How to Survive the Era of Declining Population
---- The Chinese Market as a Great Opportunity ----

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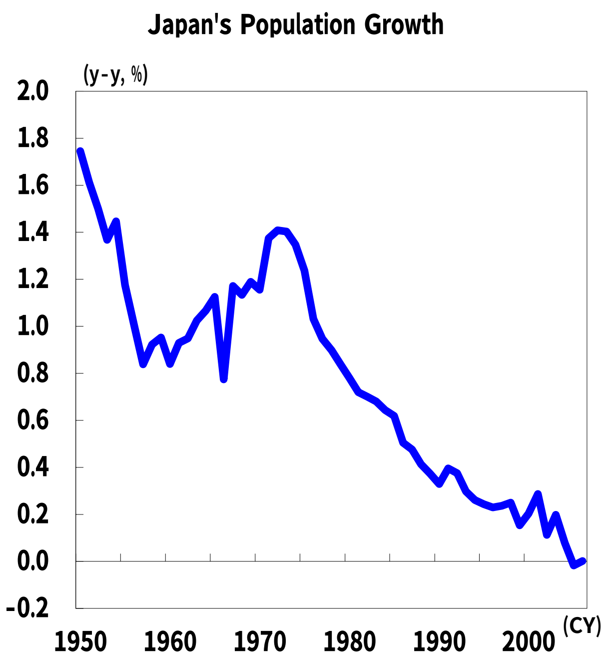
Abstract
Population decrease in Japan will affect Japanese firms in a complicated way. One way to overcome the problem is to extend business abroad. In fact, Japanese firms now have a big chance to spread their business in China, especially because excess labor supply in the country is likely to disappear within ten years or so. Japanese manufacturing firms are rapidly spreading their business in China. China's position is still a re-importing factory, but it is expected to change as income level grows. Japanese non-manufacturing firms are also extending their business in Asia. Four interviews introduced in this paper show that growing income level in Asian countries is making Japanese non-manufacturers' business profitable.

1. Introduction

Japan's population compared to the previous year decreased for the first time in 2005 (figure 1). It slightly increased again in 2006, but there seems to be a wide consensus that Japanese population is at around its peak and will inevitably decrease in coming years. If you are a policy maker and your goal is to maximize GDP growth, what you have to do is to implement policies to enhance labor productivity, such as removing unnecessary regulations and reducing tax rates, to offset a reduction in population growth.

Figure 1



Source: Japan Ministry of Internal Affairs and Communications

This paper, on the other hand, is written from the point of view of individual firms. Population decrease is a dramatic change of business environment, or at least it is perceived so. It implies each firm faces declines in demand for products and supply of labor. Even so, if these declines come at the same time with the same magnitudes, business strategy under decreasing population does not have to be very complicated. The problem is that declines in demand for products and supply of labor may come at different time in different magnitudes. Therefore, each firm has to deal with a complicated dynamic maximization problem. Moreover, relative timings and magnitudes of these declines are likely to be different from industry to industry, from firm to firm. Presumably, accurate estimation of how much and when a certain sector or firm is affected by population decline is quite difficult. As a consequence, population decrease forces each firm into an environment of tremendous uncertainty about its market forecasts.

I propose that one way to avoid the complexity and uncertainty brought by declining population is to expand business overseas. A firm is most affected by population decrease when its business is contained within the national border. If its product is sold all over the world, demand decrease in Japan will be only a trivial problem. If its employees are gathered from all over the world, decrease of labor supply will only be a marginal problem. A firm does not have to deal with relative timing and magnitude issues if its operations are spread globally.

In addition, I claim that it is a good time for Japanese firms to expand their business abroad, especially in China. China's excess labor supply in rural areas is likely to disappear in ten years or so, more likely even earlier. After the exhaustion of excess labor supply, China's real wage should increase. Higher real wages implies that Chinese firms will lose the cost advantage that they have enjoyed for a long time. It also implies higher purchasing power of Chinese households, and hence bigger markets for Japanese firms. Exhaustion of excess labor supply may imply slower growth, but that does not mean that China's presence will be smaller in the world.

Japanese manufacturing firms are already spreading their business especially in China. So far, taking advantage of low wages seems to be the main purpose for Japanese manufacturing firms to do business in China. However, considering that the excess labor supply is likely to vanish in coming years, I predict that more and more Japanese manufacturing firms will go to China to capture the local demand. Japanese non-manufacturing firms are also spreading their business in China. Our interviews reveal that Japanese firms' business opportunities are gradually growing due to the development of the country.

2. Implications of population decrease to business

Population decrease is putting additional pressures on Japanese firms. Imagine, for example, that you are a manager of a retail store. You hear news that

Japan's population will decrease in the future. What would your first guess be about the implication for your store's sales? Clearly, the number of your customers is likely to decrease simply because there will be fewer people in the country. What happens to your sales, on the other hand, is less clear. Perhaps the amount of purchases per customer will increase because per capita income will increase, offsetting the impact of the reduction in the number of customers. Per capita income will increase probably because policy reactions towards population decrease will work effectively and labor productivity will increase.

However, we are not very certain about how effective a government policy aiming at enhancing productivity can be. Effects of deregulation on productivity are simply difficult to actually see. A tax rate cut may work, but Japan's recent political environment has been more leftward and welfare-oriented. .

Thus, as a store manager you'd better expect your sales to decrease as a result of population decrease. Your decision about business strategy should be made given that population decrease will have an adverse impact on your sales. Therefore, you might want to change your current strategy if you have already planned to increase the number of employees or establish more branches allover the country. Instead, you might want to cut the unnecessary and unprofitable sections to reduce costs, or merge with or acquire another firm to seek scale economies. The recent wave of M&A in Japan can be understood as reactions from businesses to the expected decline in population.

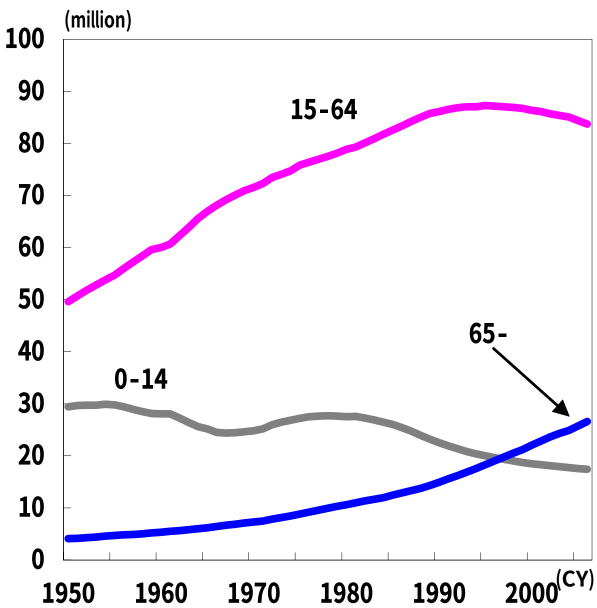
Unfortunately, simply scaling down your business or just seeking scale economies may not be enough to counter the effect of a population decrease. The reason is that labor supply is likely to decrease before demand for product decreases. Population decline is usually caused by decreased number of births, not by increased number of deaths. Therefore, the size of the younger generations starts decreasing well before total population decreases. Indeed, Japan' s working-aged population, defined as the number of people aged from 15 to 64, already started decreasing in 1996 (figure 2). Since a decline in the younger population implies a decrease in labor supply, you might want to find and hire skilled and competent workers while the labor market is not yet so tight, even if you do not need additional labor force immediately.

