within the industrialised countries. This is because new demand occurs as a consequence of increases of per capita income along with scarcity of labour for accommodating the demand for production. Production generally, however, remains in the country of origin. This situation is found in advanced countries such as the USA. In the second stage, that of the matured product, inefficient product design or inefficient production system is eliminated by the effect of learning, and the product begins to enter the domain of standardisation. At this

stage, economies of scale enable a reduction in price and thus effect a consequent increase in demand for the lower-priced product. Concurrently, demand for the product is also increasing in advanced industrialised foreign countries, such as European countries, and exportation to those foreign countries is therefore undertaken. Consequently, to cope with domestic labour costs, the firm begins foreign direct investment in those foreign countries where demand for the product already exists or is likely to be developed. Finally, in the third stage, the stage of the standardised product, the product is uniformly standardised and differentiation occurs almost exclusively in matters of price. Therefore, at this stage, labour-intensive aspects of production are likely to shift to less-developed countries which offer lower labour costs.

This PLC theory, introduced by Vernon (1979) well explains the FDI of US-based MNEs, especially in terms of business dealings with European and Latin American countries. However, the theory is not adequate for explaining the FDI of European and Japanese firms who invest in the United States.

A third, widely recognised theory of FDI is the internalisation theory offered by Rugman (1982) and Casson (1985). That theory is derived from transaction-cost theory, initially proposed by Coase (1937). Transaction cost is the additional cost that occurs as a consequence of transaction itself. In the foreign market, as a consequence of market imperfections, certain kinds of knowledge cannot be purchased within the “arm’s length market.” As a consequence, MNEs may use their own, home-based knowledge to supplement this deficiency of knowledge availability in the host country. By making this substitution, known as internalisation, the MNE can reduce the transaction costs involved in FDI. By means of internalisation, Buckley and Casson (1976) were able to account for and identify three aspects of MNE activities: (1) the advantage of vertical integration, (2) transaction among high R&D industries, and (3) internalisation of personnel and human relations. Further developing the concept of internalisation, Hennart (1982) analysed joint venture by US MNEs. Although internalisation theory is generally highly evaluated, some critics address the matter of incompatibility with location selection factors.

A fourth theory that should be considered is Dunning’s eclectic theory (1979). According to that theory, MNEs will enter into FDI when three conditions are satisfied: (1) ownership advantage, (2) internalisation, and (3) location advantage. First, it is claimed that a firm must have an ownership advantage over the host-country’s competitors, and that such ownership advantages include R&D knowledge as well as marketing knowledge, and other advantages that come with experience. These advantages, however, happen to be exactly the same as Hymer-Kindleberger’s firm-specific advantages. As for the second condition, internalisation, the MNE entering into FDI needs to implement internalisation in order to preserve their ownership advantages. Third, considering now the condition of location advantage, the MNE will attempt to locate in a country which has characteristics that make it attractive for FDI. As can be seen, this theory introduces no specifically new ideas but rather reformulates a composite theory which incorporates the theories we have already identified here in the previous paragraphs. In response to such criticism, the terminology was changed by dropping the expression “eclectic theory,” and using instead the label “OLI paradigm”. Dunning’s paradigm, being an integrated composite of other established theories, neatly captures some of the characteristics of MNEs’ FDI behaviour. As a consequence, Dunning’s OLI paradigm is now widely accepted as a workable accounting of the occurrence and development of FDI by MNEs.

3. History of Japanese FDI in the UK

(1) Rapid increase in the 1980s (Table-1)

Although some Japanese firms had started FDI in the UK during the 1960's, there was a substantial increase in the number of Japanese FDIs during the 1980's, as shown in Table-1. One of the major reasons for that was that many Japanese exporting firms were facing severe trade friction with the US during the late 1970's and early 1980's and had therefore shifted their export target from the US to the EU.

For example, in response to the then-current anti-Japanese movement by US auto-workers, auto-industry, and US government, the Japanese auto-industry undertook a "self-export quota" whereby cars imported from Japan would be less than 11% of the US market. Subsequently, four major Japanese auto-firms started production in the US. HONDA began with a 100% owned Kentucky plant in 1982, and other manufacturers, TOYOTA, NISSAN, and MITSUBISHI, established joint venture production.

