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Organisation, Motivations and Case Studies of Japanese Direct Investment in Real Estate 1985–94

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Organisation, Motivations and Case Studies of Japanese Direct Investment in Real estate 1985–94

Between 1985 and 1994 there was a remarkable rise and decline in Japanese real estate investment abroad which has been little documented or analysed, despite its economic scale and political impact. This paper is a further exploration of the nature and causes of this form of investment, following on from a broader study of its determinants in Pacific Economic Paper No. 271 of September 1997. It provides supporting evidence, through an examination of the organisation and motivations of investors, for the hypothesis that Japanese investors in real estate were predominantly influenced by the financial environment in Japan after the mid 1980s, rather than by more strategic factors such as their firm-specific advantages.

According to traditional industrial organisation theory, FDI (foreign direct investment) is associated with investor control over assets and an active managerial role by investors. Hence, the purpose of FDI is to pursue a strategic international expansion by a firm, based on its specific proprietary advantages over local firms (Dunning 1981; 1993). Notably, Hymer (1976) categorised active investment as type II if it involved both control and management; alternatively, inactive investment, without control, is categorised as type I in nature.

Evidence is provided that the corporate and financial organisational structure of Japanese real estate FDI did not exhibit type II features to any significant extent. It is argued that the organisational and corporate strengths of Japanese firms explain little of the pattern of real estate FDI over the 10 years in review. The paper concludes that Japanese real estate investment appears to be an exception to the traditional firm-specific model of FDI.

Introduction

Until the 1980s, Japanese FDI in real estate was negligible and generally considered of little importance. This perception changed abruptly when outflows of real estate FDI surged to reach over 20 per cent of total Japanese FDI outflows by 1991. The cumulative stock of real estate FDI exceeded US$71 billion by 1994 – representing an annual average increase of over 40 per cent for the decade. The unprecedented growth made real estate FDI the largest single component of Japanese FDI and one of the most politically sensitive – although this effect subsequently dissipated as many investors withdrew during the 1990s.

This pattern of rapid investment and subsequent large-scale divestment supports the proposition that Japanese real estate FDI does not readily fit into 'the existing inventory of

models and evidence' of Japanese FDI or FDI generally (Caves 1993). However, despite the magnitude and political sensitivity of Japanese FDI in real estate after 1984, there is little information on the pattern of investment or analysis of the motivations of Japanese investors. There are few studies of real estate FDI, compared to studies of FDI in more traditional sectors, such as manufacturing, for either Japan or other countries. Nevertheless, understanding the direction, timing and location of investment is a necessary precursor to exploring the reasons for its occurrence.

Explanations of FDI focus on the theory of industrial organisation, in particular, the motivations of investors, their firm-specific advantages and their strategic approaches. Since Hymer (1976), theory has emphasised the key element of investor control, with explanations of FDI emphasising firm-specific factors rather than more general country-specific factors. Hence the motivation to invest is typically seen as being based on the characteristics or advantages of the investor, with the firm's decision to expand internationally being based on the exploitation of this advantage.

Hymer (1976) observed that *passive* (type I) investment could be distinguished from *active* flows of foreign investment (type II), by the latter's element of investor control and the two-way direction of FDI between countries. As investor control is the definitional distinction between type I and type II flows of international investment, assessing the character of investment as either active or passive is critical in assessing whether a specific or general explanation of real estate FDI is more appropriate. Theoretical explanations of FDI reflect the conceptual distinction between active investment, involving management influence or control, and passive investment with ownership but not control.

Despite the definitional assumption that FDI involves both investor ownership and control, it is possible to distinguish in theory between active and passive FDI and between owners and owner-managers. This categorisation is important as the motivation of investors, whether firm-specific or country-specific in nature, is closely tied to whether the owner intends to pursue an active corporate strategy or intends to contract out the management function of the foreign enterprise.

This duality of investor motivation is also evident in the corporate and financial organisation of investment. While portfolio foreign investment generates a stream of income from a foreign asset without requiring involvement in the management process, FDI is distinguished by the element of foreign control.[1] It is not always clear that investor control is exercised and an indirect investor may delegate management responsibilities. If invest-

ment flows are essentially indirect or portfolio in nature, firm-specific investor advantages may be irrelevant. Assessment of the nature of investment also depends on the accuracy of its measurement and the structure of its funding.[2]

An assessment of the nature of Japanese real estate FDI depends on the extent of strategic involvement of investors and the active or indirect corporate and financial organisation of investment. If investors are owner-managers and take an active role in managing and controlling their overseas real estate subsidiaries, firm-specific motivations for FDI are likely to involve the strategic exploitation of some form of investor advantage, compared to local firms (Hymer 1976).

A broad overview of the nature and determinants of Japanese FDI in real estate between 1985 and 1994 was provided in a previous paper (Farrell 1997) but details of motivations of investors, the organisational structure of investment and case studies could not specifically explored. This paper seeks to complement the earlier discussion by examining these important aspects of the pattern of Japanese real estate FDI, particularly in the major host countries of the United States and Australia. The paper also seeks to reinforce the categorisation established in the previous paper between two classes of either active or indirect investor management and organisation. Firstly the pattern of investment is considered.

Geographical pattern

In the period from 1984 to 1995 a range of Japanese firms, particularly those in the real estate and construction industries, engaged in the rapid acquisition and development of real estate around the world. Many firms in other Japanese industries also participated in FDI in foreign real estate either directly or through the establishment of real estate subsidiaries in Japan or other countries. Two phases can be identified in the decade under review: the initial period of rapid expansion of investment from 1984 and subsequent divestment from 1990 to 1995.

For some investors, investment in hotel, resort or office real estate involved an active business strategy. Many others were owners and not owner-managers of these assets. Marketing of foreign real estate by real estate, finance and trading companies in Japan increased markedly in the 1980s and smaller investors gained access to foreign markets through the networks established by these firms.

Japanese investment in foreign real estate was allocated to particular overseas cities and regions, according to the type of the investment (Table 1). The location of resort investment often coincided with the most popular destinations for Japanese business and tourist travellers, provided that foreign investment and other regulatory barriers in these countries permitted investment. Office investment flowed to a few major cities, such as New York, Los Angeles, London and Sydney, which are key international financial and business centres. Typically host countries were politically stable and had deep property markets with developed financial sectors.

Table 1 Distribution of Japanese FDI in real estate, by country 1994[a]

Country	Number of cases	Amount (US$m)	Average value (US$m)	Share of bilateral FDI (%)	Share of total FDI (%)
United States	5,330	45,789	8.6	23.5	64.4
Australia	1,073	8,045	7.5	34.9	11.3
United Kingdom	186	5,620	30.2	17.5	7.9
Netherlands	153	2,648	17.3	14.1	3.7
Hong Kong	455	1,845	4.1	14.1	2.6
France	114	1,228	10.8	19.0	1.7
Singapore	145	1,059	7.3	9.7	1.5
Canada	179	966	5.4	12.3	1.4
World[b]	8,574	71,088	8.3	15.6	100

Notes: a Japanese financial years, so that 1994 (*Heisei roku-nen*) refers to the period from April 1994 to March 1995.
b Cumulative total for FY 1951–94.
Source: Ministry of Finance (MOF), *Annual Report*, 1995.

In the United States, Japanese FDI in real estate was concentrated in only a few states, in particular California, Hawaii and New York, which together accounted for more than 70 per cent of total investment in the United States (Leventhal and Co 1991). Office FDI was strongly directed to New York, while Hawaii attracted hotel and resort acquisitions and developments. Japanese FDI in Australian property was mainly concentrated in the major states (JLW 1992). Office investment was directed towards Sydney and Melbourne, while the Gold

Coast and Cairns received most tourism investment (Farrell 1994). In the United Kingdom, Japanese FDI in real estate was predominantly focused on London (Knight Frank 1990).

Outflows of Japanese FDI in real estate broadly followed the pattern of total Japanese FDI and trade flows, reflecting the importance of the United States as a bilateral trade and investment partner (Figure 1). The significant share of Oceania followed an upsurge in Japanese investment and tourism in this region, with investors creating a hotel and resort infrastructure to service this expanding market. Other factors, such as an absence of death-related taxes on wealth and lower capital gains taxes compared to Japan's, may have been a contributing factor (Sawada 1990).

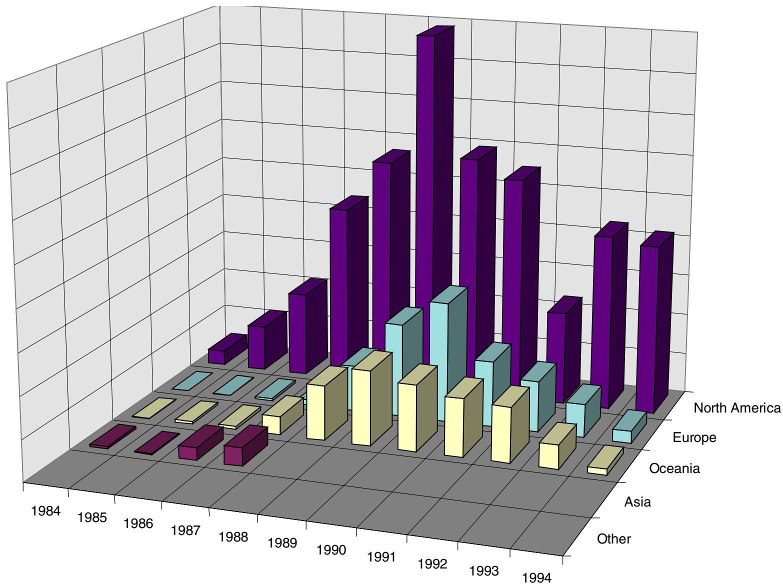
There appears to be a close relationship between the geographical distribution of Japanese FDI in total, Japanese FDI in real estate and the travel destinations of Japanese executives and tourists (Figure 2). The locations of Japanese business activity, investment and tourism are also influenced by environmental conditions, such as political security, familiarity and proximity. Japanese real estate investors may have been attracted to cities and resorts near clusters of Japanese business or tourist activity.

Japanese real estate FDI stimulated the outflow of Japanese tourists to locations, in which high-level hotel and resort accommodation was acquired, upgraded or developed. Major Japanese tourist destinations, such as China and South Korea, afforded few opportunities for investors to acquire real estate, whereas the United States – particularly the nearby resorts of Guam and Hawaii – and Australia were relatively open (PECC 1995).

Investors such as Japan Airlines (JAL) acquired or developed a number of hotels and resorts on their global networks, but not in cities such as Beijing or Seoul, where ownership was prohibited. In cities where the regulatory regime was more open, there is no clear pattern to JAL's investments, according to distance or travelling time, although JAL often invested in its major destinations.

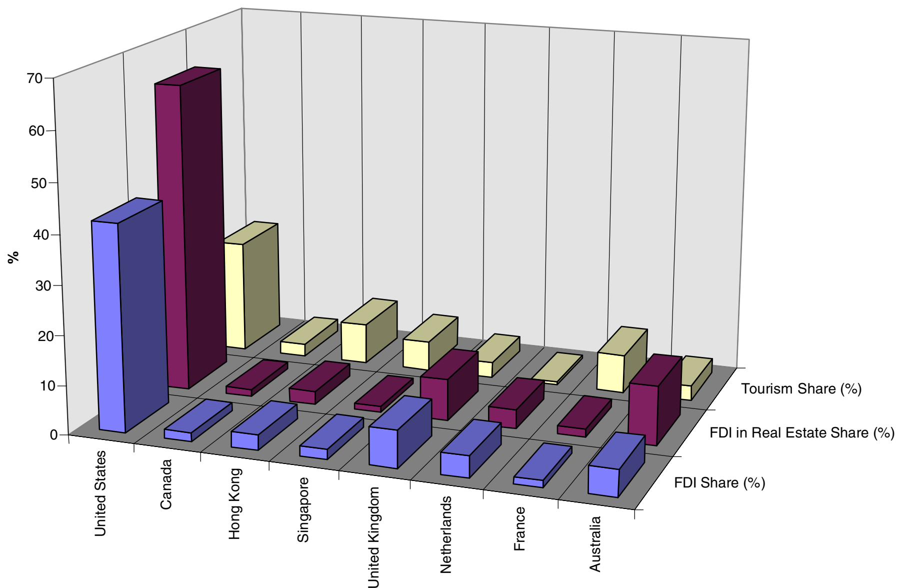
Distance from Tokyo and Osaka was important because of the limited holiday periods of many Japanese travellers – often only five days or so (MOT 1993, p. 2). Hence the spread of tourism investment from Guam, Saipan and Hawaii was limited by the travelling time involved in reaching short-term travel destinations. This factor prompted the development of Cairns, by Daikyo, as an emerging north Australian tropical resort offering closer golf, hotel and other leisure facilities (Daikyo 1990).