However, remember that the demand for your product is likely to decrease eventually due to a smaller population. If you underestimate the future decrease of demand and hire too many workers now, you will have to waste the human resources in the future. On the other hand, if you overestimate the future decrease in demand and do not hire enough competent workers, you will miss the opportunity to expand your business in the future.

Furthermore, impact of population decrease on demand for product and supply of labor will differ from industry to industry. For example, the IT industry already seems to be facing a shortage of labor. The elder care service industry is also struggling to find skilled workers. On the other hand, reductions in demand are already felt in education and the wedding industry. Possibly, the impact may be different even from firm to firm. This heterogeneity makes it tremendously difficult to estimate the impacts accurately.

Figure 2

Japan's Population by Age



Source: Japan Ministry of Internal Affairs and Communications

Under decreasing population, simply scaling down your business is not optimal, but simply expanding your employment is not optimal either. A firm has to figure out the dynamic path of optimal operation under tremendous uncertainty of how much and when the demand for product and supply of labor will decrease. These relative timing and magnitude issues with uncertainty make the firm's decision problem especially complex.

3. China as a key market for Japanese firms to globalize

(1) Overcoming population decrease by extending business to China

One obvious way to avoid the complicated dynamic optimization problem imposed by population decrease is to extend business overseas. Notice that, in 2005, Japan's GDP accounted for only 6% of world GDP (from IMF statistics, based on purchasing power parity), and Japan's population accounted for only 2% of world population. If a firm has customers uniformly throughout the world, demand decrease in Japan implies a shrinkage of only 6% of its sales. Also, if a firm has accesses to labor markets all over the world, a decrease in labor supply in Japan represents a problem of only 2% of its human resource strategy. In those cases, the effect of population decrease on the firm's business is almost negligible. Those examples are admittedly extreme, but the point here is that the more weight on foreign section in your business, the smaller the impact of population decrease.

In fact, my view is that now is a good chance for Japanese firms to globalize their businesses, especially in China. Admittedly, Japanese firms had conceived of China as a threat until several years ago. A common view was that Japanese firms cannot compete with Chinese firms because the wage in China is much cheaper than in Japan. There seemed no way for Japanese to overcome the wage difference and keep competitive prices. However, I consider that China will become a big opportunity for Japanese firms. There are two reasons to think so. Firstly, wages in a fast growing economy must grow fast and eventually the cost advantage must be eliminated. Secondly, excess labor supply in China will disappear at some point, possibly in less than ten years.

(2) Huge wage gap will not continue forever

The first reason comes from a simple thought experiment. From an individual firm's point of view, globalization can be an opportunity or a threat. When two economic regions start transactions, naturally the competition becomes severer due to the increased number of competitors, and some firms may go bankrupt. In this sense, globalization implies a threat to a firm. At the same time, when two economic regions start transactions, a firm may open a new market for its own business and benefit from scale economies. In this sense, globalization presents an opportunity to a firm. Thus, globalization can turn out to be either a threat or an opportunity to a firm.

Whether globalization turns out to be an opportunity or a threat depends on the situation. For a firm that has technology or environment that is superior to that of foreign firms, globalization implies a chance to extend its business overseas. It simply has to go abroad and acquire a new market. In this sense, the business strategy of such a firm will be simple. On the other hand, for a firm with technology or environment that is inferior to that of foreign firms, globalization implies a threat. For example, if foreign firms can take advantage of much lower wages in their own country, there may not be any way to compete with them. The firm may have to close its domestic business and establish new factories in foreign countries to reduce costs and compete with foreign firms.

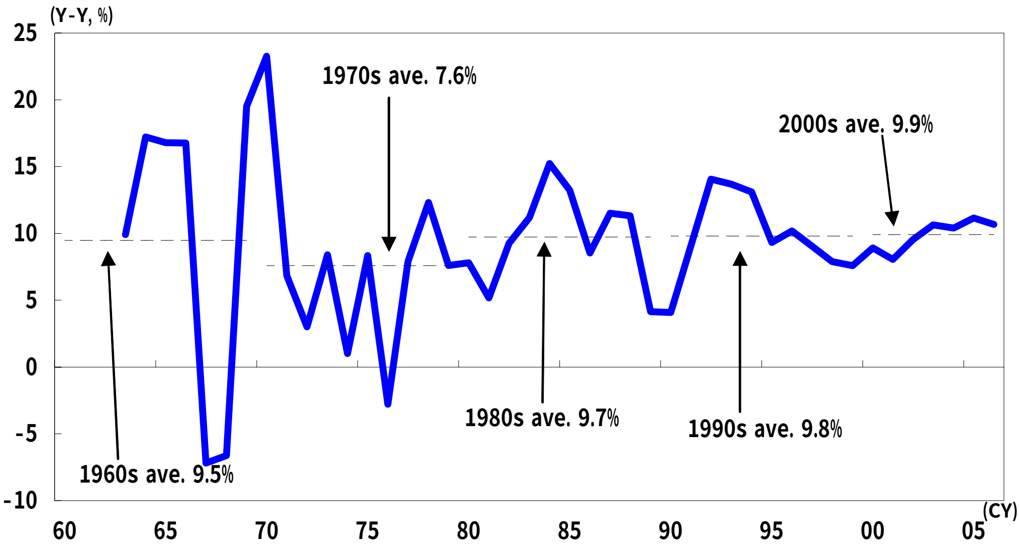
In a globalization in which a newly developing country catches up with developed countries, firms in the developed countries in general are likely to face more threats than opportunities. The reason is that the newly developing country can expand its exports utilizing low-paid workers, while high quality products produced in developed countries may not be accepted in the developing country because, for example, the income level is still low. Therefore, firms in developed countries tend to lose sales and cannot expand their business in the emerging economy.

But the situation will not continue forever. As the developing country grows, wages also increase and the cost advantage eventually disappears. In addition, higher wage level implies greater purchasing power of the households in the developing county. Thus, as time passes, firms in developing countries lose their low-wage advantage and firms in developed countries obtain more chances to expand their businesses in the developing country.

What about China? The presence of China in the global market increased significantly in the 1990s. Low-priced products from China produced with low-wage labor spread allover the world. Many Japanese firms, especially those in the textile industry, were not able to set competitive prices against Chinese products because the wage difference was too huge. However, as discussed above, this situation cannot continue forever. The Chinese economy is growing by around 10% annually (figure 3). Wages are increasing 20% every year. As a result, China's wage levels exceed Vietnam's, and are now comparable with Thailand's (figure4). Eventually, China has to lose its cost advantage and acquire purchasing power, hence creating more opportunities for foreign firms.

Figure 3

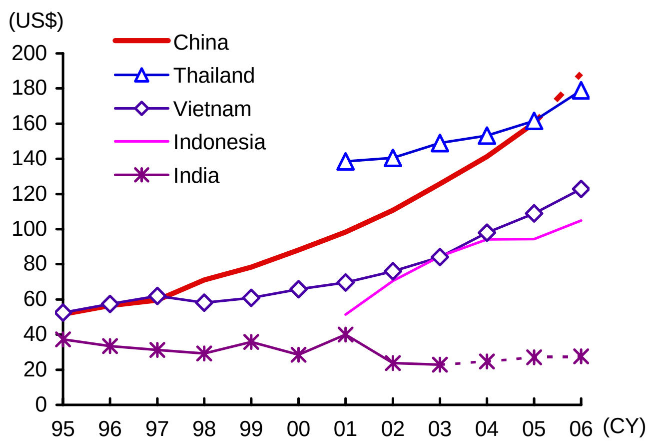
China's Real Growth Rate



Source: Nomura, based on National Bureau of Statistics of China and International Historical Statistics data

Figure 4

Per-employee monthly wages (manufacturing)



Note: (1) Figures for India from 2004 are extrapolated from 2003 data using wage growth rates at textile mills. (2) Figures for China for 2006 extrapolated from 2005 data using wage growth rates on an all-industry basis.

