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Japanese Investment Insight

Attorney With Unique Perspective Looks at What's Hot

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Q&A

The first wave of Japanese companies that settled in Orange County in the 1970s were the research and development arms of the giant "keiretsu," or multinational corporations.

At that time, the aims of those Japanese companies were simple. They wanted a place where high-technology talent was abundant, the air was clean and where they could quietly go about their work. Companies such as Yamaha, Canon and Ricoh blended quickly among the county's many electronics companies.

In the early 1980s, a second wave of Japanese companies opened research facilities in the county and also kept a low profile. Later in the decade, several Japanese companies began signing headline-grabbing deals by acquiring choice properties. Tokyo's Maruizumi California Corp., for example, bought the Dana Point Resort for about $104 million in 1988.

The new arrivals, mostly cash-rich real estate and financial concerns, were basking in the glow of a strong Japanese yen and a booming consumer and real estate market back home. But in the past year, the number of Japanese acquisitions in the county dropped for the first time in five years, tempered by growing criticism in the United States over Japanese investment.

While the number of deals may have dropped, the demand for lawyers schooled in both U.S. and Japanese business law remains strong. Japanese companies have become more prudent about their investments and are increasingly turning to lawyers for advice. Lisa Michiko Kitsuta is among a rare breed of lawyers who holds law degrees from both countries: Loyola University Law School and Kyoto University.

Kitsuta, a second-generation Japanese-American, specializes in U.S.-Japanese mergers and acquisitions at Stradling, Yocca, Carlson & Rauth in Newport Beach, the county's second-largest law firm. She's also the founder and president of the Orange County Japanese-American Lawyers Assn., and she serves on the advisory board of the Orange County chapter of the Japan and America Society. In an interview with Times staff writer Cristina Lee, Kitsuta discussed trends in Japanese acquisitions in Orange County and the United States.

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Lisa Michiko Kitsuta, an attorney with law degrees from Loyola University and Kyoto University, next to her diploma from Kyoto.

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Q. Is it more difficult for an American lawyer to practice law in Japan than it is for a Japanese lawyer to practice law in the U.S.?

A. Yes, because the Japanese government and Japanese Federation of Bar Assn. have placed severe restrictions and limitations on the practice of foreign lawyers in Japan, even though there have been significant improvements since 1987 that permit foreign lawyers to practice in Japan under certain circumstances. And, of course, language is a problem.

For example, a foreign lawyer in Japan is not permitted to display the name of the law firm on the marquee of the building. Instead, the lawyer must use his or her individual name as opposed to the law firm's name.

Also, there are considerably more American lawyers than there are Japanese lawyers. For example, Japan has only approximately 14,000 lawyers for the entire country, whereas there are at least 140,000 lawyers in the state of California alone.

It is extremely difficult for even a native Japanese to pass the Japanese bar exam. Less than 2%, or approximately 500 people, pass the Japan bar exam per year. Since it is already extremely difficult for a native Japanese person to pass the Japanese exam, it is virtually impossible for a foreigner to pass it.

Q. What's driving Japanese companies to invest in the U.S. market?

A. There are a variety of reasons for the dramatic increase of Japanese investments in the United States. The primary reason is the increased value of the yen, which has risen from 361 yen per U.S. dollar in 1964 to 128 yen today.

In addition, Japanese real estate prices increased dramatically, not only in Tokyo, but throughout the country. The price of land increased roughly fourfold over the relatively short time period from 1975 to 1989. Mortgage rates were relatively low as well, hovering around 6%, or so, for 20 to 25 years. So, at least until 1986, land prices and homes were fairly reasonable, and the average Japanese could purchase a decent house.

The strength of the yen and the rapid rise in domestic real estate prices resulted in increased collateral for inexpensive real estate loans for the companies and this fueled the Japanese companies' foreign acquisitions.

In the U.S., a lot of the savings and loans foreclosures and actual closures of some of the golf resorts in Arizona is well-known, and Colorado has an abundance of ski resorts that the Japanese consider underpriced. This has also helped to increase Japanese investments.

