



Foreign direct investment by Japanese firms and corporate governance: in relation to the monetary policies of China, Korea and Japan

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Abstract

Reflecting upon the lessons from the Asian currency crises, more attention is being paid to the importance of consolidation for the domestic financial and capital markets, as well as international cooperation to avoid disturbing factors from abroad, such as massive inflows of speculative capital. The aim of financial reforms being executed in the East Asian countries, such as Japan, Korea, and China, is to improve the managerial efficiency of the business corporations and financial institutions.

Recently, foreign direct investment by Japanese firms in the rest of the East Asia has been recovering. However, the existence of a financial system to realize optimal corporate governance is indispensable for the enhancement of direct investment. Namely, it is necessary to improve corporate profitability, and to distribute the increment of such profits between the host and the investor countries, in order to boost the welfare of the respective citizens, notwithstanding the type of foreign direct investment.

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1. Introduction

It has been more than ten years since the Bubble economy had burst in Japan, yet the managerial competence of Japanese financial institutions still remains sluggish. Meanwhile, in the ASEAN countries—Korea, and China—the managerial weaknesses of the business

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corporations and financial institutions, and the delay in financial reforms were made apparent by the currency crises.

Such managerial sluggishness of the companies and financial institutions are mainly caused by low capital efficiency. This problem, while is common throughout much of the East Asia, derives from inadequacies in the economic deregulations and prudential regulations. The best way to mitigate this problem, perhaps, is to strengthen the capabilities to check and monitor these organizations through participation by the citizens.

The purpose of this paper is to discuss the possibility of a financial system to realize optimal corporate governance, through the examples of direct investment activities by Japanese enterprises. We anticipate that, in the future, individual investors as well as domestic and foreign institutional investors should play important roles as relevant entities in corporate governance. In this paper, we shall expand the definition of the individual investors to include citizens in general as the main participants in corporate governance. It should be so, because the citizens not only check and monitor corporate management as individual investors, but in the Asian countries, where indirect financing is dominant, they monitor the financial institutions as depositors.

Since the Asian currency crises, some changes in the international financial environment have been apparent. One notable example is the recovery of direct investment, to replace short-term funds. In order to further direct investment, it is necessary to improve corporate profitability, and to distribute the increment of such profits between the host country and the investor country, in order to foster the welfare of the respective citizens, no matter how the direct investment takes place. And this may be realized by the following: (1) strengthening the corporate profitability in both investor and host countries, (2) developing and enhancing the financial and capital markets in the host country, which is achieved by strengthening the prudential regulations. In other words, we aim at the establishment of the optimal financial infrastructure.

In order to discuss this issue, in [Section 2](#), we shall overview how the profitability and dividend rates of Japanese manufacturers had changed through the Asian currency crises, and argue that they exercised managerial efforts to reduce financing costs. In [Section 3](#), we shall discuss the directions of the financial reforms in Japan, China, and Korea, which are important sources of financing for direct investment, in order to foster corporate governance. And in the final section, we shall summarize the discussions, and make some proposals.

2. Managerial efficiency of Japanese enterprises

How did the direct investment of Japanese enterprises change through the Asian currency crises? First of all, we shall take a look at their profitability and dividend rates, and then we will consider the managerial efficiency and financing patterns of Japanese enterprises.

2.1. Profitability and dividend rates

Forms of direct investment can be divided into two types, namely, vertical direct investment and horizontal direct investment. The former includes those of whose main

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