Source: Nomura, based on CEIC and International Labour Organization (ILO) data

(3) When will China's excess labor supply disappear?

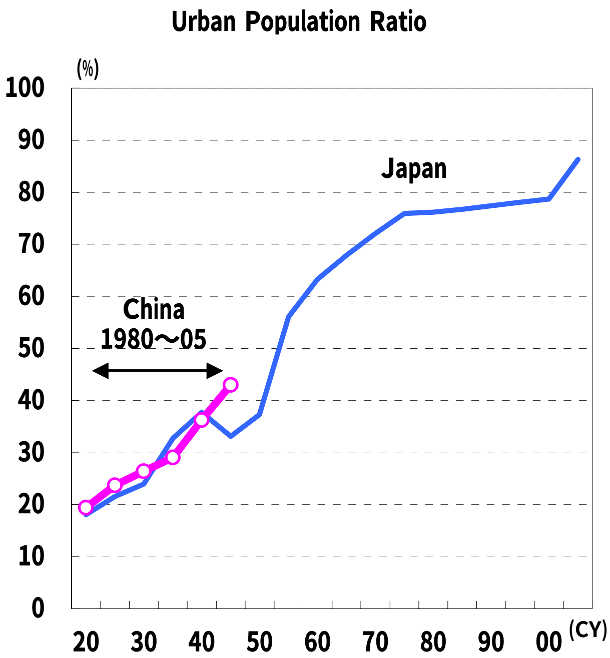
The second reason to think that China will be a big chance for Japanese firms comes from consideration of excess supply of labor. It is often discussed that China's competitiveness comes from unlimited labor supply from rural areas. This argument is based on the idea of Lewis (1954). In this framework, the "subsistence" sector provides unlimited labor supply to the "capitalist" sector. The "capitalist" sector can obtain as much labor as necessary without raising wages much beyond the subsistence level. During this period of unlimited labor supply, the economy can grow rapidly by exporting low-priced products abroad. Contemporary China can be thought to be at this stage of unlimited labor supply from rural areas.

But eventually the unlimited labor supply from the "subsistence" sector evaporates simply because the population is only finite. At this point, rapid labor shift from the "subsistence" sector to "capitalist" sector stops, and real wages in both sectors start to grow. Since the real wage starts increasing, the economy will be losing its cost advantage. Therefore, it ceases to be a threat to foreign firms. Also, since the real wage starts increasing, domestic households start gaining purchasing power. Therefore, the economy will become a prospective market for foreign firms.

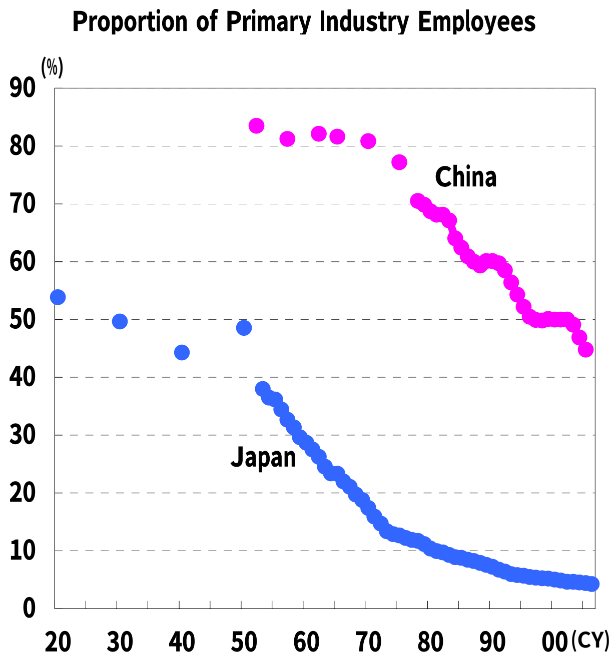
Thus, when China's excess labor supply will vanish is critical to strategies for Japanese firms. However, there seems no consensus on when it will occur. Is it next year or 50 years from now?

The Chinese government's view is that there still exists 150 million excess workers in rural areas (cited in Kwan (2007)). During the past 25 years, urban population in China almost tripled, or increased by close to 200%. This is equivalent to an annual growth rate of 4-5%. Overall population growth was slightly more than 1% during the same period. Assuming that the natural population growth rate is the same as overall population growth, three-fourths of the population growth in urban areas is due to migration from rural areas. During 2000-05, urban population increased by about 100 million. If three-fourths of this increase is due to migration, we calculate that 75 million people moved from rural to urban area during the five years. At this rate, it takes ten years for 150 million people to move from rural to urban areas. Thus, if the Chinese government's view is correct, the transformation will happen in ten years.

Figure 5



Source: National Bureau of Statistics of China, Japan Statistical Association

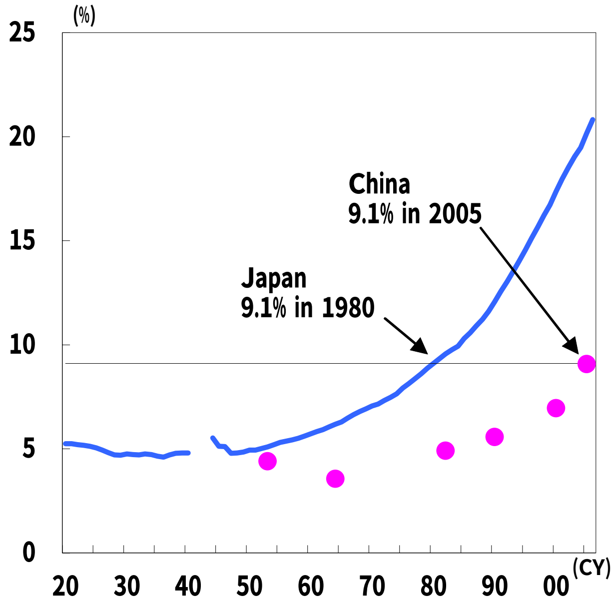


Source: Nomura, based on National Bureau of Statistics of China, Japan Ministry of Internal Affairs and Communications and Japan Statistical Association data

Population shift from rural to urban areas was a driving force of Japan's rapid growth in the 1960s (Yoshikawa (1992)). Thus, comparing the degree of urbanization in China and Japan may help us guess how much excess labor remains in China's rural areas. China's urban population ratio was 43% in 2005, which is comparable to Japan in the 1950s (figure 5). The ratio of employment in primary industry to total employment in China is 45%, which is also comparable to Japan in the 1950s. Those comparisons suggest that, from the point of view of urbanization, current-day China corresponds to Japan in the 1950s. In Japan, urbanization even accelerated after the 1950s and created rapid economic growth. It implies that China still has much excess labor supply in rural area and room for continuing 10 or more years of rapid growth. This is consistent with the estimation by the Chinese government.