Q. What else is happening that's pushing even medium-sized Japanese companies to expand abroad?

A. Japanese companies are eager to diversify their business operations because of extreme competition and saturation of the Japanese market. So they looked abroad to expand and diversify.

The United States has been seen as probably the most desirable investment venue because of its stable political environment. It has a familiar and increasingly popular culture and, most importantly, a government that has historically favored and nurtured foreign investment.

Q. Are big Japanese financial concerns, such as insurance companies and banks, passive lenders in Japanese companies' foreign acquisitions?

A. Their interest is twofold. First, they're financing these acquisitions for their customers and, secondly, they're indirectly acquiring properties themselves through their non-banking or non-insurance subsidiaries.

What's fascinating is a shift of sources of capital for these acquisitions. They've moved away from banks, which have become heavily regulated by the government, to new providers of capital, which include finance, leasing and consumer credit companies.

Q. When did this shift start?

A. This began in late 1989 when the Japanese Ministry of Finance set a limit to the total amount of lending Japanese banks can make to the real estate industry. So companies such as Sumitomo Corp. have provided real estate loans and industrial financing through its computer and office equipment leasing subsidiaries. The finance companies, which are not as heavily regulated as banks, are often formed by a group of banks.

Q. A lot of Japanese acquisitions in Orange County are cash transactions. Are these cash transactions actually loans provided by Japanese banks?

A. It depends on the investor. A larger acquisition, such as a hotel or resort, may be paid for initially in cash and then subsequently secured by a loan from a Japanese bank or a Hong Kong subsidiary of a Japanese bank, or even the U.S. branch of a Japanese bank.

If it's a wealthy Japanese individual, payments for a resort, office building or raw land are done in cash. I've seen wealthy individual investors pay up to $80 million in cash for such acquisitions in Orange County.

Q. How do Japanese investors go about acquiring a property?

A. It depends on the level of sophistication and experience of the Japanese investor. The larger, more successful companies follow the traditional route of relying on the best lawyers, accountants and consultants for a coordinated and thorough analysis of any proposed acquisition.

Japanese individual investors do not always try to use lawyers or entities from the start. When these individual investors decide to acquire a property, they will then contact an American lawyer and the lawyer will then draft either the letter of intent or the purchase agreement, usually on a cash basis.

A few foolish and naive individuals have attempted to acquire a property without a lawyer and have been burned. There were cases of some losing their deposits. They would attempt to negotiate directly with the sellers without engaging the services of professionals. They'll come here by themselves, see a piece of property, negotiate directly with the sellers, and seem to make a decision about whether or not they want to purchase a piece of property shortly after.

Q. Should a seller feel secure with a letter of intent signed by a Japanese company?

A. No. Even after signing a letter of intent, many Japanese investors, big or small, will continue to review and analyze a property or company in excruciating detail before they will sign a purchase and sale agreement. And even after they execute this agreement, they continue their exhaustive review and analysis right up to the scheduled closing date.

Despite the large number of acquisitions in recent years, there are countless numbers of transactions that have never been consummated because the Japanese investors got cold feet and decided against the investment.

Q. Japanese industry depends heavily on foreign energy sources, and Japanese companies recently have been investing in natural resources such as timber, mining and energy. Are there any laws that would prevent Japanese companies from investing in U.S. natural resources?

A. The Exon-Florio amendment, which was enacted by Congress in 1988, enables the president to block or order divestiture of any foreign acquisition of U.S. interests and properties that are essential to national security. There is no definition of what national security is, but it typically includes nuclear energy, military weapons or technology, certain types of high-tech products or manufacturing components and related products such as industrial gases, raw materials associated with such high-tech materials, aviation and aeronautics.

For example, Nippon Sanso K.K., which is one of Japan's leading suppliers of industrial gases, has proposed acquiring Hercules Inc.'s Semi-Gas Systems, a San Jose company whose special, extremely high-purity gas is critical to semiconductor manufacturing. This transaction was subject to review by President Bush and, on July 27, he decided not to intervene even though there was considerable pressure by various politicians who opposed the transaction.