Figure 1 Regional distribution of Japanese FDI in real estate, 1984-94



Source: MOF, *Annual Report of the International Finance Bureau*, various years.

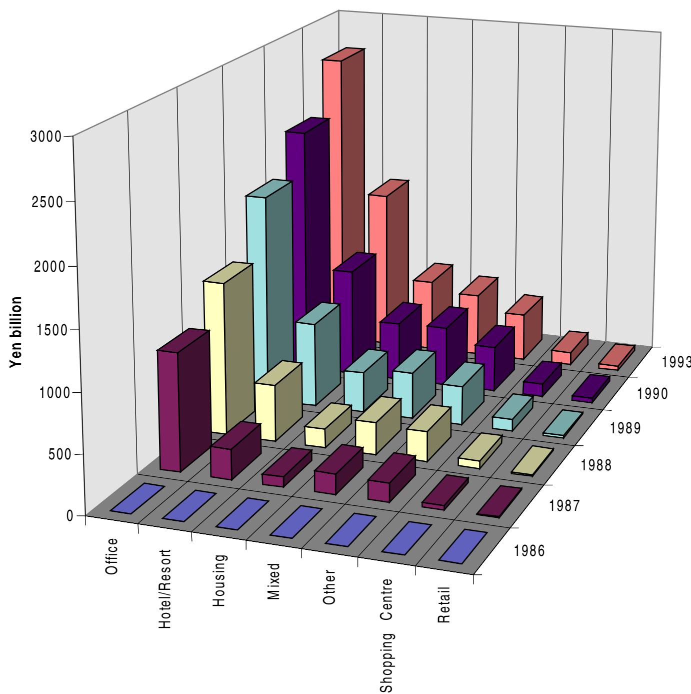
Figure 2 Distribution of Japanese FDI, FDIRE and tourism, 1993



Source: MOF, *Notifications of FDI*, various years and Ministry of Justice, *Overseas Travellers*, 1993.

Japanese investment in office real estate was related more to the location of other Japanese businesses in world cities, such as New York, Los Angeles, London and Sydney. Japanese financial institutions were similarly drawn to these cities, in which financial services industries were important users of office buildings, as part of their global expansion in the 1980s. Many sought to establish a visible presence by acquiring or developing major office buildings in the central business areas of these cities; one example was the acquisition of London office buildings by Mitsui Trust and Mitsubishi Bank in 1986 (Asian Property 1990). Japanese banks and other financial institutions, which had recently expanded their overseas presence, favoured real estate as an investment instrument and as collateral for loans (EPA 1994).

Figure 3 Major types of Japanese real estate FDI, 1986–1993 (¥ billion)



Note: Foreign real estate assets, such as industrial land, office buildings and factories are not recorded in the official real estate statistics. Such investment is not classified as real estate investment if it is 'incidental' to the principal activity of the enterprise. Information for the years 1991 to 1992 is not available.

Source: Survey conducted by the Ministry of Construction, *Survey of Japanese Investment in Foreign Real Estate*, 1986-1993.

Categories of Investment

Japanese investors in overseas real estate in the 1980s focused on office, hotel and resort real estate in particular, with residential, mixed use and undeveloped land also attracting interest (Figure 3). Major purchasers of established office property were institutional investors, such as life insurance companies and the larger integrated real estate firms. Development and construction firms were responsible for most new construction projects in the United States, Australia and the United Kingdom. After construction, either these properties were on-sold to other Japanese investors, or ownership was retained, often with the motivation of achieving capital gains in a rising market.

Table 2 Japanese investment in the US by property type (US$ million)

Property type	1987	1988	1989	1990	1991
Office	5,190	8,310	3,331	2,163	941
Hotel/resort	4,570	3,577	4,158	3,790	1,258
Mixed use	740	2,416	2,184	1834	963
Residential	1,300	702	2,216	2,056	809
Retail	460	644	350	524	136
Industrial	30	310	305	129	35
Land	470	302	1,321	1,718	581
Golf course	10	202	394	547	325
Other	–	81	517	298	12
Total (a)	12,770	16,544	14,775	13,059	5,060

Note: The sum of individual components may not equal totals due to rounding.

Source: Leventhal and Co., *Japanese Investment in US Real Estate*, 1991.

The MOC survey records total investment in US real estate of over US$70 billion. Office acquisitions and developments accounted for about 35 per cent of the stock of FDI, with hotel and resort investment accounting for about 20 per cent. Mixed use, residential property, land and golf courses comprised most of the remaining stock of investment. A similar pattern is evident in the private survey of the US accounting company Leventhal that recorded total investment of ¥4.8 trillion in the United States by 1990. (Table 2).

Profile of investors

In the 1980s, a wide range of Japanese firms engaged in an unprecedented period of acquisition and development of real estate around the world. Real estate and construction firms were particularly important, but there was also a wide range of other investors, including tourism entrepreneurs, institutional investors and finance and trading companies. For some investors, investment in hotel, resort or office real estate involved an active business strategy. Many others were owners and not owner-managers of these assets. Marketing of foreign real estate by Japanese firms increased markedly in the 1980s and smaller investors gained access to foreign markets through the networks established by these firms.

Falling prices of overseas real estate, relative to rising prices in Japan, increased demand for foreign real estate investment. Many realtors established overseas subsidiaries, particularly in the United States, in order to act as agents or intermediaries in the acquisition or development of offices, hotels or other real estate. Some investors, such as Shuwa Real Estate, acquired a large number of office buildings in the United States to both retain and lease or sell to other Japanese investors. Others, such as Itochu, helped with financial and legal advice, or formed joint ventures with investors.

Larger Japanese realtors, security firms and finance houses typically formed associations with overseas firms with local expertise in these fields in order to market or financially 'package' real estate investment deals so as to take advantage of local conditions - particularly the relative lack of financial regulation outside Japan. Increasingly, leveraging and financial techniques such as securitisation were used to fund their acquisitions and developments.

Motivations of investors

Numerous surveys of Japanese FDI are conducted by the Japanese Ministry of International Trade and Industry (MITI), the Japanese Export-Import Bank (EXIM) and the MOF, but these exclude real estate investment, while the Bank of Japan series on FDI does not provide industry-level detail. Evidence on the motivations of real estate investors is however available from an occasional survey conducted by the MOC, which examines 2,267 of the leading real estate and construction firms in Japan.

In 1990 the MOC survey identified 176 of these firms as investors in foreign real estate, of which 85 firms responded and 64 firms provided details of their foreign real estate activities

(Table 3). Only one firm reported that it was involved in the sale of domestic real estate in foreign countries. Apparently no firms were involved in the sale of foreign real estate to non-Japanese investors. About 40 per cent of investors reported their involvement in selling overseas real estate in Japan.

Table 3 Foreign activities of Japanese firms that invested in overseas real estate, 1990 (multiple answers: 64 respondents out of 85 firms)

Principal company activity to do with overseas real estate	No. of firms
Selling overseas real estate in Japan	26
Agent or broker selling overseas real estate in Japan	22
Selling domestic real estate in foreign countries	1
Agent or broker selling domestic real estate overseas	1
Agent for lease of domestic real estate overseas	0
Lease of own overseas real estate, outside Japan	55
No answer	21

Note: Multiple answers: 64 respondents out of 64 firms.

Source: MOC (*Kensestsu-sho*), *Survey of Japanese Investment in Foreign Real Estate* (*Kaigai fudosan jittai chosa*), 1994, Tokyo.

The coverage rate of the MOC survey of total Japanese real estate FDI is relatively high. Its results are likely to be significant because many real estate investors tend to cooperate with the MOC, given the importance of public works contracts in Japan and aid projects overseas to many of these firms or their affiliates. The major survey finding is that the principal motivation of investors was to retain ownership of overseas real estate for the purpose of rental income (55 firms). A smaller proportion of investors sought to on-sell real estate to investors in Japan (26 firms), or to act as a broker or agent selling overseas real estate in Japan (22 firms).

Several private and official surveys have been conducted among Japanese investors in overseas real estate (Leventhal 1992; Nippon Credit 1989; JLW 1989) and provide considerable detail on the categories of investors active since the mid 1980s. A common finding of these surveys is that firms in the Japanese real estate and construction industry predominate as active investors, while a range of other firms, including life insurance companies, trading

companies, financial institutions, private investors, manufacturing firms seeking diversification and resort-oriented firms are also involved.

A comparison of motivations for investment in the United States and Australia was made using a survey in Australia (Farrell 1994), based on a survey in the United States (Daggett 1991), although the coverage varied.[3] This combines survey results on the motivation of Japanese investors in overseas real estate for the United States and Australia, two of the most important destinations for this form of FDI (Table 4).

Table 4 Survey of investors: reasons for investment in foreign real estate

Reason	Australia (1994)[a]		United States (1990)[b]	
	Past	Future	Past	Future
Cheap price	3.25	3.3	3.25	4.12
Capital gain	3.25	3.3	4.43	4.50
High return	2.5	3.25	4.29	4.54
Portfolio diversification	2.6	2.75	3.18	3.50
Tax benefit	1.2	0.75	2.89	3.23
Political stability	2.6	3.7	4.68	4.62
Business opportunity	3.8	4.0	3.00	–
Growth of Japanese tourism	4.0	3.3	–	3.12
Familiarity as nation	4.25	4.3	3.36	3.35
Publicity effects	3.0	2.7	2.86	3.00
Own use	2.25	2.5	1.41	1.24

Notes: a Taken from survey of Japanese FDI in Australian real estate in 1994. Only five of 102 firms participated, but these firms accounted for about 25 per cent of Japanese FDI in Australian real estate (Farrell 1994).

b Taken from survey of Japanese FDI in US real estate by Daggett (1991).

According to the sample, investors who terminated their investments in Australia did so primarily because of unprofitable operations and other factors, such as exchange losses, while political problems were not important. Divestment was apparently motivated by 'a declining number of attractive properties' and by the slowing of real estate markets in Australia and Japan. For many firms, investment in Australian real estate was their first foray into overseas expansion, for which they were not fully prepared. One investor reported that 'lack of proper information and a business master plan with full research prior to a decision making

process' was a major factor affecting the firm's investment performance in Australia (Farrell 1994).

The survey results reveal that Japanese investors were attracted by the low price of overseas real estate, the prospect of capital gains from overseas real estate and business opportunities associated with the acquisition or development of property. Political stability and familiarity also rated highly as factors in determining the location of Japanese FDI in real estate. The prospect of high returns or yields, relative to the domestic real estate market, was a more important factor for Japanese investors in the United States than in Australia, suggesting that these locations were perceived differently. The higher proportion of Japanese tourism real estate to total real estate FDI in Australia, compared to that in the United States, is one explanation.