Figure 6

Proportion of Population Aged 65 or Over



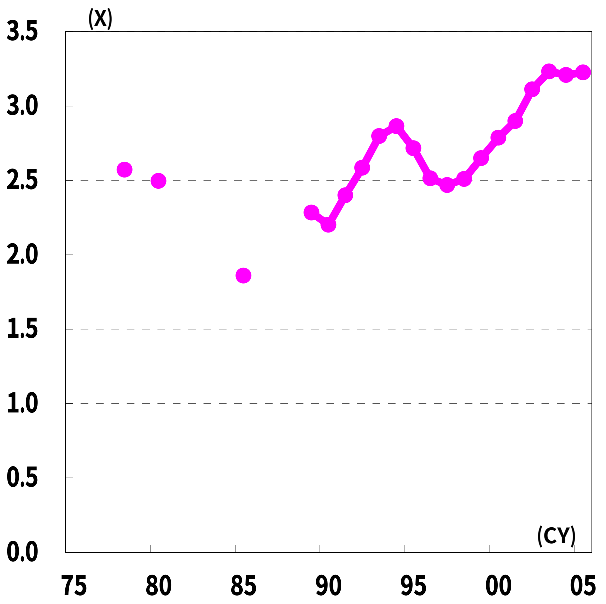
Source: Nomura, based on National Bureau of Statistics of China and Japan Ministry of Internal Affairs and Communications data

In contrast, there is a strong argument against the view that China still has excess labor. The ratio of population aged 65 or more accounted for nine percent of total population in China in 2005 (figure 6). This is much lower than the 20% in Japan in 2005, but similar to that in Japan in 1980. By 1980, the massive migration within Japan had already stopped, as had rapid economic growth. After the elderly ratio reached 9%, Japan's urban population ratio has risen by only 10% points until today. One possible reason is that it is younger generations that migrate from rural to urban areas. If China's population in rural areas is already aged and does not have many younger people, the amount of excess labor is much smaller than the degree of urbanization suggests.

Also, there exists a huge income gap between rural and urban areas in China. Admittedly, such a gap can be a strong driving force for migration. However, it is more likely to reflect some barriers to migration. In Lewis' model, the wage in urban areas is determined by the wage in rural areas. In fact, in Japan, the largest income gap between farmers' households and employee's households was 1.5 in 1960s, the period of massive migration (figure 7). In China, the income gap between urban and rural areas is three-fold, which should be swiftly eliminated by rapid migration if there are no barriers. However, the speed of urbanization in China has been only similar to Japan's experience. Thus, it is reasonable to believe that there is something preventing smooth geographical population shifts within China.

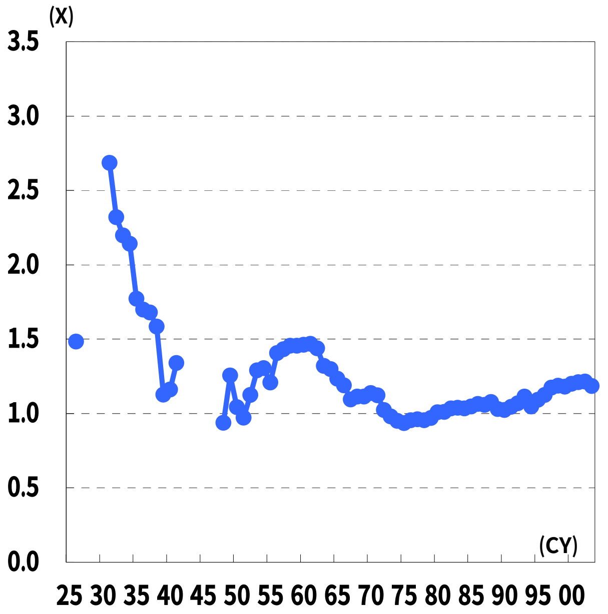
Figure 7

Urban/Rural Income Ratio of Chinese Households



Source: Nomura, based on National Bureau of Statistics of China data

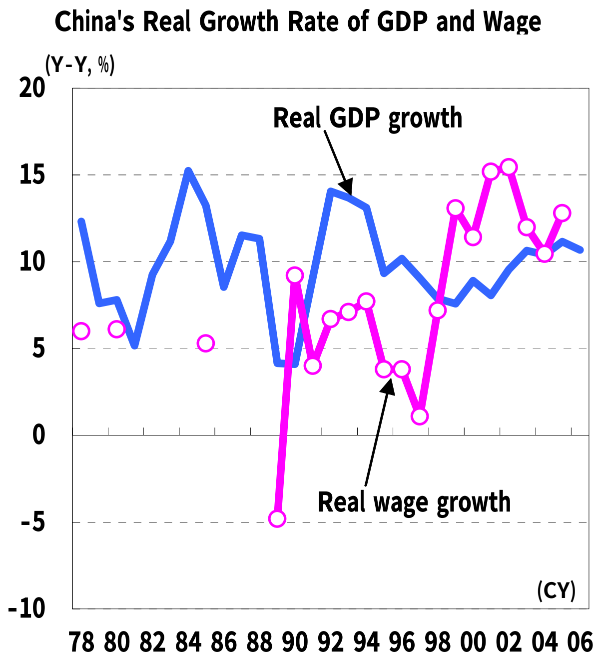
Wage-workers' Income / Farmers' Income in Japan



Source: Nomura, based on Japan Statistical Association data

Furthermore, if excess labor supply still exists in rural areas, real wages should not increase in both rural and urban areas in Lewis' model. This has not been quite right for Chinese economy, but at least the growth rate of real wages had been lower than real GDP growth rate. However, as Kwan (2007) points out, China's real wage started to increase more rapidly than real GDP from 1998 (figure 8). This can be an indication that the unlimited labor supply from rural areas is near its end.

Figure 8



Note: See Kwan "China in Transition."

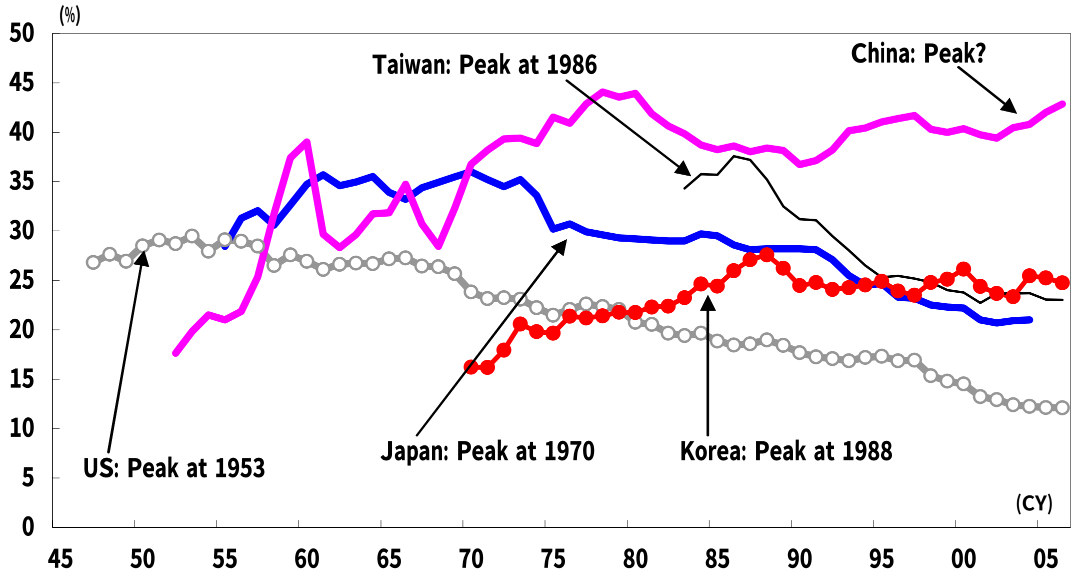
Source: National Bureau of Statistics of China

(4) A comparison of industrial structure

A comparison of industrial structure might be interesting when we think about China's developmental stage. As an economy develops, the weight of primary industry tends to decrease and that of secondary industry tends to increase. As the economy further develops, the weight of secondary industry turns to a downward trend and the tertiary industry starts increasing its weight. This pattern was pointed out by Clark (1957), who in turn attributes the finding to Petty. This Petty-Clark law can be observed in many countries. The ratio of manufacturing industry in GDP peaked in 1953 in the US. It peaked in 1970 in Japan, 1986 in Taiwan, and 1988 in Korea (figure 9). Not surprisingly, the ratio is still increasing in China.