In Europe, there was a similar anti-Japanese movement and trade war. Again, in response, the Japanese auto-industry enforced the same kind of "self-export quota", a measure which still remains now. During that time, the French government ordered Japanese video-exporting firms to submit to import inspection of goods one-by-one at a small inland customs office. Soon, Japanese auto manufacturers and video manufacturers considered starting up production within Europe. Therefore after that, three auto manufacturers started local production in the UK: NISSAN (in Sunderland), TOYOTA (in Derby), and HONDA (in Newberry). All are currently 100% owned. The reasons for these companies to choose the UK include: (a) the large UK market and accessibility to EU market, (b) economic reform by political leadership (Thatcher in 1979), and (c) good condition of the labour market, including reasonable labour cost, the co-operative attitude of the labour unions, and availability of skilled labour.

Table-1 The number of Japanese FDI in the UK

<u>Years</u>	<u>No. of Japanese FDI</u>	<u>Remarks</u>
'60s	3	YKK (Runcorn near Liverpool)
'70s	17	NSK (1976; NSK merged with United Precision, 1990)
'80s	80+	NISSAN
'90s	132	30% of Japanese FDI is 30% of Europe's 529 (100,000 employment)
Total	230+	(cf. French FDI= 92)

(2) Location advantage (country attractiveness)

Among European countries, the UK has attracted the largest number of Japanese production sites. There are several reasons for location in the UK being seen as superior to location in other countries: (1) ease of establishing the new firm, (2) availability of skilled labour, (3) tax advantages, (4) accessibility to the European market, (5) high standard of R&D, (6) low cost of public services, (7) existence of advanced information and telecommunication network, (8) convenience of financial market (City of London), (9) stability of

domestic economy, (10) English as the language of business, and (11) governmental policy of welcoming investment.

4. Characteristics of Japanese FDI in the UK

(1) Three areas: Northeast, Midland., and Wales (Table-2)

As can be seen in Table-2, most of the Japanese FDI sites are located mainly in three areas: Northeast England, Midland, and Wales. In Northeast England, NISSAN Motors is dominant in Sunderland. Some parts suppliers have also established business in the same area. Therefore, Nissan has substantial presence in that area. By contrast, TOYOTA dominates the Midland area, with its own FDI and suppliers, specifically in Derby. In Milton Keynes, a newly industrialised area, there are a number of machine and parts manufacturers. On the other hand, SONY and MATSUSHITA, principally home-appliance industries, are the prominent Japanese FDI in Wales.

Table-2 Location and number of Japanese FDI in the UK

<u>Location</u>	<u>No. of Japanese FDI</u>	<u>Notes</u>
N Ireland	2	
Scotland	16	
NE England	30	NISSAN (Sunderland)
NW England	7	
Mid England	23	TOYOTA (Derby)
E Angolia	3	
Wales	33	SONY (Bridge End)
SE England	17	
SW England	6	TOSHIBA (Plymouth)

(2) Assembly-type manufacturers (such as automobiles and home-appliances) (Table-3)

As can be seen in Table-3, the major Japanese FDI in the UK are automobile related, though the home-appliance industry also employs a substantial number of workers. Both industries are essentially assembly-type industries and therefore they utilise many parts suppliers and thus further affect the local economy and provide good opportunities for British workers. For these reasons, both the central and local governments are solicitous of Japanese FDI. In the late 1970s, the British economy was just beginning to recover from a long slump, and Japanese investment was recognised as contributory to the economic recovery.

Table-3 Major Japanese FDI in the UK

<u>Company Name</u>	<u>(Location)</u>	<u>Product</u>	<u>No. of Employees</u>	<u>Foundation</u>
SP TIRE	(Birmingham)	Rubber tire	1,700	1985
SONY	(Bridge End)	TV	1,400	1973
NISSAN	(Sunderland)	Automobile	2,700	1986
SHARP	(Lexaim)	Home appliance	1,200	1985
NKK BEARINGS	(Peterlee)	Bearing	1,100	1976
EUROPEAN COMPONENTS	(Countytown)	Auto parts	960	1988
HITACHI	(Abadia)	Home appliance	864	1984
ALPUS ELEC.	(Milton Keynes)	VTR parts	700	1985
BROTHER	(Lexaim)	Typewriter	700	1985
JBC	(East Kinbride)	TV, CD player	650	1987

(2) More local parts suppliers in UK than US.