Investors in Australian and US real estate perceived each country somewhat differently. Both locations were considered to be politically safe and to offer inexpensive opportunities to invest in all forms of real estate, particularly in comparison to the prospects for investment in real estate in Japan. Investors in the United States appear to have been more responsive to high yields on central business district office buildings and the promise of capital gain. In Australia, investors in real estate were more influenced by the promise of tourism real estate, where investment yields were less certain and less easily quantified, particularly during the development of the Gold Coast and Cairns as major Japanese tourist destinations.

Surprisingly, few investors considered political stability in Australia as a reason for investment, although many were familiar with the country, possibly due to increasing Japanese tourism. The promise of tax advantages ranked higher for the United States than for Australia. The survey results suggest Japanese investment may have been strongly motivated by general country-specific factors, such as variations in the domestic and international price of real estate; locational and regulatory variations between countries; and the availability of finance for investment.

Motivations by category of investor

Investors can be grouped into four categories according to their differing motivations. These are: integrated developers who became project managers for international real estate developments and retained ownership after completion; international realtors who acquired

or developed real estate, particularly office buildings, to lease or sell to other investors; tourism entrepreneurs who acquired or developed hotels and resorts to serve the needs of Japanese overseas travellers; and institutional investors and other passive investors who acquired foreign office real estate.

In each broad category firms were motivated to invest by the impact of the domestic land price bubble on their domestic operations. For *integrated developers*, the rising price of land impeded hotel and office developments in Japan and encouraged involvement in foreign projects. Japanese contractors also took advantage of the ready availability of funding for real estate FDI to launch new projects, with the intention of retaining ownership or selling the completed projects to other Japanese firms.

Japanese real estate firms were often beneficiaries of the asset bubble, through appreciation of their land assets or access to funding. Real estate FDI allowed realtors to escape high land prices and to build up of stocks of land and buildings for sale or lease, typically to other Japanese firms. The emergence of *international realtors* reflected the increased international purchasing power of many Japanese real estate firms, which acquired portfolios of overseas offices or hotels with the intention of leasing to other firms or marketing these properties to investors in Japan.

Other Japanese firms emerged as *tourism entrepreneurs*, seeking to establish integrated resorts and hotel chains for business and tourist travellers from Japan. Many of these firms had expanded their tourism and leisure activities in Japan, encouraged by the 1987 Resort Law (Comprehensive Regional Resort Preparation Plan or *Sogo hoyo chiiki seibi ho*). The law encouraged a wave of resort-type developments and the establishment of large-scale integrated resorts in rural Japan, incorporating hotels, golf courses and condominiums (McCormack 1992). Increasing demand for high-quality overseas accommodation from Japanese holidayers, and political opposition to further resorts in Japan, also encouraged some golf and leisure service firms to acquire or develop overseas facilities, especially in host countries already attracting significant numbers of Japanese tourists and maintaining open foreign investment policies.

Other firms that invested in foreign office, tourist, retail or residential real estate were often motivated by the low cost of these assets, compared with the price of similar land or buildings in Japan. *Institutional investors*, such as Japanese life insurance firms, sought higher yields than those available during the bubble period at home. Individuals or small firms often invested to achieve capital gains. Some investors sought to achieve international

prestige through owning a famous office building or hotel, without seeking to actively expand their commercial operations outside of Japan.

The relatively low price of foreign real estate, compared with that in Japan, led investors to buy regardless of yields. A high degree of financial leverage was often used to finance acquisitions or developments but, in the 1990s, divestment was more likely if FDI was fundamentally speculative and highly leveraged. Other motivations were also important – for owner-occupiers, a condominium in Hawaii offered holiday accommodation and potential capital gains, a retirement home, or a vehicle for avoiding domestic taxes.

In examining investor strategies and motivations, a key issue is whether the investor exercised control through either management or ownership of office buildings, hotels, resorts or other types of real estate. Within the four established categories, firms and individuals with little management involvement in their real estate acquisitions are categorised as 'passive' investors acquiring office buildings, resorts, hotels and other property for rental returns and capital gains. Others are 'active' owner-managers intent on adding value to their overseas assets, for example, tourist entrepreneurs who seek to integrate their corporate activities in Japan with the operations of overseas subsidiaries. This dichotomy is also reflected in the corporate and financial organisation of investments.

Organisational structure

For many Japanese investors, the small size of their overseas real estate subsidiaries meant that real estate services were provided by the parent company, or through the auspices of subsidiaries of Japanese financial institutions or trading companies. Many investors did not establish overseas offices but acquired hotels, offices or resorts as passive owners, with the management of the property being handled by a specialist company. Examples of the marketing of foreign real estate in Japan and the formation of intermediary companies to buy, sell and lease such real estate are given (Table 5).

In the mid-1980s Japanese real estate firms anticipated a sharp rise in domestic demand for foreign real estate and established overseas sales, marketing and information networks to help them meet this demand. Once this intermediary infrastructure was established, the upturn in foreign real estate sales was almost immediate. Increasingly, smaller investors were able to participate as unit trusts were established to lower the average size of investment.

Information gathering

Initially, Japanese real estate investors followed a cautious strategy of forming associations with overseas real estate, legal and financial companies, with local or international expertise. Larger Japanese real estate companies and institutional investors, such as life insurance companies, established capital participation, contractual arrangements or joint ventures to obtain greater knowledge about foreign real estate markets, particularly in the United States. In later projects Japanese investors increasingly developed real estate in the United States and Australia without an end-user, or local equity partner, and retained ownership in the development after completion.

Table 5 Examples of Japanese real estate intermediary companies in the United States and marketing of US real estate in Japan, 1986-88

Mitsui Real Estate expands its operation into property management, as well as acting as an agency for overseas real estate investment (Nikkei Sangyo, 24 December 1986).

Mitsui Trust Bank expands its system for intermediary investment in overseas real estate (Nikkei Sangyo, 8 January 1987).

Shuwa Real Estate acts as an intermediary for overseas real estate acquisitions and acquires an office building with its customer (Nikkei, 24 January 1987).

Toyo Real Estate improves its marketing network inside and outside of Japan, establishes 10 new offices in the Kansai region and hastens to expand its information network in the United States, so as to sell foreign real estate in Japan (Nikkei Sangyo, 6 February 1987).

Hasegawa Koumuten publishes an information paper on overseas real estate investment (Nikkei Sangyo, 28 May 1987).

Seiyo Kankyo Kaihatsu acts as an intermediary for 100 sales of foreign real estate, 90 per cent for the purpose of investment (Nikkei Sangyo, 13 August 1987).

Itochu expands its intermediary work in selling foreign real estate and provides financial services for domestic investors by securitising the rights of ownership of overseas buildings into small lots for easier investment (Nikkei, 14 August 1987).

Misawa, Orient Finance and Itochu form a new company to act as middlemen for investment into US real estate (Nikkei, 19 August 1987).

Sumitomo Real Estate establishes an intermediary company in Los Angeles to sell real estate to Japanese investors and to cope with the sudden increase in demand for such real estate (Nikkei Sangyo 2 September 1987).

Mitsui Real Estate establishes a local entity in Hawaii to provide legal advice and intermediary services to Japanese investors in foreign real estate (Nikkei Sangyo, 9 October 1987).

Seiyo Kankyo Kaihatsu expands its investment intermediary operations in Hawaii and San Francisco (Nikkei Finance, 31 October).

Daiwa Bank links up with the largest US real estate agent and exchanges information (Nikkei, 31 July 1988).

Houseboat Seiyo acts as an intermediary to lease New York residences and forms links with a US general insurance company (Nikkei, 17 August 1988).

Joint ventures with local developers or real estate companies, such as in the capital participation of Nomura Securities with Eastdil Realty in 1986, allowed Japanese investors to undergo a learning process as they first entered international real estate markets (Table 6). The intermediary companies establishing these networks were encouraged by the relatively high fee income and other revenues they could charge investors (Brash 1990).

Table 6 Japanese real estate investors and their advisers

Japanese company	American company	Relationship (*Kankei*)
Sumitomo Trust Bank	Richard Ellis	Information consultant
Yasuda Trust Bank	Citibank Real Estate Advisers	Information cosultant
Yasuda Trust Bank	Grubb and Ellis Co	Information consultant
Mitsui Real Estate	AMB Investments	Information consultant
Mitsubishi Trust Bank	Cushman and Wakefield	Information consultant
Mitsui Trust Bank	Landauer Associates	Information consultant
Mitsui Trust Bank	First Interstate Bank	Information consultant
Toyo Trust Bank	Citibank	Information consultant
Daiwa Bank	Security Pacific	Information consultant
Yasuda Trust Bank	First Interstate	Information consultant

Source: A.M. Mitchell and M. Murai, *Facts on Real Estate Investment Towards the United States* Tokyo, 1989, p. 127.

While the initial stage of internationalisation of major Japanese real estate and insurance companies involved the establishment of overseas representative offices and formal associations with major real estate, insurance or financial companies, subsequent investors appear to have increasingly jumped to the stage of full ownership (Leventhal 1991). Apart from real estate companies in Japan, which devoted significantly more attention to marketing foreign real estate after 1985, trading companies and financial institutions were sources of legal and financial advice (Brash 1990).

Foreign partners or associates transferred knowledge to Japanese investors, such as financial techniques to establish real estate investment trusts (REITs), a common form of securitisation. Under this arrangement, an investor acquires a property, such as a New York office building, and then sells unit shares to smaller investors (Mitchell and Murai 1989). The

initial investor then acts as an overall manager of the building, although day-to-day management is delegated to local real estate companies. Major Japanese real estate acquisitions, such as the Mitsubishi Estate's acquisition of the Rockefeller Center office building portfolio, were often financed in this way (*Australian Financial Review* 13 September 1995).

Japanese and US insurance companies formed joint ventures to acquire office property in the United States, with the Japanese partner drawing on the greater experience of the local institutional investor. Ownership of projects was typically taken up by the developer on completion, or on-sold to other Japanese companies. The Leventhal survey shows the declining importance of joint ventures as investors became more familiar with the market for foreign real estate. Examples of Japanese real estate joint ventures in the United States during this period are in Table 7.

Table 7 Japanese real estate joint ventures in the United States

Japanese Investor	US Joint Venture Partner	Mode of Cooperation
Sumitomo Bank	Goldman Sachs	Capital participation
Nippon Life Insurance	Shearson Lehman Bros/Balcor	Capital participation
Orix	Rubloff Co	Capital participation
Nomura Securities	Eastdil Realty	Capital participation
Nippon Life	Prudential	Joint venture
Nippon Life	Trammel Crow Co	Joint venture
Nippon Life	Gerald Hines Interests	Joint venture
Aoki Construction	Metropolitan Life	Joint venture
Daiwa	Equitable Life	Joint venture
Nippon Life	Equitable Life	Joint venture
Asahi Life	Equitable Life	Joint venture
Dai-Ichi Life	Equitable Life	Joint venture
Dai-Tokyo Fire Insurance	Equitable Life	Joint venture
Taisei Construction	Vantage Cos	Joint venture
Itochu	Holiday Corporation	Joint venture
Itochu	Balcor/American Express	Joint venture
JAL-Nikko Hotels	Tishman Realty	Joint venture
Aoki Construction	Tishman Realty	Joint venture
Kumagai Gumi	Zeckendorf	Joint venture

Source: A.M. Mitchell and M. Murai, *Facts on Real Estate Investment Towards the United States* Tokyo, 1989, p. 89.

As a result of the network of associations, capital participation agreements and joint ventures, entry to foreign real estate markets, deregulated after 1980, now became much simpler for even small investors in Japan (Mitchell and Murai 1989: 127). The *requirement* for investors to have proprietary advantages to overcome higher host-country costs and entry barriers (Dunning 1993) became less relevant. Indeed, the large numbers of Japanese investors who acquired foreign real estate suggest that entry became increasingly open for both firms and individuals in Japan. For investors in Japan there were few apparent barriers to entry or exit and the industry was therefore relatively 'simple' in nature (Caves 1994).