Figure 9

Share of Manufacturing Industry in GDP



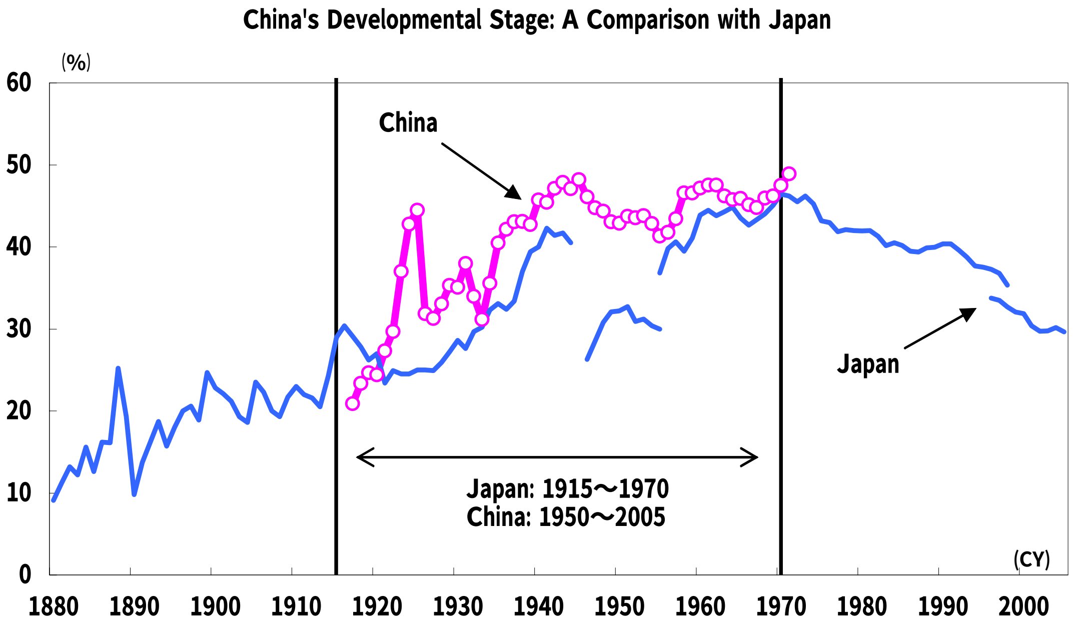
Source: Nomura, based on US Department of Commerce, Japan Cabinet Office and Thomson Datastream data

If there exists a pattern of industrial structure that is commonly followed, it may be useful to compare China's industrial structure with Japan's experience and guess which developmental stage current China is at.

Japan's heavy industry started developing with World War I. Its secondary industry ratio in GDP increased especially in the 1930s under government influence to get ready for war. After WWII, the ratio declined temporarily but soon started increasing. The ratio kept increasing until 1970 when it reached 46% and turned to a downward trend. On the other hand, the ratio of the secondary industry in GDP in China had been increasing from 1950s to 1970s, when industrialization proceeded under government planning. In 1978, Deng took over the leadership and led the Reforms and Opening Up. After Deng came to the position, the ratio of secondary industry declined temporarily, but it resumed its upward trend again in the 1990s and reached 49% in 2006.

About 55 years passed from the first development of heavy industry in Japan until 1970 when the ratio of secondary industry peaked at 46% and started decreasing (figure 10). Close to 50 years has passed since Mao's Great Leap Forward in 1958 until now, when the ratio of secondary industry is 49% in China. A naïve comparison of secondary industry ratio suggests that China's current industrial structure resembles that of Japan in 1970 and the ratio will start declining soon. If the development of the secondary industry is supported by excess labor supply, a halt to the rise in the secondary industry ratio may imply its exhaustion.

Figure 10



Source: National Bureau of Statistics of China, Japan Cabinet Office, Japan Statistical Association, Nomura

(5) It's time to go to China

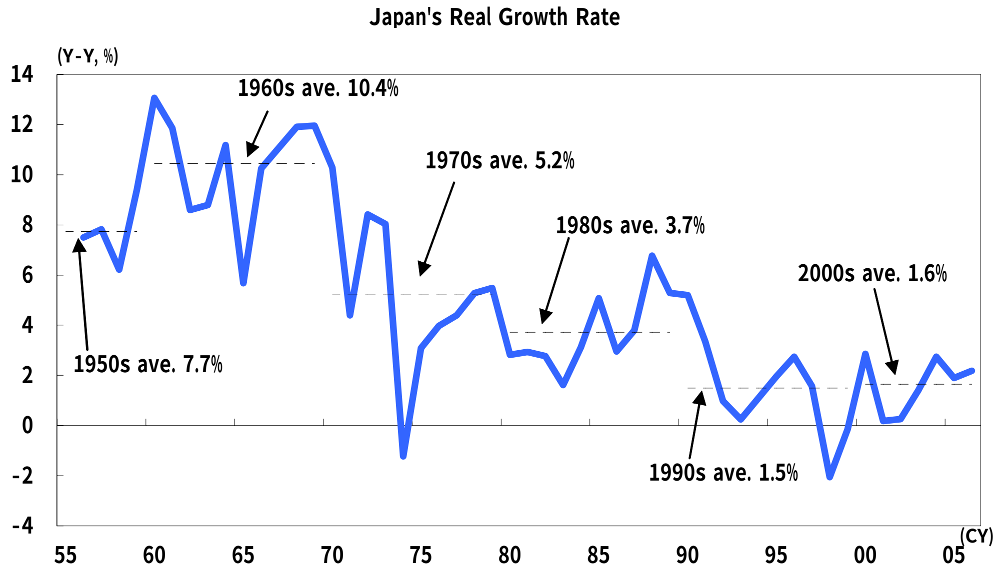
A comparison of urbanization between China and Japan suggests that China still has much excess labor supply, which is consistent with the view of the Chinese government. However, aging population, large income gap, rapid growth of real wages and a comparison of industrial structure with Japan all suggest otherwise. In the first place, it is impossible for a rapidly growing economy to maintain its cost advantage forever. Japanese firms should consider that China is turning from a factory that threatens their business to a market with great opportunities. This view is especially important because they are going to face decline in population and associated problems.

(6) China Risk?