As for the automobile industry, three major auto manufacturers (TOYOTA, NISSAN, and HONDA) brought along their parts suppliers to their American production sites. They did so because they did not have enough knowledge about local suppliers, particularly in terms of quality and capability to adapt to the Japanese just-in-time production system. Compared to the American automobile parts industry, the British parts industry was seen as much better developed for absorption into the Japanese production system because of the long history of subcontracting. Japanese auto manufacturers also by then had sufficient knowledge about parts suppliers abroad and were better able to negotiate with the local manufacturers. In the case of home appliances, the Japanese firms were also similarly well informed and were already acquainted with British parts suppliers. So the relationship between Japanese FDI and already-existent local parts suppliers was comparatively smoothly established.

5. Cases of the Japanese auto industry and other firms in the UK**(1) NISSAN in NE England (Table-4)**

The plan for production of NISSAN automobiles in Sunderland was originally announced in January 1981, and was finally decided in April 1984. The production site was constructed on the grounds of the old local airport near New Castle. In the middle 1970's, the land of the local airport which had been closed for many years was prepared for a prospective Japanese firm, but that project was aborted because of severe anti-Japanese sentiment. However, the public's attitude towards Japanese FDI completely changed after Thatcher became Prime Minister in 1987 because the people came to understand the necessity of recovery of the local economy. Even though the investing company would be a foreign firm, the local people realised that the benefits of the investment would fall to the local workers and the local economy. For this reason, they began to welcome foreign investment, and government officials looked for ways to entice corporations to establish in their community.

In July 1986, the opening ceremony for the new plant in Sunderland, which began production of the “Bluebird”, was the site of a public address by Prime Minister Thatcher. The ceremony was well covered by the media, as were subsequent visits by the Prime Minister, who returned to the plant on other occasions. This presence of high-level government officials underscored the value of FDI for the British economy and helped smooth the way for later investors. This is one of the reasons for the rapid increase of FDI in the UK after 1986.

Table-4 History of NISSAN (Sunderland) and Japanese FDI in NE England

<Japanese FDI in NE England>

- 1976 NSK (producer of bearings, in Peterlee, Durham).
- 1977 DAI-NIPPON INK merged with a printing-plate maker.
- 1977 HITACHI planned production-site in Sunderland, but abandoned the plan.
- 1979 KOMATSU established a marketing branch.
- 1981 YKK (producer of fasteners, in Washington near Sunderland) .
- 1885 SP TIRE (merger of Sumitomo Rubber and Dunlop Tire, also in Washington).

<NISSAN>

- 1981.1 Plan for Sunderland plant announced.
- 1984.4 Decision finalised.
- 1986.7 Stated production of “Blue Bird”.
Capacity = 24,000 cars/year, 400 employees, major-parts from Japan.
- 1986.9 Forecast for 1991: 100,000 cars/year, 2,700 employees, 80% UK parts.
- 1987.12 Announced forecast production of “Micra” (Japanese name is “March”).
- 1989.4 Aluminum Casting Plant for Micra’s cylinder-head.
- 1991 Capacity = 200,000 cars/year, 3,600 employees.
Target for late 1990s: capacity for 400,000 cars/year, with intention.
to have more than 120 parts-suppliers (UK=97, Japan=16).

<Auto-related firms>

- 1885 SP TIRE (SUMITOMO) Washington (500 employees) supplies 60% of tires for NISSAN.
- 1985 IKEDA/FOOBER (100 employees) car-seat and interior. (1989: 250 employees).
TI NIHON, exhaust-system.
NISSAN/YAMATO (250 employees) Pressed parts and semi-assembly.

<Other Firms>

- MITSUMI ELEC. (300 employees).
- SMI ELECTRONICS (200 employees).
- 1989 SANYO (500 employees).
- 1991 SANYO, planning semi-conductor plant (1,500 employees).