Management and control

It is unclear if FDI in real estate involves the exercise of control. Effective control may be delegated completely to a management company, so that the investment essentially takes on an indirect and passive nature. This is true for office buildings in particular, although Japanese hotel investors also used well known US or UK management companies, such as Sheraton or Hilton, to manage their investments.

The MIT Center for Real Estate Development studied foreign investment in US real estate in Los Angeles, Atlanta, Honolulu, Chicago, Phoenix and Washington (Bacow 1987) and found it similar to portfolio investments made for income and capital appreciation and the investors did not take an active role in management. The structure of Japanese investment in Australian real estate was similar.

> When the Japanese acquire a company, they try to run and expand it, with a long term view by seeking good labour relations and investing the additional necessary funds...The key factor in their decision is whether the acquired company is strategically meaningful or not for that Japanese corporation. The attitude, however, is completely different from that of those who purchase real estate; some Japanese investors just seek the capital gain or the simple investment opportunity for idle cash, or even buy office buildings in New York or Los Angeles for decoration (Yamamoto 1989).

Decision-making in the Japanese company commonly involves a group of managers and a collective responsibility for decisions. Decision-making in large organisations typically relies

on consensus (Ouchi 1981: 36–43). The acquisition of real estate by Japanese companies and institutions in the 1980s reflected common assumptions about its low cost and high returns. Nevertheless, the rapidity of investment after 1985 suggests that many firms neglected to consider the sustainability of many projects and the risk of a market downturn.

Financial organisation

Financial deregulation in the Japanese banking system and a loosening of monetary policy in Japan after 1985 contributed to the Japanese 'land bubble'. In addition, Japanese banks and other financial institutions sought to maintain growth rates, in a period of reduced demand for funds by the manufacturing sector, by increased lending to the real estate and construction sectors. Such loans were increasingly made to small and medium-sized firms within these industries (Noguchi 1993 p. 38). Using the appreciating value of their real estate collateral, either existing or to be developed, realtors and contractors within these sectors were able to borrow to expand their development and investment activities, both in Japan and overseas.

The international expansion of Japanese banks and other institutions, which facilitated the rapid growth of FDI in real estate, was also influenced by deterioration in prudent lending standards during the period of the asset bubble. In its survey of the credit risk management of Japanese financial institutions, the Bank of Japan (1991: 10) found that

> under the long-term monetary easing conducted throughout the 1980s, credit analysis and risk management systems were, in some cases, insufficient because the credit analysis section was dominated by the loan promotions section and as a result, its monitoring function was weakened. Further, the tracking of funds usage and the analysis of borrowers' repayment ability were given little weight since financial institutions extended loans relying mainly on collateral, such as stocks and land, which was overoptimistically valued during the era of sharply rising markets.

Access to funding was *particularly* important for Japanese FDI in real estate and this became evident when government restrictions on lending for real estate investment were imposed in the 1990s and land prices began to decline despite the continuation of low interest rates. After

the imposition of official limits on further lending to real estate in April 1990, funding continued for some time through the non-bank subsidiaries of Japanese banks, but many real estate and construction firms became bankrupt as both domestic and overseas land prices fell.

The international expansion of Japanese banks in the 1980s facilitated the rapid expansion of Japanese lending for overseas real estate investment, which was often heavily leveraged, although institutional investment was equity based, using premium income. Subsidiaries of real estate investors contributed most investment funds (MOC 1994: 5). Debt of the subsidiaries was typically guaranteed by the parent company, based on its real estate holdings in Japan (Mead, 1990: 4).

Syndication of real estate investment

The syndication of real estate ownership of overseas offices and hotels into smaller units of ownership was a method of effectively changing the *nature* of investment, from direct to indirect. Syndication was generally not permitted in Japan in the 1980s, under Ministry of Finance regulations, but was possible for overseas real estate investments (FAIR 1990). Initially, syndications of overseas office buildings and hotels were designed for individuals with a very high net worth, but by 1987 the smaller size of syndicated units attracted smaller investors in Japan (Institutional Investor January 1988).

Widespread advertising of syndicated properties was prevalent in Japanese newspapers and magazines after 1987 and the spread of US real estate franchises to Japan in the 1980s created a sales network for overseas property. The Century 21 Real Estate Corporation, for example, was franchised as 'Century 21 of Japan' in 1984 and by the end of the decade had developed 245 franchised offices in Tokyo alone (Mead 1990).

To overcome domestic restrictions, Nomura Securities and others securitised real estate assets outside Japan and then sold shares and debt instruments to the holding company. In the United States, partnership structures were also used; Figure 4 provides details of the indirect acquisition through a partnership or syndicated unit trust of an office building by Nomura Real Estate in 1989. Syndication was characterised by a high level of borrowing relative to equity, with investors often taking a 50 per cent loan in the United States and then raising equity through low-interest loans in Japan based on domestic real estate holdings (Brasch 1990).

Figure 4 illustrates differences between the direct acquisition of foreign real estate by an investor and an indirect acquisition through a unit trust or partnership. In the former investment the investor has direct ownership and control, but in the latter ownership is diluted into numerous units and management is delegated to a management company. The limited partnership structure aimed to preserve tax benefits, such as depreciation, transaction costs and deductible interest, for investors in Japan.

Joint ventures

Japanese real estate investors initially followed a cautious strategy of forming associations with overseas real estate, legal and financial companies with local or international expertise. Larger Japanese real estate companies and institutional investors, such as life insurance companies, established capital participation, contractual arrangements or joint ventures to obtain greater knowledge about foreign real estate markets, particularly in the United States. In later projects Japanese investors increasingly developed real estate in the United States and Australia without an end-user, or local equity partner, and retained ownership in the developments after their completion.

Foreign partners or associates transferred knowledge to Japanese investors, such as financial techniques to establish real estate investment trusts or REITs. Under this arrangement, an investor acquires a property, such as a New York office building and then sells unit shares to smaller investors. The initial investor then acts as an overall manager of the building, although management is delegated to local real estate companies. Major Japanese real estate acquisitions, such as the Mitsubishi Estate's acquisition of the Rockefeller Centre office building portfolio, were financed in this way. Similarly, a joint venture between Goldman Sachs and Daiwa Securities allowed large-scale real estate investments in the United States to be securitised in Japan through Daiwa's domestic retail network.

As a result of such capital participation agreements and joint ventures, entry to foreign real estate markets became much simpler even for small Japanese investors (Mitchell and Murai 1989 p. 127). The *requirement* for investors to have proprietary advantages to overcome higher host country costs and entry barriers (Dunning 1993) therefore became less relevant. For investors in Japan there were few apparent barriers to entry or exit and the industry was

therefore relatively 'simple' in nature (Caves 1994). The nature of investment is now examined using case studies.

Case studies

The bubble economy in Japan clearly had a significant impact on the financial and strategic motivations for Japanese foreign real estate investment and divestment between 1985 and 1994. In effect, bubble shaped the pattern of investment, through its influence on both the organisational structure of FDI and the motivations of investors. To further substantiate this point, the following case studies examine the major categories of investors and the corporate and financial organisation of FDI activity.

The dichotomy between financial and strategic real estate FDI is distinguished by the disparate motivations of real estate investors (speculators or strategists) and the two forms of ownership adopted (owners and owner-managers). The range of Japanese firms and individuals which invested in foreign real estate in this decade are grouped into four major categories, according to the orientation of their investments: integrated contractors, international realtors, tourism entrepreneurs and institutional investors. The activities of owners or owner-managers within categories of firms with similar characteristics are then assessed and contrasted.

The case studies illustrate the linkages between the direct or indirect motivations of investors, their active or passive organisational structure and the likelihood of divestment. In the selection of case studies the focus is on large-scale investors, accounting for a large share of total investment – for example, the tourist entrepreneur EIE International had an overseas property portfolio exceeding US$10 billion in 1990. The international experience and the corporate strategy of these firms is representative of the overall pattern of Japanese real estate FDI because of the scale of their cumulative investments.

Integrated developers such as Kumagai, Shimizu and Aoki, and international realtors such as Mitsubishi Estate, Mitsui Real Estate Development and Shuwa, each accumulated foreign real estate assets worth over US$3 billion by the end of the 1980s. Typically, these large investors did not actively manage their newly acquired overseas portfolios, in contrast to firms such as Daikyo, which established a tourism entrepot in Cairns, with a complex layer of management involvement. The firm also borrowed heavily to fund its activities in Australia.

The scale and duration of Japanese investment in foreign real estate was often linked to changing financial conditions in Japan. Many investors accepted low yields in anticipation of capital gains and were vulnerable to lower international real estate prices and domestic restrictions on further real estate lending. By the 1990s a large number of investors found their overseas portfolios financially unsustainable, without continuing support from Japanese lenders or a firm-specific advantage to exploit and were forced to divest. The assessment of the relative importance of financial and strategic real estate FDI in the four investor categories seeks to further clarify the character of Japanese real estate FDI and divestment and determine the relevance of the firm-specific theory of FDI in explaining this form of investment.

Integrated contractors

Prior to 1985, many Japanese construction firms had established international operations, especially in civil engineering operations in the Middle East and Asia (OCAJ 1990). Subsequently, these markets began to decline, partly due to a decrease in orders after the appreciation of the yen (*Japan Economic Journal* 21 September 1985). As a result, Japanese contractors became more active in Oceania and in the United States (International Construction Week December 1985).[4] High land costs in Japan and the greater ease of funding development also encouraged other Japanese construction firms to expand overseas (MOC 1993).

In the United States, Australia and Europe, the rise in Japanese FDI created new opportunities for construction orders.[5] Shimizu America, for example, constructed Sharp's headquarters building in New Jersey and an assembly plant in Oregon for Fujitsu America, while Ohbayashi built a Georgetown Toyota plant for US$800 million. Like other Japanese contractors, Shimizu acted as project manager in new overseas developments and delegated actual construction to local firms (Levy 1990: 105). To facilitate its overseas expansion, in 1987 Shimizu became the first Japanese contractor to invest in a construction firm in the United States, when it acquired a minority share in Dillingham Construction in California. It then established Shimizu Land Development (real estate development), Shimizu Equities (building information and venture capital investment) and Shimizu Development (hotel investments) (Toyo Keizai Shinposha 1995).

In the second half of the 1980s, an increasing number of Japanese construction firms sought to be 'integrated contractors' in their overseas operations, by becoming project managers or joint venture partners of foreign real estate developments and then retaining ownership after completion (OCAJ 1990). Under the 'integrated developer' strategy, Japanese contractors began to handle planning, developing, financing, construction and ownership of a project. Partnerships were often formed between contractors, trading firms and financial institutions, with the latter two partners providing information and financial expertise (Leventhal 1990).

Seeking foreign construction and development work, Japanese firms embraced the role of project developers and financiers, and sub-contracted construction to local firms (Walkley 1994). In adopting this strategy Japanese contractors typically needed to borrow heavily to fund both development and retained ownership.[6] Compared with local firms these investors held a financial advantage because of their access to funding, for real estate development (Rimmer and Black 1986; Edgington 1990). The sharp divergence in Japanese interest rates, compared with those in the United States and Australia, during the late 1980s, also meant that Japanese firms had access to lower cost home country funding.

The overseas strategy of Japanese integrated developers differed sharply from their activities in Japan. Domestically, their activities consisted primarily of building and civil engineering services for clients and estate operations were comparatively small and ownership was not retained (Table 8). For overseas operations, project management and financing became more central, while building and civil engineering were delegated to local firms. Construction firms increasingly developed major new foreign projects in which they retained ownership (OCAJ 1990; Walkley 1994).

While, initially, Japanese contractors enjoyed short-term financial advantages in bidding for development sites and funding their development, the existence of significant lags between the commencement and completion of major projects also made developers vulnerable to a cyclical downturn in prices, or changed credit conditions (Goldberg 1994 p. 256). The Ministry of Finance restrictions on real estate investment of April 1990 led to many integrated contractors becoming financially over-extended and unable to maintain their overseas portfolios.