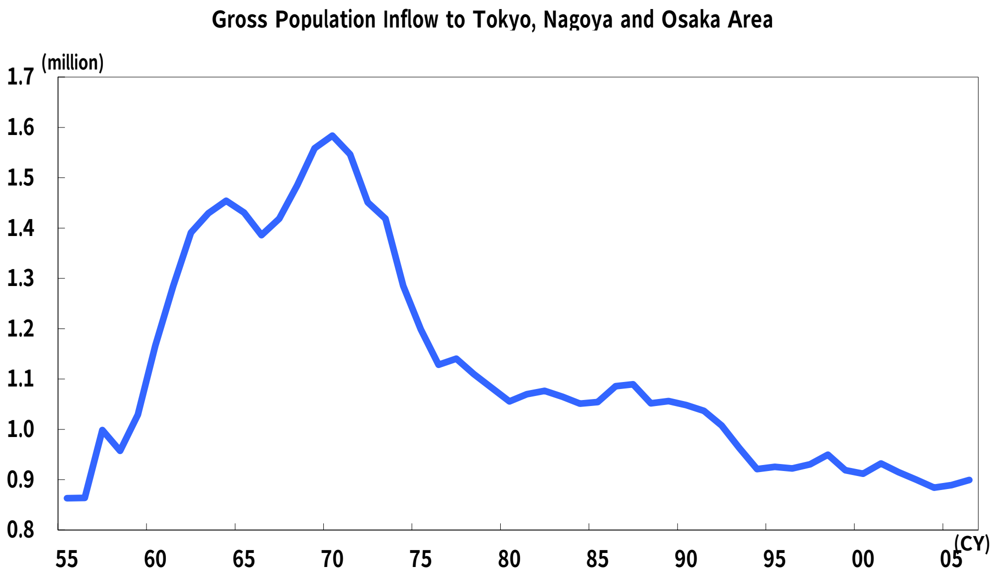
I discussed that business opportunities in China will become increase for

Japanese firms, especially after excess labor supply in China's rural area disappears. But in Japan's experience the halt of labor supply from rural areas resulted in a significant reduction in real growth rate by about 5 percentage points (Yoshikawa (1992) see figure 11). Possibly, the rapid growth of the Chinese economy will also finish with the evaporation of excess labor supply. It may seem that China's attractiveness is likely to diminish with a significant reduction in its growth rate.

Figure 11



Source: Japan Cabinet Office, Nomura

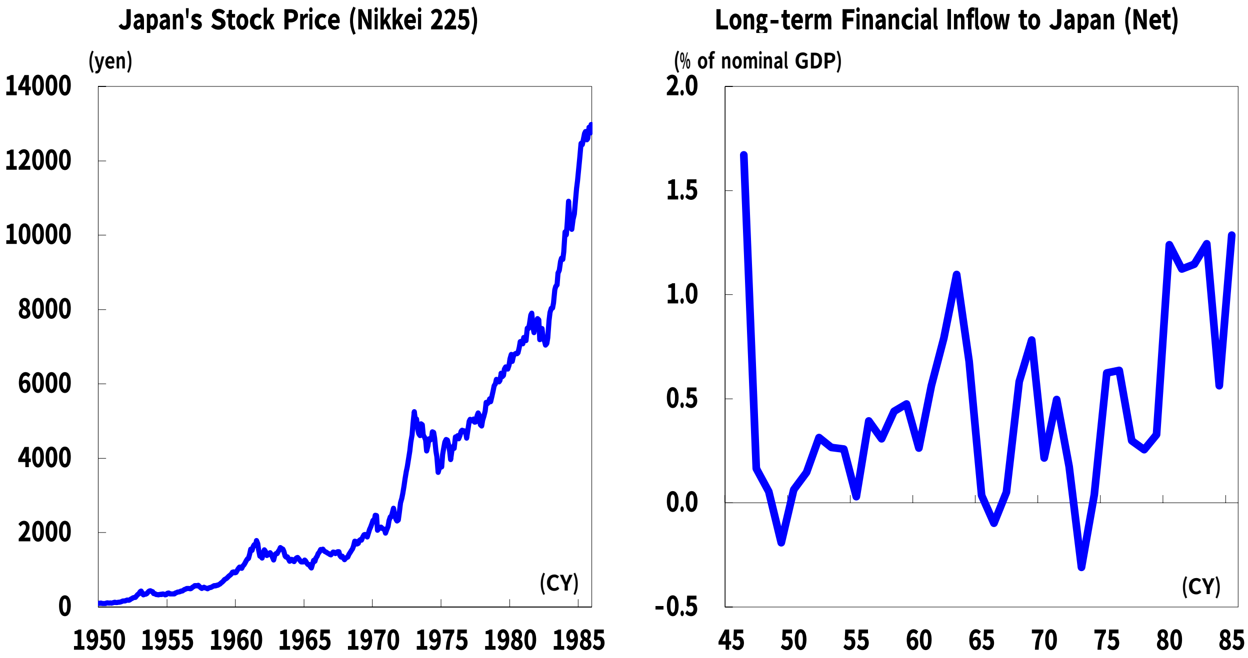


Source: Japan Ministry of Internal Affairs and Communications

However, it is my view that a lower rate of growth does not necessarily mean that the Chinese economy is less attractive. For example, Japan's stock prices kept rising even after its growth rate slowed. Furthermore, there seems no strong evidence that investment into Japan from abroad slowed down significantly in the 1970s. After the disappearance of excess labor supply, real output started growing slowly but financial markets seem to have been quite confident about Japan's future (figure 12). After all, it's not that the economy stops growing; it just stops growing at 10% annually. Also, remember that Ezra F. Vogel's *Japan as Number One* was published in 1979, long after Japan's population transition and rapid growth finished. The global presence of Japan's economy got even bigger after its growth rate stabilized.

China's growth rate of more than 10% is not sustainable forever anyway. There will be an end, probably within next ten years or so. That does not mean that China will stop attracting attention from businesses abroad. On the contrary, we will find even more chances in China as the Chinese economy matures.

Figure 12



Source: Nikkei

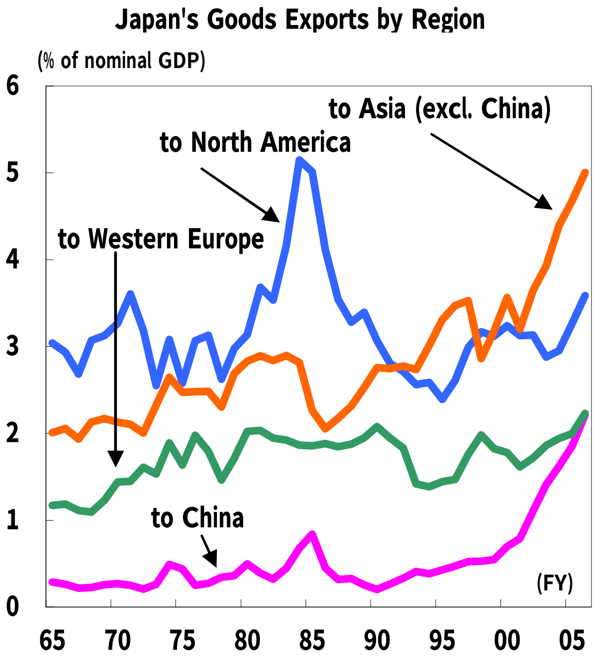
Source: Japan Statistic Association, Japan Cabinet Office, Nomura

<u>4. How Japanese are doing business in China</u>

(1) Globalization of Japanese Manufacturing Firms

So far, I have argued that one way for Japanese firms to counteract population decrease at home is to globalize their business, and the Chinese market is a big opportunity for them. Indeed, Japanese manufacturing firms are aggressively spreading their business abroad. In particular, there has been a dramatic surge of exports to Asian countries recently. Total goods exported from Japan stayed around nine percent of nominal GDP during the 1990s, but started increasing afterwards reaching 14% in 2006. A majority of the increase can be explained by increased exports to Asian countries. Japan's goods exports to Asia increased from 4.3% of nominal GDP in 2000 to 7.2% in 2006, and about half of the increment is exports to China (figure 13). It seems that Japanese manufacturing firms have already started to capture China's growing domestic market in response to population decrease.