Overall, the U.S. investment climate has been very favorable to foreign direct investors, even though occasionally there might be criticism of foreign acquisitions, such as Matsushita's pending acquisition of MCA. With the Exon-Florio amendment and no definition of national security, it is possible in theory for President Bush to block or order divestiture of a proposed foreign acquisition of U.S. entities [on the grounds] that it would impair national security. I would assume that national security includes oil, especially in these uncertain times when countries around the world are concerned about a disruption of oil and energy supplies if war breaks out in the Persian Gulf.

Q. There were recent reports that Japanese ardor for prime U.S. properties has cooled. What kind of properties would likely interest Japanese investors?

A. Japanese investors have become more cautious, sophisticated and selective about their investments in the U.S., but one type of investment that continues to increase is the Japanese investments in hotels and resorts.

With a few exceptions, such as the acquisition of the Pebble Beach Co. by Cosmo World for about $850 million, trophy properties or companies are being shunned by Japanese investors because of concerns about their high visibility and pressure from the Japanese government to avoid headline-grabbing acquisitions.

Q. How do Japanese invest in the United States?

A. There are four major forms of Japanese investments. The first is direct investment, which is defined as 10% or more of a U.S. firm's equity. This includes mergers or acquisitions of various companies, office buildings, land and other more tangible types of investments.

There's also foreign portfolio investment, which is the purchase of equity or bonds, including municipal and company bonds. This investment increased from 6.2% in 1984 to 17.2% in 1988.

Then there's the purchase of U.S. government securities, and finally, financial assets, such as U.S. bank borrowing from abroad and foreign deposits in the U.S.

Q. Have there been shifts in the forms of Japanese investment?

A. There has been a dramatic decrease in Japanese investment in U.S. Treasury securities. This drop probably has a significant impact on the U.S. trade deficit in that Japanese funds have long been available for the U.S. government to finance its debt. For example, in 1984, Japanese investment in those securities was about 57% of their total U.S. investment. However, it dropped to just 32% in 1988 (the latest figure available). The Japanese have found that foreign bonds denominated in the European Currency Units (ECU) are a more attractive investment due to the higher yield. They are now selling their interests in U.S. securities and are investing instead in the ECU, the European Economic Community's monetary unit.

The other change has been in direct investment, which has dropped from 25% of Japanese total investments in the U.S. in 1984 to only 19% in 1988. This includes investments in the more viable acquisitions such as purchases of properties and companies.

Interestingly enough, Japanese portfolio investments and financial assets have both increased. One thing you might find interesting is that the Japanese are buying a number of different properties in different states, creating a portfolio and then syndicating them back in Japan. One of our clients is very active in that field with Nomura Finance.

Q. What business opportunities are available to Orange County companies in Japan?

A. There are a variety of opportunities available. At the top of the list are consumer products, recreational sports and activities, and products related to them will be in great demand. I expect demand for outdoor activities such as lessons in golf, tennis and scuba-diving. And the equipment and designer sportswear that comes with these activities will rise substantially in the next few years.

Various agricultural products, such as oranges, apples and beef, continue to be in great demand and popular among Japanese consumers. What the country's agricultural producers have to be careful of is how they package their products. Japanese consumers are obsessed with appearance and packaging, and cost is not a particularly important consideration to Japanese consumers. A blemish-free, perfectly shaped orange or melon makes an ideal gift.

The average Japanese consumer spends at least $2,000 a year on social and business gifts. Exported products should be presented in an attractive package.

U.S. biotechnology and pharmaceutical products will also have a receptive market in Japan, due to the aging Japanese population: medicine dispensers, intravenous dispensers, blood-pressure machines and arthritis-related products.

There are opportunities in construction, sewage, airport, infrastructure, and engineering design. One current growth area is in architecture and master-planned communities, which includes golf course and resort designing.