Table 8 Structure of the construction industry, selected firms, 1989

Construction firm	Business Operations in Japan, % and ¥billion				
	Building	Civil engineering	Real estate	Total sales (¥billion)	Overseas ratio
Taisei	70	26	4	1,430	7
Ohbayashi	69	24	7	945	9
Shimizu	80	16	4	1,255	4
Kajima	65	31	4	1,241	2
Mitsui	61	32	7	414	3
Sumitomo	56	42	2	271	3
Nakanogumi	88	8	4	74	19
Hazama	62	36	2	520	11
Tokyu	71	27	2	450	5
Kumagai	68	30	2	452	11
Aoki	35	45	20	282	20
Penta Ocean	35	63	2	355	`9

Note: Overseas ratio refers to overseas share of all firm activities to total turnover.

Source: Toyo Keizai, *Japan Company Handbook*, *First Section*, 1989.

In the field of construction, many Japanese contractors had extensive experience and technical knowhow, but few Japanese contractors had experience of domestic or international real estate ownership or management, despite their expertise in the development phase. Likewise, integrated developers did not have experience of the cyclical nature of international real estate markets and were vulnerable to the reversal of fortune, which ensued. A number of case studies will now be considered: Kumagai Gumi, Aoki Kensetsu and Kajima Corporation, which are representative of the overseas real estate development and ownership strategy of Japanese construction firms after 1985.

Kumagai Gumi: a type I owner and integrated developer

In the 1980s Kumagai operated actively as an international contractor, particularly in civil engineering projects. In this period the construction firm also became a major Japanese investor in foreign real estate, by financing its own office, hotel and other developments. Kumagai altered its strategy of developing projects for pre-arranged clients and began to

develop projects in the United Kingdom, the United States and Australia so as to become an 'integrated developer', retaining ownership after completion.

> Kumagai Gumi's management assessed that, as a foreign company, its best chance of gaining participation in choice local construction projects was to do something it had never done before - becoming a developer, and virtually a banker. Kumagai Gumi used its strengths, an ability to provide finance, as the door-key to target some leading Australian property developers in major projects. While this cast the company in an unfamiliar role (it had previously been almost exclusively a contractor), it allowed Kumagai to develop its own projects rather than tender for work against local groups... (Kumagai 1990 p. 2)

In a period of rising property values up to 1990, Kumagai guaranteed project finance and sub-contracted construction to local firms and accepted low profits to accelerate its international expansion. The management of the firm's real estate developments was typically sub-contracted to local firms. Kumagai Gumi's strategy of development and passive ownership encompassed both hotel/resort projects, such as the Loews Coronado Bay Resort and the Hyatt Regency Waikoloa Resort in Hawaii, and office and retail projects, such as Melbourne Central.

The second phase of Kumagai's expansion in Australia involved participation in major commercial and engineering developments. A significant degree of project finance was involved in Kumagai's type I integrated developer' corporate strategy, which left the firm vulnerable to credit restrictions in Japan and a cyclical decline in foreign real estate markets. A number of major projects were not completed when property capital values began to fall after 1990 – for example construction of the 222 Exhibition Street office tower development in Melbourne took from 1984 to 1989.

By 1990 Kumagai Australia was involved in projects worth over $3 billion, although shareholder funds were only $100 million, and the company was committed to retaining a number of its larger property development projects on completion. At the end of the decade, Kumagai had retained a total property portfolio valued at $12 billion in Australia, the US and the UK (*Australian Financial Review* 3 June 1993). The main flaw in Kumagai's strategy as an integrated developer was a highly leveraged reliance on debt finance in a very cyclical

market. Few of its infrastructure or real estate developments were profitable in the short term (Walkley 1994).

Kumagai adopted an inflexible strategy of retaining ownership of its developments despite a market downturn. The developer did not have proprietary assets relevant to the active utilisation of its foreign property portfolio. As the yield on its stock of retained properties was falling and vacancy rates in the United States and Australia began to climb in the 1990s, Kumagai was exposed to restrictions on real estate finance in Japan and falling domestic and overseas real estate prices. The contractor gambled on capital gains to sustain its 'integrated developer' strategy, but incurred large capital losses when Japanese demand for foreign real estate began to ebb after 1990.

Aoki construction: from owner-manager to type I integrated developer

Aoki Construction is a medium-sized Osaka-based construction firm centred on civil engineering, which ranked about 20th in size among general construction firms in Japan in 1990. The firm is not a member of a traditional construction industry group in Japan and was excluded from large domestic projects because of its size and rank. In a 1989 interview, the chairman of Aoki Corporation, Mr Hiroyoshi Aoki, emphasised the problems Aoki faced as a relative newcomer to the Japanese construction industry and the importance of establishing a track record to obtain access to major projects in Japan (*Tokyo Business Today* August 1989).

As a result, the firm pursued a strategy of 'the two pillars of construction and hotels', to diversify its operations and also to create business for its construction arm. In 1976 Aoki diversified into the hotel industry by acquiring the Caesar Park Hotel in Brazil and then expanded Caesar Park into a chain of nine hotels in Brazil, Panama, New York and Taiwan, as well as developing golf and leisure facilities in South America. For the next decade Aoki owned and operated this chain of hotels but did not expand further (Toyo Keizai Shinposha 1992).

In the easy money environment of the 1980s, Aoki adopted an international strategy of debt-financed expansion. With the support of the Industrial Bank of Japan (IBJ) and Kyowa Bank, Aoki began to acquire and develop overseas hotels, as a means of diversification and so as to participate in foreign construction projects. The speed and scale of this debt-funded expansion meant Aoki could not directly manage its new portfolio of hotels and was, in effect, a passive investor.

Aoki began its expansion in 1988 with the acquisition of the Westin hotel group in the United States for US$1.5 billion. The company thereby gained control of a hotel chain with 65 sites in 10 countries. In 1989 Aoki announced plans to double the number of hotels in the Westin chain in a decade, began to develop a joint venture hotel and resort in Shanghai for US$60 million, and planned a US$200 million resort project in Cancun, Mexico. Aoki constructed two hotels at Disney World in Florida and formed a joint venture with a US construction firm to build two Westin hotels in Japan (Daggett 1991).

The overseas expansion of Aoki was encouraged by its main bank in Japan, but was heavily dependent on continued bank finance. Aoki increased sales and net income from US$1.1 billion to US$3 billion in 1990, but net income rose less rapidly, from US$30 million in 1988 to US$59 million in 1990. Aoki's low ratio of net income to sales, of 1.7 per cent in 1990, stemmed from the high level of borrowings used to fund overseas expansion and by 1991 net income declined by 60 per cent to US$26 million, due to losses incurred by the Westin chain. Bank finance was also constrained by MOF controls from April 1990 and the need for Japanese banks to restructure their balance sheets (*Nikkei Keizai Shimbun* 3 May 1991).

Aoki was therefore forced to consider divestiture of its foreign real estate portfolio. In November 1994, Aoki Corporation sold the Westin Hotel Company for US$561 million, but retained ownership of a number of hotels. Then, in May 1995 Aoki announced that it would sell 70 per cent of its remaining 28 Westin hotels for US$1.2 billion by the year 2000, thereby abandoning its strategy of international hotel development and ownership (*Australian Financial Review* 16 May 1995).

Aoki's corporate strategy of type I debt-funded international acquisitions in the 1980s differed markedly from its earlier and slower type II phase of expansion. The key difference between the two periods was the ease with which FDI could be financed, particularly as Japanese banks and non-banks willingly lent to real estate developers during the bubble period (Bank of Japan 1991). In the 1980s Aoki was unable to integrate its newer hotel acquisitions successfully with its existing real estate and hotel management activities before its access to finance diminished.

Kajima Corporation: a strategy of type I integrated development

Kajima followed the 'integrated developer' strategy adopted by earlier investors, such as Kumagai Gumi, in the late 1980s. One of the world's largest construction firms, Kajima formed joint ventures with local construction firms to develop a range of office, hotel and retail

property and it retained ownership. By 1990 Kajima had accumulated a real estate portfolio valued at $1.5 billion in Australia (*The Australian* 26 November 1994).

When the Australian property market began to decline at the end of the 1980s, Kajima was still developing a range of medium to large-sized projects, which subsequently fell sharply in value. In a joint venture with Costain, an Australian contractor, Kajima had acquired derelict sites at Riverside Quay in Melbourne and developed a 10-storey office building, which was completed in the early 1990s and then sold at a significant loss in 1994. Similarly, Kajima was a joint venture partner in the development of the $400 million Perth QVI office complex, but suffered a significant loss when it was sold in 1991 for $340 million (*The Australian* 9 January 1995).

Similarly, Kajima developed the Park Lane Grand Hotel in Sydney in the early 1990s, at a cost of A$650 million. Austcorp Hotels and Park Lane International were appointed as managers so that Kajima was a passive investor. By the time of its completion and opening in 1993, the 561-room hotel had already fallen in value. Kajima acted to remove the hotel managers and the hotel was subsequently sold to ITT Sheraton Corporation for A$310 million in July 1994 (*Australian Financial Review* 16 March 1995). Similarly, Kajima developed the Century Radisson Hotel, managed by Southern Pacific Hotels Corporation, costing over A$90 million in 1990, but sold for A$42 million in 1993. The Metro Inn in Sydney's Darling Harbour was developed by Kajima after 1990 at a cost of A$80 million, but was then sold to a Singapore firm for A$36 million in 1993.

In 1992 Kajima wrote off losses of about ¥70 billion off its ¥110 billion property investment in Australia and its chief executive officer, Dr Shoichi Kajima, announced the re-organisation of the firm into four divisions: construction, design, development and new businesses. As part of the re-organisation, all of Kajima's overseas real estate holdings were liquidated and the company abandoned the integrated developer strategy of project financing and the retention of ownership of its developments (*Australian Financial Review* 11 August 1992).

Kajima's energetic diversification as an 'integrated developer' failed because of its over-commitment to building large-scale offices and hotels at the peak of foreign property markets. The firm used a high level of debt financing to expand into real estate ownership and leasing and this considerably increased interest costs and exposure to a falling market. Kajima's optimism that real estate prices in Australia and the United States would continue to rise led to large capital losses when the reverse development occurred. High debt also reduced

flexibility, since Kajima was virtually forced by its bankers in Japan to divest its overseas property holdings at the lowest point in the property cycle in Australia.

For integrated contractors, a short-term capacity to fund ownership and development of foreign real estate projects was a major factor in their adoption of this approach, together with forecasts of increasing Japanese demand for foreign property. Firms were able to pursue major projects, without clear cost constraints, without a contractual agreement with specific clients, thereby speculating that prices would continue to rise. The erosion of financing advantages and falling prices after 1990 made these type I investments unsustainable.

International realtors

A range of large to small Japanese real estate firms developed or acquired international real estate, with the intention of retaining ownership and leasing in the long term or selling to other investors in Japan. Large realtors in Japan acquired or developed large office buildings in major overseas cities or hotels and resort complexes in tourist destinations. Spurred on by the enthusiastic support of domestic financial institutions and rising property values in Japan after 1985, realtors increasingly retained ownership in anticipation of capital gains and heightened demand for foreign real estate.

After 1985 Japanese real estate firms made acquisitions or pursued developments at a high cost relative to other investors. Large real estate companies in Japan competed in a quest to obtain prestigious overseas trophy buildings. Small and medium real estate companies in Japan also participated in the acquisition or development of hotels, resorts and office buildings in other countries.

High prices in Japan led many investors to over-bid for foreign real estate and ignore actual yields because of emphasis on the apparently inexpensive cost of these assets compared with similar land or buildings in Japan. Rivalry between major realtors, such as Mitsui, Mitsubishi and Sumitomo, also led to over-bidding, with the successful investor accepting a low yield as the price of owning a famous or prestigious landmark building, such as the Exxon building, headquarters to one of the world's largest corporations.