Figure 13



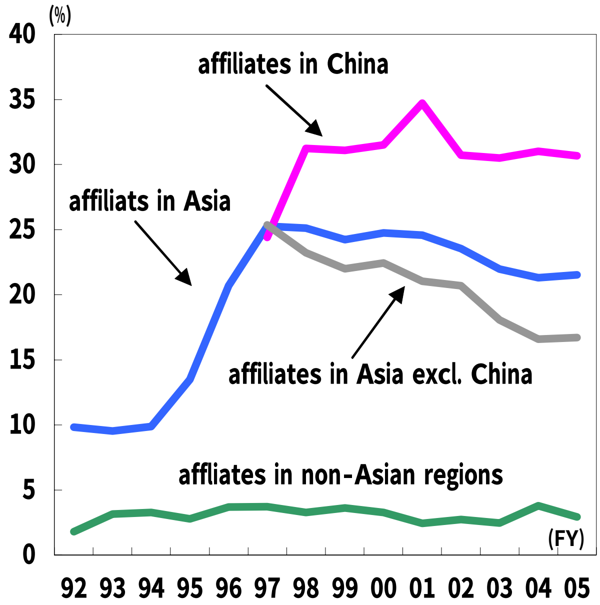
Source: Nomura, based on Japan Ministry of Finance and Japan Cabinet Office data

However, not all exports to Asian countries are directly for local final demand. About 25% are for local affiliates of Japanese manufacturing firms. In particular, about 40% of Japan's exports to China are for local affiliates. Foreign affiliates seem to be playing an important role in manufacturers' transactions between Japan and other Asian countries. Thus, to understand the business of Japanese manufactures in Asian countries, we have to see what kind of role local affiliates in Asian countries have.

It is straightforward to see that Japanese manufacturers' affiliates in Asian countries have a clear role as re-importing factories. Foreign affiliates of Japanese manufacturers in non-Asian countries export less than five percent of their sales to Japan. On the other hand, more than 20% of Asian affiliates' sales are for Japan (figure 14). This is especially true for affiliates in China. In FY2005, the share of sales that go to Japan accounted for 30% of Chinese affiliates' sales, while affiliates in other Asian countries exported only less than 20% of their sales to Japan. Furthermore, the share of sales to Japan in total sales of non-Chinese Asian affiliates has been declining since 1998, while the ratio for Chinese affiliates stayed stable. It seems that non-Chinese affiliates are losing their role as re-importing factories while Chinese affiliates are still maintaining this position.

Figure 14

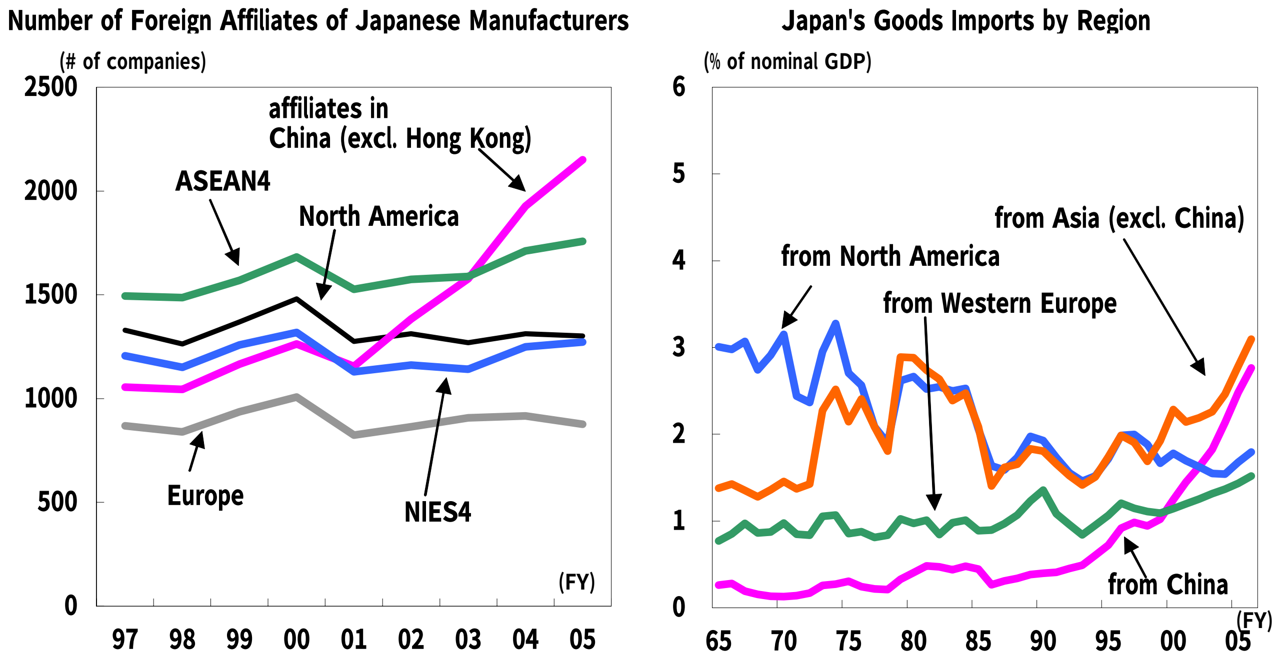
Share of Sales to Japan in Total Sales



Source: Nomura, based on Japan Ministry of Economy, Trade and Industry data

In addition, the number of local affiliates in China has been increasing particularly from 2001 to 2005 (figure 15). The result is the significant increase in imports from China to Japan. Imports from China accounted for less than one percent of GDP until the first half of 1995, but they amount to close to three percent in 2006. Among Japan's imports from China, about 30% is directly from local affiliates. It seems that China's economy is strengthening its position as a factory that provides low-priced goods to Japan.

Figure 15



Note: NIES4 = Korea + Taiwan + Hong Kong + Singapore
ASEAN4 = Indonesia + Malaysia + Philippine + Thailand
Source: Japan Ministry of Economy, Trade and Industry

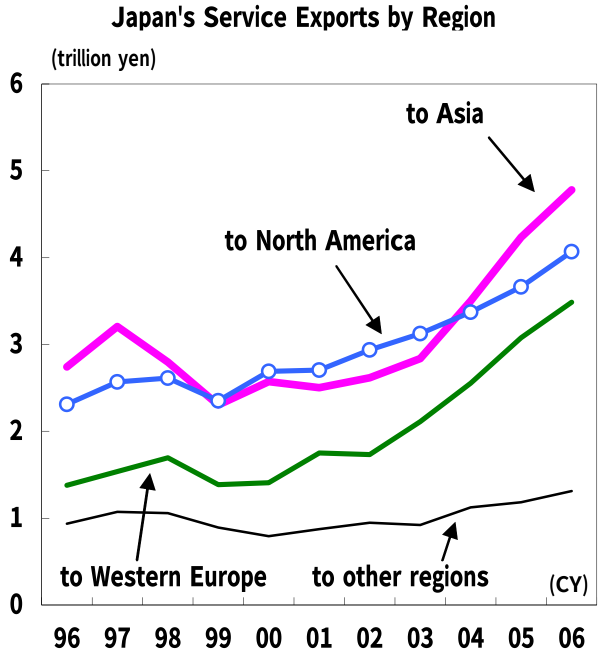
Source: Nomura, based on Japan Ministry of Finance and Japan Cabinet Office data

However, as I discussed, this situation will not continue forever. China's excess labor supply will eventually evaporate, and it will not necessarily be reasonable to operate a re-importing factory in China. I expect, local factories in China to reduce their reliance on the Japanese market and expand their sales in China's local market.