Although the Sunderland plant produced 24,000 cars a year and employed about 400 persons, the major parts for production were shipped in from Japan. In mid 1986, plant managers had forecast a 1991 production of 100,000 cars per year, an employee-list of 2,700, and 80% UK parts. Actually, however, already in early 1989, with production of the "Micra" ("March" in Japan) added to the line-up, the plant was producing 200,000 cars per year—double the forecast—with 3,600 employees. The target for the late 1990s was to double the output again and to have more than 120 parts suppliers, with the plan to purchase from nearly a hundred UK suppliers. Most of the new labour was trained as multi-talented labour at the nearby, newly established Wierside College. Also located in Sunderland is NISSAN's R&D division and technical centre. Additionally, R&D facilities were also established in the area by KALSONIC, a major Japanese electrical parts supplier for NISSAN. Other Japanese suppliers who established technical centres in the vicinity of Sunderland are NSK, which produces bearings, and SP TIRE, which was originally not fully Japanese owned.

(2) TOYOTA (Derby) in Midland

In 1989, TOYOTA announced plans to open production in Derby. Production actually began in 1992, when the company began turning out 1800cc automobiles in a plant that had a capacity to produce 200,000 cars a year with 1,700 employees. Currently they are planning to increase employment to 3,000. The engine for the car is produced in Wales.

(3) HONDA (Newberry) in S. England

HONDA had a sales subsidiary, as joint venture with ROVER, which was at the time not in the control of the government. HONDA later began production at ROVER's Newberry plant and through this joint-venture manufacturing established production in the UK. Subsequently, the government sold ROVER to the German manufacturer VOLKSWAGEN. HONDA then purchased the entire Newberry plant, and thus now has 100% control of the plant.

(4) Other firms

SONY started production of colour television sets in Wales in 1972. Fifteen years later, the Bridge End plant was employing 1,400 persons, including 400 skilled workers of whom 140 were trained in Japan. Another television production site in Wales is that of KYUSHU-MATSUSHITA. Approximately 90% of their UK production was designed in the UK. The company has production of color televisions and microwave ovens in Gardiff, and electric typewriters in Newport. Additionally, televisions are produced by HITACHI, which has a production site in Hillwine, where audio-equipment and microwave ovens are also produced.

In Southwest England, TOSHIBA's presence is well established in Plymouth. The decision to have UK production was made in 1980 when the plan was to have a plant producing 76,000 television sets per year with 300 persons employed. By 1991, however, the plant had 1,000 employees and was producing 36,000 sets per year, but had added also a yearly production of 120,000 VTRs and 120,000 microwave ovens.

6. Conclusion: Determinants of the establishment of Japanese FDI in the UK

Clearly the trigger for implementation of FDI in the UK was the existence of trade friction. Japanese firms responded by establishing local production sites in order to protect the market which they had already developed through foreign exports. Major exported goods were automobiles and home appliances, both of which were successful in competition with other foreign competitors as well as with domestic producers. In other words, Japanese manufacturers of automobiles and home appliance both had significant firm-specific advantages such as R&D and marketing skills which enabled them to enter the market and sustain production. Having these ownership advantages enabled the Japanese firms to gain entrance in the UK. However, supporting their entry was the existence of an economy that was in substantial need of foreign investment.

In the case of Japanese FDI in the US, many were begun as joint venture whereas in the UK, though only a few years later, the Japanese firms entered as 100% owned subsidiaries. The reasons for increased ownership in UK relate to the experience of establishment of production in the US, and also, perhaps, to different labour markets. The greater percentage of Japanese ownership, however, further indicates that the Japanese firms internalised their own firm advantages for the establishment of FDI in the UK.

The selection of the UK as the most attractive country for FDI in Europe is the result of Japan's having had a longer history of dealing with English-speaking peoples, and the dominance of English in the curriculum of Japanese education. Additional factors, of course, were the availability of skilled labour, social conditions, welfare structures, and receptivity of the local community.

The determinants of FDI in the UK by Japanese MNEs are notably well accounted for by the now widely accepted OLI paradigm, which however has mostly been applied to the FDI of US-based MNEs and British-based MNEs. The determinants are: (1) ownership advantage, (2) internalisation, and (3) location advantage (country attractiveness).

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