The acquisition by Mitsubishi Estate of the famous Rockefeller Center and the Daiichi America Real Estate acquisition of the Tiffany building were made at above-market prices. Similarly, the Minoru Isutani purchase of the Pebble Beach golf resorts was made at a price far above that justified by its earning capacity and relied on the sale of golf memberships to

Japanese investors, for up to US$700,000 per member.[7] After speculation in Japan over the price of golf memberships burst in 1990, it became clear that Isutani's investment in Pebble Beach was unsustainable.

Firms in other industries established real estate subsidiaries in Japan and overseas, with the aim of reaping additional profits and capital gains from real estate transactions.[8] The relative ease of entry also encouraged a wave of firms in other industries to diversify into the real estate industry (Bank of Japan 1991). The bias of Japanese lending institutions towards property also stimulated real estate FDI.

Prevailing *expectations* of continually rising land prices encouraged many firms to invest or develop overseas office, hotel/resort or residential projects. Constraints on expansion in the domestic market also stimulated Japanese realtors to expand overseas. The lower foreign price of condominiums, land and other real estate drew smaller investors unable to buy in Japan. Realtors in Japan acquired a stock of foreign property to sell to Japanese investors or to lease to other firms. The main activities of Japanese realtors were the sale or leasing of property and this also motivated them to acquire foreign real estate (Table 9).

Table 9 Structure of the Japanese real estate industry, major firms, 1989

Company	Revenue in Japan			Overseas investments
	Real Estate leasing (%)	Real Estate sales (%)	Total sales (¥ billion)	
Mitsui Real Estate	29	55	470	US, UK
Mitsubishi Estate	64	20	274	US,UK
Sumitomo Realty	47	49	146	US,UK, Australia
Daibiru	95	0	na	–
Sankei Building	93	0	7	US
Tokyo Construction	90	0	13	–
Tokyu Land	16	75	163	US, Australia
Towa Real Estate	8	84	128	–
Daikyo	2	98	218	Australia
Heiwa Real Estate	61	38	16	US
Tokyo Tatemono	45	49	50	US
Osaka Building	92	8	13	US
Hankyu Realty	41	58	25	–
Keihanshin Realty	61	39	10	–

Source: Toyo Keizai, *Japan Company Handbook*, First Section, 1989, and author's database.

The acquisition of foreign real estate by Japanese realtors was essentially passive in nature. Even the largest realtors, such as Mitsui or Mitsubishi, had few resources to manage international hotels or offices and established only small overseas representative offices. The role of subsidiaries in brokering sales of real estate, or in leasing office space or resort accommodation, was not extensive and the head office of the parent company directly controlled marketing and sales.

In the case of Japanese FDI in Australian real estate, less than 100 Japanese personnel indirectly managed an investment of over $20 billion in 1990 (AJEI 1996; Farrell 1994). International realtors were owners and not owner-managers. This pattern is now illustrated for the cases of Mitsui Real Estate, Mitsubishi Estate and Shuwa Corporation.

Mitsui Real Estate: a strategy of type I international office ownership

Mitsui Real Estate is one of the largest developers of office, commercial and residential property in Japan and built up overseas real estate holdings of about ¥250 billion by 1990. Mitsui begun to acquire and develop real estate outside Japan after 1972, when the Japanese Government lifted restrictions on international real estate FDI by Japanese residents. In 1979 Mitsui Fudosan acquired French and US properties as long-term investments and an UK property in 1983. But until 1985 it had significant experience of the development and ownership of foreign real estate, especially office buildings, but had not yet made a major acquisition (Mitsui Real Estate Development 1990).

In some of these transactions, Mitsui Real Estate developed properties for other clients, in some it retained ownership of projects and in some it acquired office buildings, acting as a broker, for Japanese institutional investors. In 1987, for example, the company purchased the Demonet building in Washington D.C. and the Bedminster building in New Jersey and sold these to Japanese institutional investors. Falling prices for foreign real estate, in terms of yen, encouraged Mitsui to also retain ownership in properties, such as the New York Exxon Building.

Analogously with the integrated developer strategy, Japanese realtors borrowed extensively to retain ownership of foreign buildings they would otherwise have merely acquired on behalf of another Japanese client, such as a life insurance company. In this way, firms such as Mitsui emerged as international realtors:

> Operating in the US for well over a decade, Mitsui has increasingly expanded on its earlier strategy to include a more complicated role along with ownership. While this means a considerably higher risk for the company, Mitsui sees it as an opportunity to realise greater intrinsic and financial rewards…in properties overseas as a means of business expansion and asset portfolio diversification. As in its domestic operations, Mitsui Real Estate seeks long term business and investment opportunities rather than short-term capital gains (Hamaoka 1990).

The motivation of Mitsui Real Estate was to diversify its portfolio of investment assets by investing in foreign real estate. The rapid fall in the yen price of these assets led to a lack of prudence exemplified in the willingness of Japanese to over-bid for foreign 'trophy' buildings. Acquisition of the prestigious Exxon Building in 1987, for example, is estimated to have been at US$200 million above the market price. This acquisition inspired Mitsubishi and Sumitomo, to acquire comparable landmark buildings (Rall 1995).

Mitsubishi Estate: a strategy of type I office ownership

Mitsubishi Estate has one of Japan's largest portfolios of office buildings in Japan, with an estimated US$40 billion in domestic property assets.[9] The firm relies on the management and leasing of its large property portfolio as its main business activity.[10] The acquisition of overseas properties, typically major central office complexes, was intended to be an extension of the company's domestic strategy of long-term ownership and leasing of real estate. In practice, the limited international management resources of Mitsubishi led to the appointment of local realtors as managers of its foreign assets (Mitsubishi Estate 1991).

Mitsubishi came into international prominence in 1989 when it acquired the Rockefeller Center and ownership of 14 major office buildings in New York, as well as entertainment facilities and telecommunications businesses. The firm incurred widespread criticism in the United States over its purchase of this national symbol (Mead 1990). The acquisition of the Rockefeller Centre, the major office complex in central New York, involved a US$1.3 billion mortgage on twelve of the Center's buildings, which was held by a real estate investment trust (REIT).

Through this securitisation process, other investors in Japan were able to share in the ownership of the building, while Mitsubishi remained the major owner. Unit trust owners also shared in the risks associated with the over-heated New York property market. At the time of acquisition, the Rockefeller Center appeared inexpensive compared to property values in Japan, but Mitsubishi accepted a very low yield to acquire the portfolio of New York office buildings – so that rental earnings were insufficient to cover interest costs. In 1992, after a slump in US real estate values, an appraisal revealed that the Center's buildings were worth only US$1.2 billion.

In 1994 the Rockefeller Center's value slumped further when 40 per cent of its leases came up for renewal, resulting in lower than forecast rental revenue. A study by the US Securities and Exchange Commission suggested that Mitsubishi Estate had lost US$517 million over the period 1985 to 1994. The Commission noted that the subsidiary's cash-flow problems: 'raise substantial doubts about the borrower's ability to continue as a going concern' due to the gap of US$460 million between rental income and mortgage payments (*New York Post* 11 May 1995).

In May 1995, Mitsubishi Estate announced that it would enter bankruptcy in order to restructure its US$1.3 billion mortgage. In September 1995 the firm stated that it would give up ownership of the Rockefeller Centre, by allowing a foreclosure and transfer of ownership to the subsidiary company, Rockefeller Centre Properties, the Center's mortgagor (Australian 14 September 1995). Mitsubishi Estate's total losses on its investment in the Rockefeller Centre are estimated to have exceeded US$2 billion. These include a write-off of the total original investment of US$1.3 billion and subsequent expenditures, which can be added to Mitsubishi's operating losses over the period from 1989 to 1995 of US$603 million, together with a US$200 million tax liability in the United States. In order to avoid further investments in the Rockefeller Centre, Mitsubishi decided to terminate its investment (*Australian Financial Review*, 13 September 1995).

Shuwa Corporation: a strategy of type I office ownership

Through a strategy of debt-funded acquisition, Shuwa, a major Japanese real estate firm, had by 1988 accumulated a real estate portfolio valued at US$10 billion, with rental income of US$160 million and a yield of only 1.6 per cent. Its acquisition of high-profile real estate assets in the United States, including Arco Plaza in Los Angeles and the ABC building in New York,

was firmly guided by its president, Mr Shigeru Kobayashi, and was characterised by purchases at prices well above market expectations (Meyers 1988, p. 138).

Shuwa Corporation acquired over 35 major office buildings in the United States in the two years from 1986 to 1988, using borrowings of US$2.5 billion.[11] Availability of finance allowed a type I expansion of real estate FDI and Shuwa acquired ownership but delegated management to local realtors, such as Cushman & Wakeman and Tishman-West (Meyers 1987). The company's rapid overseas expansion was strongly influenced by the speculative valuation of real estate in Japan, which was premised on low yields and a continually rising market. The motivation in assembling this real estate portfolio was to achieve both rental income and capital appreciation, but Shuwa neglected the need for yields to cover interest costs. In the 1990s, changing financial conditions made Shuwa's speculative investments unsustainable.

Many other Japanese realtors followed a path similar to that of these three case studies, in terms of their corporate and financial organisation. Investment behaviour was often influenced by non-strategic motivations, such as access to finance and the speculative acceptance of low yields, through the anticipation of capital gains. Even the largest realtors, such as Mitsui or Mitsubishi, did not have sufficient management resources or international experience to emerge as owner-managers of their overseas portfolios, which closely resembled indirect investment.

Tourism entrepreneurs

Tourism entrepreneurs acquired or developed hotels and resorts, particularly to meet the needs of Japanese overseas travelers. Increasingly after 1985, Japanese investors recognised the need to provide high-quality accommodation for the rapidly expanding number of Japanese business people and tourists travelling offshore. Initially, hotel and resort construction or acquisition centred on traditionally popular destinations, such as Guam and Hawaii (Table 10).

Activity then expanded to newer locations in the United States and Australia, with a focus on integrated resorts, including hotels, resort facilities, golf courses and condominiums (*Tokyo Business Today*, September 1989). This expanded infrastructure extended the scope for Japanese tourists to travel around the pacific region and stay at high-quality hotels and

Table 10 Japanese departures by travel purpose and destination **('000)**

Year	Purpose			Major Destination					
	Business	Tourism	Total	Hawaii	Guam	Total US	Hong Kong	Singapore	Australia
1975	349	2,027	2,466	420	84	746	383	119	na
1980	483	3,269	3,909	568	212	1,125	466	299	49
1983	545	3,498	4,232	729	294	1,283	494	381	54
1984	631	3,816	4,659	816	301	1,415	584	369	60
1985	697	4,024	4,948	855	302	1,496	636	378	72
1986	756	4,506	5,516	944	332	1,681	727	404	88
1987	879	5,642	6,829	1,161	413	2,128	1,034	541	106
1988	1,025	7,028	8,427	1,358	494	2,542	1,240	682	146
1989	1,112	8,107	9,663	1,319	556	3,080	1,176	841	216
1990	1,443	9,085	10,997	1,440	638	3,231	1,332	972	352
1991	1,470	8,701	10,634	1,385	582	3,320	1,260	871	350
1992	1,477	9,842	11,791	1,637	677	3,653	1,324	1,001	480
1993	1,500	9,954	11,934	1,592	549	3,543	1,281	1,001	529

Note: na not available.

Source: Ministry of Transport, *National Transportation Statistics Handbook*, 1995.

resorts, which were typically managed by Nikko, Hilton or Hyatt. After 1986 the scale of investment projects increased significantly and in 1988 alone there were a total of 17 new projects worth over ¥10 billion. Many investors anticipated capital gains from their investment in tourism infrastructure, as had occurred during the leisure boom in Japan, particularly after the *Resort Law* of 1987.