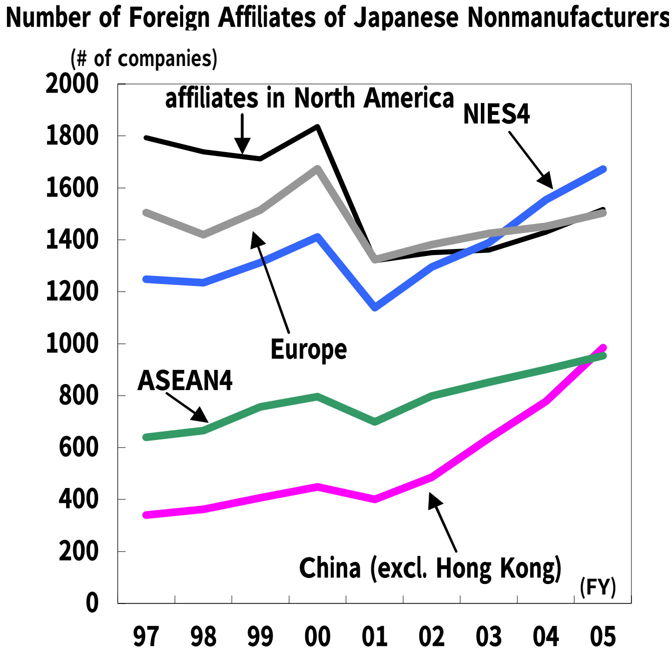
(2) Globalization of Japanese non-manufacturing firms

Business models that provide call-center services or accounting services to customers abroad have lately attracted attention. Those are examples of globalization of non-manufacturing firms. Japanese non-manufacturing firms, though not as sensational as Indian call-centers, are also gradually spreading their business abroad. For example, Japan's service exports amounted only 1.4% of GDP during the 1990s, but increased to 2.7% in 2006. In particular, service exports to Asia have been increasing rapidly (figure 16). Also, the number of foreign affiliates of Japanese non-manufacturers has been increasing in Asian countries. After all, Japan's population decline will affect not only manufacturing firms but also non-manufacturing firms. I consider that Japanese non-manufacturers have strong motivation to globalize their business.

Figure 16



Source: Bank of Japan



Note: NIES4 = Korea + Taiwan + Hong Kong + Singapore
ASEAN4 = Indonesia + Malaysia + Philippine + Thailand
Source: Japan Ministry of Economy, Trade and Industry

However, macro data on the non-manufacturing sector are limited. It is quite difficult to describe exactly what kind of business they are doing abroad. Therefore, we have directly interviewed several Japanese non-manufacturing firms to find out how they are globalizing their businesses.

Watabe Wedding

The wedding industry is among those most severely hit by a decline in population. This is because the number of wedding ceremonies a person has in her or his life is likely to be limited. Anyway, it is not common to encourage people get married often. Thus, the population size is critical to the industry. Facing a decline in the younger population, wedding service firms in Japan are struggling to acquire customers with new plans and concepts, such as restaurant weddings, house weddings, and overseas weddings, as departures from the traditional hotel wedding.

Watabe Wedding, on the other hand, is trying to capture foreign customers. Among young generations in Asia, Japanese culture is becoming popular. In Hong Kong and Taiwan, there is strong demand to be married in "cool Japan". For those customers, Watabe Wedding proposes a wedding plan in *Gajoen*, a premier wedding center it operates in Tokyo. Demand from Japanese couples for wedding ceremonies at *Gajoen* is expected to decrease, but Watabe expects that the reduction can be offset by demand from abroad.

Another reason for the increased demand for wedding ceremoies in Japan is that income in Asian countries has increased. In China, average income is still low, but rich people have become really rich. Furthermore, Chinese yuan is expected to appreciate in the future. Watabe is comfortable with the macroeconomic environment.

On the other hand, language and culture are barriers against Watabe's business. For example, a wedding ceremony is not part of traditional Chinese culture, according to Watabe. The company wants to spread a wedding style that similar to that in Japan. Another example is language ability of taxi drivers in Tokyo, who are not used to having passengers speak foreign languages, which makes inviting overseas guests to weddings in Tokyo difficult. Overcoming such barriers is one challenge to Watabe in expanding its global business.

SECOM

SECOM, a security system provider, had a hard time selling its products when it started business in China. The reason is that purchasing a security system cost more than simply hiring a guard. However, the rapid increase of wages in China is making SECOM's service relatively more reasonable, thus helping the business to grow. SECOM has already been successful in Taiwan, Thailand, Malaysia and Singapore. The company is now aiming at the Chinese market, operating in major cities.

SECOM's basic strategy is to transplant the system that has been successful in Japan to China without major modification. But, of course, fine tuning is necessary. In China, SECOM mainly hires workers who were born in the locality of each particular office. The reason is that bloodline is very important in China, and it is difficult for wrokers to cheat when they live close to many relatives. This strategy is currently working, but restricting employees to those who were born nearby is causing a labor supply problem. Acquiring highly qualified workers is a big challenge to SECOM's growth in China.

Benesse Corporation

Benesse Corporation's business relates to various stages of life: pregnancy, giving birth, raising children, education, and elderly care. Among these, the education market is expected to shrink due to the declining population. This is a reason why Benesse Corporation is expanding its education business abroad. The company's educational materials featuring *Shimajiro*, a character resembling a baby tiger, are widely used in Taiwan. Benesse started business in China in 2006 and has acquired 50 thousand customers.

Benesse is also running English training schools. Berlit, which operates in 63 countries around the world, joined Benesse group in 1993. In Germany, its business tends to be related to government projects; it is establishing a route through which engineers learn English and find a job in Ireland. In China, demand for English education is strong among Chinese who work for American and European companies. On the other hand, in the UK and the US, English speakers demand for non-English language education while recent immigrants demand English language training.

One of the growing parts of Benesse's businesses is elderly care services, but the company faces the challenge of a shortage of skilled workers. Hiring foreign workers is a possible solution, but Benesse considers that it is not that simple. Traditionally, the elderly in Japan have been taken care of by their own family members. Benesse considers elderly care as a part of culture, so a simple introduction of foreign workers is not a solution.

Nomura Research Institute

Nomura Research Institute (NRI), a Japanese system integrator, is outsourcing the production of computer systems to China. Interestingly, the reason NRI decided to outsource production is *not* the low cost in China. According to NRI, outsourcing to China does not reduce the overall cost of production very much once various associated costs are taken into account. To prepare for outsourcing production, NRI repeated test orders and invested in educating Chinese engineers.

The primary reason for outsourcing was a shortage of engineers in Japan. Facing difficulty in finding skilled workers, NRI decided that outsourcing to China could benefit its business despite the cost.

NRI says that selling computer systems to Chinese companies is not profitable because the price that Chinese firms will pay for a computer system is still low. The situation may change if Chinese incomes go up further and people start to require high quality.

What we can see from these four examples above is that the economic growth of Asia is benefiting Japan's non-manufacturing companies. Watabe Wedding can offer a wedding plan to younger generations of Asian because their income is high enough to pay for Watabe's service. Benesse's education service is expected to grow in China since income is growing there. SECOM's service has now become reasonable enough to purchase because the cost of hiring guards became more expensive. If there are shortages in labor supply in Japan, China's labor market is a good place to seek workers, as shown by NRI's experience. I predict that Japanese non-manufacturing firms will further extend their business abroad, especially in China.

5. Conclusion

In this paper, I proposed that a way for Japanese firms to overcome population decrease is to extend business abroad. In fact, Japanese firms now have a big opportunity to spread their business in China, especially because excess labor supply in the country is likely to disappear within ten years or so. Japanese manufacturing firms are rapidly spreading their business in China. China's position is still a re-importing factory, but this is expected to change as the income level rises. Japanese non-manufacturing firms are also extending their business in Asia. Interviews with four companies introduced in this paper show that higher income levels in Asian countries are helping Japanese non-manufacturers' despite declining population at home.

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