A significant concentration of large-scale projects occurred in Hawaii, but the regions targeted for resort development diversified to mainland cities in the United States and Europe and resort areas in Australia. Newer investors also emerged, often with no historical link with the hotel or leisure industry in Japan, but drawn by joint ventures with construction firms, their access to finance and the anticipation of rising prices for international real estate. In Australia, many Japanese investors did not have other tourism interests (Forsyth and Dwyer 1991). They were nevertheless encouraged by the growth in overseas tourism, due to the lower yen cost of travel and by the keenness of financiers in Japan to lend for foreign real estate investment.

Inevitably, many such investors took a passive approach to hotel or resort management. In most hotel acquisitions, including those by Japanese investors, management and ownership were distinctly separated. Notably, specialist Japanese hotel-managers, such as Nikko Hotels or Pan-Pacific Hotels, did not directly acquire hotels to manage, but managed the acquisitions of others. The development of type II tourism FDI, involving investor management and control, occurred comparatively rarely. In terms of day-to-day management control of a hotel or office building lies with its manager, such as international hotel operators. Typically, specific management agreements are entered into between the owner and the manager, which give the manager responsibility for all operations of the hotel such as international booking networks, staffing and profit (Dunning 1982).

The Japanese hotel and travel industry, which is typically affiliated with airline or other travel companies, generally did not use FDI to acquire real estate to assist its expansion, despite its firm-specific tourism advantages. In Australia, for example, there was not a single example of a Japanese travel agency or related travel group acquiring tourist real estate until 1995 (*Australian Financial Review*, 10 November 1995).

Tourism entrepreneurs vary from type I investors such as EIE International and Seibu Saison, which passively acquired a large collection of overseas properties through easy access to bank lending and type II investors such as Daikyo, JAL and ANA, which established management control over their foreign tourism operations and used their knowledge of the Japanese tourism and travel market. These five firms are surveyed because their experience is representative of other investors.

There is also some doubt over the boundaries between type I and type II tourism FDI since the extent of management control was often heavily dependent upon a contracting-out of functions, as with JAL and ANA, for example. The cases of EIE and Seibu Saison are more clear-cut, since all management functions were delegated to other firms and the firms had no prior experience of domestic or international hotel or resort ownership or management.

EIE International: a strategy of type I hotel and resort ownership

First established as a small Tokyo electronics firm, EIE International expanded rapidly in the second half of the 1980s to become the largest Japanese property investor in Oceania, acquiring a vast portfolio of hotels, resorts, office buildings, development projects and other assets (Rowley 1992). Its international property portfolio focused on tourist-related resorts

and hotels, as well as some office properties, and was valued at US$15 billion at the peak of world property markets.

EIE was able to acquire its international real estate portfolio despite complete inexperience in the field of hotel/resort ownership or management. The firm received seemingly unlimited financial support from its financial institutions in Japan. There was little prudent assessment of these investments. The president of EIE International, Mr Harunori Takahashi, referred to the 1980s as: 'a once in a lifetime opportunity' for investment. Mr Takahashi traveled around Australia, Fiji and New Zealand on a private Boeing 727 with a number of advisers and rapidly purchased a large property portfolio (Hartcher 1995). A significant number of acquisitions were securitised and other major Japanese financial and industrial institutions contributed to loans for the company, such as Mitsui, Nissan, Nippon Steel, Toshiba and Taisei Corporation (Hills 1995).

The firm's expansion was totally debt-funded and launched in response to the ease of finance and the low price of overseas real estate assets, in yen terms.[12] By the next decade, falling property prices in Japan and overseas had severely affected EIE's equity position and long-term viability. Restraints on the financing of real estate investment led to a crisis in 1991 (Rowley 1992). In mid-1992, EIEs bankers agreed to forego interest payments on loans of US$10 billion and EIEs main creditor, the Long-Term Credit Bank (LTCB), gave the firm three years to sell US$2 billion worth of property.

In July 1993 Japanese banks withdrew support for EIE International and decided to take effective control of the highly leveraged company when it refused to cooperate on a reconstruction plan (*Nihon Keizai Shimbun*, 3 November 1993). The LTCB planned to make a loss provision of ¥90 billion (total debts to EIE of ¥190 billion). It was reluctant to place EIE formally into bankruptcy, as the bank wanted the freedom to sell EIE's collaterised assets at its own convenience, not under court order (Australian Financial Review 12 July 1993). Subsequently it was revealed that the President of EIE had obtained further funding from the two Tokyo credit unions of which he was a director (*Japan Times*, 7 May 1996).

EIE's ease of access to financing was a key element in explaining its international expansion – as was the acceptance of low yields. The chief strategist of EIE, Dr Ishizaki has stated that: 'I do take a lot of responsibility and I have a lot of remorse for concentrating absolutely on capital gains-type investment and ignoring the ability to service debt. I did put EIE in the position when the bubble burst – and we could no longer just flip a property over and make a killing – that we couldn't service our debt. Our portfolio should have been more

balanced with cashflow. But in those days, talking about 6 per cent yields just wasn't in vogue. That was our big mistake, there's no doubt about it' (Hartcher 1995).

The company's ability to obtain funds was also linked to the political connections of Mr Takahashi who was even able to enter the Diet in 1994, despite the huge losses of EIE International (McGregor 1995). Given this background, the industrial organisation theory of FDI, which emphasises factors such as the exploitation of firm-specific proprietary advantages, appears to have little relevance in explaining the EIE case study.

Seibu Saison: a type I strategy of hotel and resort ownership

Seibu Saison, a major Japanese department store, purchased 60 per cent of the Inter-Continental Hotels chain from the UK firm Grand Metropolitan PLC in 1988. Saison generated nearly all of its US$25 billion (1987) revenues in Japan and has a portfolio of upscale department stores, supermarkets and restaurants as well as credit companies, travel agencies and hotels. Saison paid US$2.27 billion for the company's 100 international hotels – about 41 times the 1988 projected earnings for Inter-Continental – or a yield of only 2.5 per cent. This can be compared with the US$500 million paid by Grand Metropolitan in 1981 for the same asset. In 1992 Seibu Saison acquired the remaining 40 per cent share of Inter-Continental Hotels from Scandinavian Airlines Systems (*Japan Times* 7 March 1992).

Saison Corporation's acquisition of the Inter-Continental Hotels group was one of the largest Japanese acquisitions of tourist-related overseas real estate. It was financed through a letter of financial support from the Long-Term Credit Bank for US$2.15 billion and a loan of US$1.6 billion was then syndicated among 21 other Japanese banks. Saison had no experience of international hotel management when it acquired Inter-Continental and did not attempt to manage the organisation directly. This debt-funded acquisition put considerable pressure on the parent because of the size of interest payments and the capital losses incurred because of the decline in international property prices in the 1990s.

Daikyo Incorporated: a type II resort owner-manager

As Japan's leading condominium developer, Daikyo is an integrated real estate firm involved in real estate leasing, redevelopment, real estate brokerage, hotels and leisure facilities development, and housing-related services. To further diversify its operations in the 1980s,

Daikyo established 13 subsidiaries overseas and pursued the development of mixed resorts (golf, condominiums, hotels and resort facilities) in Hawaii, Cairns and the Australian Gold Coast (Daikyo Australia 1990).

In Australia, Daikyo first invested in real estate in 1972, but virtually all of its later acquisitions and developments were after 1985. It became the single largest foreign investor in the Queensland tourism market, particularly in Cairns. The firm was one of the first Japanese leisure companies to invest in Australia because of its political stability, economic prosperity, and similar time zone and opposite seasons. Daikyo became involved in the development of a number of large resorts, including the Green Island Resort, and Fitzroy Island, Lloyds Ships, Great Adventures, Daikyo Dolphins and the Clifton Beach Resort.

Daikyo sought to be an active owner-manager, but delegated hotel, resort and office management to specialists, such as Hilton and Sheraton. Its attempts to manage its tourism assets more closely have been hindered by the cost of servicing its interest repayments on its investment portfolio and a shortage of Japanese personnel to service its diverse real estate assets. In 1991 Daikyo abandoned plans to use its subsidiary, Matson Hotel Corporation, as the group's hotel management company, because of financial problems – the company had been established to manage the Daikyo-owned Matson Plaza Hotel in Cairns – with the long-term aim of managing Daikyo's entire international network of hotels. Hence, although Daikyo exercised control over its overseas subsidiaries, it initially had little expertise in international hotel management (Owen 1991).

Daikyo has been actively involved in the development and operation of its tourist operations in Queensland, particularly in Cairns, which has become a major entry point into Australia for Japanese tourists. Nevertheless, Daikyo's debt-funded acquisition and development of pacific rim tourism assets is in difficulties because of the high level of borrowing involved. In the 1990s Daikyo experienced large capital losses due to falling Japanese and international real estate prices. The company suspended a number of resort developments, such as the Palm Cove resort and the proposed Cannon Farm resort, because of financial problems (*The Australian* 15 January 1991).

Japan Airlines and all Nippon Airlines: type II hotel owner-managers

The rapid growth in the number of overseas travelers in the 1980s encouraged the major two Japanese airlines to expand their domestic network of travel and accommodation services

into overseas markets. Both firms aimed to offer integrated travel and accommodation packages to tourists and business people and to achieve economies from such integration. Japan Airlines (JAL) sought to achieve a high-quality standard through its hotel management subsidiary, Nikko Hotels, while All Nippon Airlines (ANA) also established a hotel management division to operate its chain of hotels.[13]

JAL pursued a strategy of developing and acquiring its own portfolio of hotels and resorts on its major route destinations, as well as in Japan, to become a larger international airline and to meet the travel and accommodation needs of the rapidly increasing number of Japanese international tourists. Until the mid-1980s JAL was the sole Japanese national carrier, but thereafter faced competition from ANA, which had formerly focused on travel within Japan. The rivalry between JAL and ANA in establishing overseas hotel and resort investments is illustrated in Figure 5.

The ANA Hotel Group is a subsidiary of ANA, which owns most of the 24 hotels it operates within Japan and the seven properties it operates overseas. ANA followed a strategy of establishing hotels in important destinations for Japanese tourists and diversified into international hotel management, in order to compete with JAL. Both airlines competed against each other for the burgeoning Japanese tourist market, by creating a network of high-quality hotels for their passengers. The strategy of using FDI to acquire international hotels allowed JAL and ANA to maintain quality control for its overseas hotels, although the extent of management was often limited by the scarcity of internationally experienced Japanese staff and the need to sub-contract to local firms.

Rivalry between the two carriers increased the momentum of acquisition, but the main phase of hotel investment occurred after 1985. A major influence was the declining price for international hotels, in terms of yen, and the willingness of Japanese financial institutions to support this debt-financed expansion. The narrowness of management base and the key role of finance suggest that real estate FDI by JAL and ANA was not clearly either type I or type II in character.

The high cost of servicing the debt incurred through this strategy caused both firms to slow down their expansion strategy in the 1990s. Despite the synergy of the hotel acquisitions with JAL and ANA's main business activities, the airlines incurred significant foreign exchange and property-related losses from the investments because of a high entry cost in a falling market (*Japan Times* 9 March 1995).

Institutional investors

Japanese institutional investors became attracted to overseas real estate in the 1980s after the freeing up of Ministry of Finance controls on foreign investment. These investors aimed to diversify their investment portfolios away from earthquake-prone areas of Japan and also sought higher returns on real estate investment than were available in Japan. Higher overseas property yields and the possibility of capital gains from office property in New York, London and other cities encouraged institutional investors to acquire major CBD buildings in these cities. The need of insurers to reap greater returns from premium income, in order to sustain higher returns for insurance products, was also a motivation for institutional FDI in real estate (Reier 1995).

Japanese institutional and other indirect investors had little experience of international property management and contracted management of their foreign property portfolios to local real estate companies. The international offices that were established by the institutional investors were comparatively small. Institutional investors were prohibited by the Ministry of Finance from borrowing to fund FDI and were less affected by the expansion of lending for real estate in Japan than other investors. [14]

Life insurance firms were major overseas investors in the 1980s and accounted for up to 60 per cent of total portfolio outflows from Japan over this period. These investors diversified by acquiring office buildings in major overseas cities. Traditionally, life insurance companies invested only in leased office buildings, but in the 1980s they began to diversify into other forms of real estate, such as hotels, shopping centres and department stores, both in Japan and overseas. They were required to give notice to the Ministry of Finance when purchasing property for more than ¥1 billion.[15]

Nippon Life Insurance pioneered the Japanese life insurance industry's entry into the overseas real estate market. In 1981 it acquired an interest in a Manhattan office building and in subsequent years accumulated a 'well-diversified' portfolio. Nippon Life had only 7 per cent of its assets located outside Japan and invested in foreign real estate to diversify its holdings (Nippon Life 1990). Following this lead, Sumitomo Life Insurance established Sumitomo Life Realty (NY) in 1982 to invest in real estate projects in major American cities; in 1988 it established Sumitomo Life Realty (UK); in 1989 Sumitomo Life Realty (Australia) and in 1990, Sumitomo Life Realty (France) (Sumitomo Life 1990).

Unlike most other investors, overseas real estate acquisitions by Japanese insurance companies were financed out of cash flow, from premium income, rather than from highly leveraged borrowings. Japanese life insurance sought higher yields from their acquisitions of established foreign office buildings, in response to low yields and the difficulty of realising capital gains in Japan – particularly as Article 86 of the Insurance Law prevents life insurance companies from distributing capital gains to policy holders (Kawaii 1991 p. 28). Overseas investment by insurance companies was essentially confined to the relatively large economies of the United States and Western Europe. Japanese insurance companies were reluctant to invest in Australia because of concern over future growth and the relatively small size of the Australian property market for large institutional purchases.[16]

By the end of the decade, most Japanese insurance companies had ceased their investments in foreign real estate, because of falling yields and increased risk. Also, fund management practices within life insurance companies were relatively simple, with regard to portfolio management and hedging for exchange risk.[17] All institutional investors appear to have lost heavily from foreign real estate investments, due to lower international prices.

Investment in foreign real estate by Japanese institutions slowed considerably in the second half of the 1980s as yields began to fall and the market in the United States became more speculative. The main motivation was portfolio diversification and attaining higher yields than those available in Japan during the economic bubble period after 1985. Indirect investment of this type was undoubtedly type I in nature. Indeed, investment by insurance companies and other institutional investors is officially classified as portfolio investment by most countries.

Conclusion

In this paper, a distinction is made between financial or type I real estate FDI and type II strategic real estate FDI, according to both the motivation of investors and the organisation of investment. Type I investors are characterised as owners and type II as owner-managers, with passive and active approaches, respectively, to the management and control of their foreign real estate assets and subsidiaries. The land bubble in Japan bolstered speculative development and acquisition of foreign real estate by Japanese investors. Many type I investors speculated on rising prices and eschewed a type II strategic approach to real estate FDI.

It has been argued that Japanese real estate FDI is predominantly type I in character, analogous to portfolio investment in that investors typically did not significantly expand their corporate activities beyond the home country. Most Japanese real estate FDI involved the delegation of management functions and passive ownership. Many investors had little international experience in the ownership or management of these assets or took an active role in controlling the day-to-day direction of their foreign acquisitions of office buildings, hotels, resorts, condominiums, retail or other properties.

The strategic approach of Japanese investors towards the acquisition or development of foreign real estate was influenced by the long Japanese bull market of the postwar period, in which land prices rose continually. Low yields on real estate were accepted because of false expectations of capital gain, fuelled by easy access to real estate financing. These conditions allowed a range of contractors, realtors, leisure-oriented firms and others to quickly acquire large portfolios of foreign real estate, seemingly at a large discount, compared with equivalent land and buildings in Japan. In the bubble years between 1985 and 1990, financial monitoring by Japanese financial institutions was ineffective (BOJ 1991). Real estate FDI was often financed without due consideration of its long-term viability.

Political leverage and family connections could pave the way to preferential access to finance and political influence, as in the case of EIEs President Takahashi, who had unlimited access to the resources of the LTCB and also entered the Diet despite the collapse of his company. Similarly, firm-specific motivations for FDI were predicated less on actual or assumed proprietary advantages, than short-term access to finance perceptions of the low cost of foreign real estate and investor optimism.

While low cost and easily available capital can provide a competitive advantage, this is a viable strategy 'only if it is used to finance profitable long-term speculations' (Baldwin 1986). Investor optimism or inexperience often led to a disregard of the inherent risk of market downturn. Some tourism entrepreneurs made use of other firm-specific assets and were able to establish sustainable offshore operations, but most Japanese investors adopted an indirect and speculative approach to overseas real estate and incurred large losses.

Rivalry, prestige and follow-the-leader behaviour by investors came to the fore, influenced by the speculative environment in Japan after 1985. Case studies illustrated the limitations of investor strategy and the role of implicit capital gains speculation, mistiming and inexperience. After 1984, competition for prestigious overseas real estate and speculation led to a less cautious approach to acquisition.

Investor control and management of real estate, whether offices, hotels, resorts or other properties, was typically indirect once the asset had been developed or acquired. The scale and pace of Japanese real estate FDI limited the capacity of investors to directly influence the strategic direction of these foreign businesses or assets, since few had staff with international experience in real estate management. This finding was reinforced by a review of case studies of integrated developers, realtors, tourism entrepreneurs and institutional investors.

The need for investors to have some proprietary advantages became more obvious over time, with divestment linked to the absence of such advantages (Boddewyn 1983). As passive owners, investors were often unresponsive to market changes, such as a decline in real estate prices, or new opportunities to invest in a depressed market with higher yields. Some type II investors did create new business activities through the establishment of tourism and resort infrastructure in new areas, such as Cairns, which became viable despite lower property values, but they were exceptions rather than the norm.

The widespread failure of Japanese real estate investors in the decade under review suggests that investor advantages were both general and transitory in nature and insufficient to sustain FDI in the long term. Japanese investors in overseas real estate lost vast sums on their investment splurge, and viable long-term investment was the exception rather than the rule. Few firms developed an integrated global approach to FDI (Porter 1990) or were able to sustain operations in the host country. The absence of sustainable type II investor advantages contributed to widespread divestment by Japanese investors in the early 1990s.

The general conclusion of the paper is that the pattern of rapid investment and subsequent large-scale divestment supports the proposition that Japanese real estate FDI does not readily fit into 'the existing inventory of models and evidence' of Japanese FDI or FDI generally (Caves 1993). It therefore appears to be an exception to the firm-specific explanation of FDI.

Notes

1 The official definition of 'direct ownership', owning 10 per cent or more of an investment is relatively arbitrary and control may not be exercised in management terms even if complete ownership is attained.

2 One of major problems with most official statistics on FDI, and FDI on real estate especially, is the exclusion of borrowing in the host country as well as various

categories such as investment below certain thresholds and in non-regulated areas. This is a major omission since foreign direct investment is possible even without a flow of capital across borders, although usually some equity enters the host country and a large proportion of the value of the acquisition can be funded by loans from financial institutions in the host country itself. A debt/equity ratio of 3:1 or 2:1 is common for real estate FDI and the official estimates of real estate are therefore too low. Further, debt acquired by a Japanese real estate subsidiary in Los Angeles from the subsidiary or branch of a Japanese bank in the US would not be recorded in either Japanese or US statistics on FDI.

3 To supplement information obtained from a thorough survey of media sources, annual reports of investors and fieldwork in Tokyo and Osaka, a comprehensive survey of 102 Japanese investors in Australian real estate was attempted in late 1994. Only five of these firms participated, while others declined to participate in the survey, or had recently closed down their Australian offices due to significant losses. Nevertheless, the survey provides important data as these firms accounted for about 25 per cent of Japanese FDI in Australian real estate (AJEI 1996).

4 From 1984 to 1988 contracts from the overseas subsidiaries of other Japanese firms rose from 20 to 35 per cent of total overseas construction contracts of Japanese contractors (OCAJI 1990).

5 Initially civil engineering projects, such as bridges and tunnels for government, but the 1988 Brooks-Murkowski Amendment made it illegal for foreign firms to tender for United States public works contracts. Following this, Japanese contractors increasingly invested in real estate development projects in the United States (Levy 1990).

6 Japanese construction firms responded to the rising domestic demand for foreign real estate by developing office buildings, hotels and resorts, condominiums and other forms of property. Contractors such as Kumagai, Kajima, Ohbayashi and others sought to service the current or future needs of investors in Japan. Rising prices in cities such as New York and Los Angeles and resorts such as Hawaii and the Gold Coast, encouraged contractors to speculate on future orders and capital gains by building in anticipation of later sales (Daggett 1991 p. 38).

7 In 1991 the California Coastal Commission decided to prevent the investor from selling golf memberships to make the resort viable, illustrating the need for investors to know about the legal and political environment in the host country. In 1992 Isutani announced he would sell Pebble Beach for about US$500 million, a loss of US$341 million after 17 months of ownership (The Japan Times 21 November 1991).

8 A Nihon Keizai Shimbun survey in 1990 found that real estate companies filled 8 of the top 10 positions of companies in terms of profitability to sales. The ratio of profits to sales for these companies was: Heiwa Real Estate (41.6); Osaka Building (37.1); Mitsubishi Estate (33.3); Sankei Building (29.3); Hanshin Real Estate (29.0); Sumitomo Real Estate Development (27.5) and Hankyu Realty (27.1) See Japan

9 In 1890 the Mitsubishi Company purchased a 35-hectare tract of land in Tokyo from the Japanese Government, an area which subsequently became known as Marunouchi, a vital part of the central business district of Tokyo. See Mitsubishi Estate (1991, p. 2).

10 Based on 1994 property values, but possibly overstated because of the fall in the Japanese real estate market (The Age 23 November 1994).

11 In 1986 Shuwa acquired the 1900&1901 Avenue office building in Los Angeles for US$235 million (at US$200 square ft), the Paine Webber Building in Boston for US$107m (at US$339 square ft), the 500 Washington Building, San Francisco, the Crocker Bank Center in California, the Hughes Aircraft Office Building in California, the Xidex Building in California, the Guardian Bank Building in Los Angeles, the Chase Plaza in California, the Downey Savings Building in California, the ABC Building in New York for US$175 million (US$365 square ft). In 1987 acquisitions by Shuwa included the US News and World Complex for US$80 million and the Arco Plaza in Los Angeles for US$640 million (US$291 square ft).

12 Hills (1995) notes that Mr Takahashi observed in 1990 that 'Including personal guarantees (for others) I have debts worth three trillion yen. That should go into the Guinness Book of Records.' In 1994 EIE's total debts exceeded 13 trillion yen, although the company had not been formally bankrupted.

13 Survey of annual reports of ANA and JAL.

14 In 1980 the Ministry of Finance had freed up the approval process for almost all forms of Japanese FDI, thereby allowing insurance companies and other investors to invest in overseas property. However, approval for the large Japanese pension funds to make significant investments was limited to 2 per cent of total pension fund assets (a 20 per cent ceiling on real estate investment in a 10 per cent ceiling on overseas investment for pension funds (Reier 1985 p. 246).

15 Under the *Insurance Industry Act* and related acts and regulations, which are administered by the Ministry of Finance. Insurance companies are prohibited from borrowing and investment funds come from premium income. Insurance companies are limited from investing more than 20 per cent of their total assets in real estate, either in Japan or overseas. (Ordinance of MOF based on *Insurance Industry Act*).

16 Interview with the Director of the Nippon Life Overseas Investment (Real Estate) Division in June 1991.

17 However, life insurance companies had large unrealised capital gains in the Tokyo market that balanced out possible overseas losses.

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