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Japan will be the beneficiary of a high-tech boom fueled by China's massive investments

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Continuous investment is indispensable for China to reach global hegemony

China's National Congress of the Communist Party, an event held once every five years, has come to an end. China, under the leadership of President Xi Jinping, is no longer concealing its desire for global hegemony. During the past decade, the annual economic growth rates were about 9% in China and 4% in the United States. If there is no change, China's economy will surpass the United States in 2026. This would be the first step toward accomplishing the strategic goals of President Xi Jinping.

On the other hand, China's trade surplus is plummeting. Since China relies on investments for about half of its GDP, the country probably has no option other than to continue making investments even to the extent of being excessive or wasteful. The bad debt problem will explode if China's economy stops growing, producing a crisis for the country's economy and government. Continuing to fuel growth is the only course of action. But investments in real estate and smokestack industries have both reached a dead end. Now China has to fly on only one engine by using public-sector spending for infrastructure projects.

Huge high-tech investment is the sole option

China's only hope of ending this problem is to make huge investments in the high-tech sector. The goal would be to use the rapid pace of innovation and progress in this field to capture a big share of the global market for high-tech products. Sophisticated products like semiconductor devices and liquid crystal displays are a category where companies can easily benefit from economies of scale. Constantly making investments on an unlimited scale will always result in victory in this market. Massive continuous investments are the critical reason that the United States lost to Japan and that Japan subsequently lost to Korea and Taiwan.

Enormous high-tech investments would accomplish two goals at once for China. First, there would be enormous demand creation fueled by these investments. Second, China would be able to increase its global market share for high-tech products. The steel industry illustrates this point. China's global share of crude steel output rose from 10% in 2000 to a dominant 50% in 2010. Economies of scale are even greater in the high-tech sector. As a result, China could probably boost its market share even faster in this industry.

Nevertheless, semiconductors and LCDs alone are not big enough to drive growth in China. This is why the country has started making big investments in all major high-tech fields based on the Made in China 2025 master plan. Examples include batteries for electric cars, robots, artificial intelligence and factory automation. Investments by China will spark an investment war that will encompass companies worldwide. These developments will create many attractive opportunities for Japan.

Big follow wind for Japanese high-tech niche hardware manufacturers

Japan has no mega-players in semiconductors, LCDs, smartphones, TVs and PCs that have been driving the ongoing global rally in high-tech stocks. However, Japan has high-tech manufacturers that specialize in multitude of niche core peripheral technologies. These companies have established dominant positions involving the technologies these mega-players require. Each technology involves only a niche sector of each product category. But all of these superior technologies in Japan enable Japanese companies to maintain control over prices, thereby shielding companies from price-based competition. Japan has used these strengths to establish a solid position as a niche high-tech hardware supplier within the global division of labor. This is by far the most important reason for the recovery in earnings at Japanese companies in recent years.

When I asked this to a high-tech analyst I admire, he made the following statement to me. “You are right about this strength of Japanese companies. Japan is a leader in the machine tools and robots needed by semiconductor, LCD and automation companies. Also, China is giving preferential treatment to manufacturers of automobiles and batteries in order to create a domestic electric automobile industry. I expect to see a shift to Japanese companies for the procurement of high-quality battery materials. And I think that Nidec Corporation is quietly targeting opportunities for motor involving an electric car made in China. So I believe China will move even faster to shift from Korea and Taiwan to Japan for imports of materials and parts. I have just come back from the Tokyo Motor Show press day. I saw lots of displays about AI and automated driving. I left with a strong feeling that the world is entering an era in which Japanese companies in a broad range of industries – automobiles, electrical machinery, components and materials, IT – can leverage their strengths.”

Shifting from price competition to superior technologies and quality

Many years ago, Japanese companies used highly competitive prices to dominate the world’s high-tech manufacturing sector. But Japan subsequently lost this competitive edge due to trade friction, the yen’s strength, the emergence of competitors in Korea and China, and other events. Today, the mega-players are the U.S. and Chinese internet platform companies and Asian mega-hardware companies (Samsung in Korea, Taiwan Semiconductor Manufacturing and Foxconn in Taiwan, Huawei in China, and others). Other than U.S. firms, the mega-players are all in Korea, Taiwan and China. No Japanese companies belong to this club.

For a number of years, Japan, which lacks mega-players, has been left out of the global boom in high-tech stock prices. This was probably unavoidable. But now Japanese companies are no longer participating in price competition (because they lost!). Instead, they are generating higher earnings by concentrating on niche categories where they have superior technologies and quality. Electronics is one example. Japan ended up losing the battle to supply key digital products like semiconductor chips, flat-panel televisions, smartphones and PCs. This was entirely caused by Japan’s inability to win the price competition war.

Having lost this war, Japan altered its stance in order to survive by focusing on interfaces, which are vital to the functions of digital devices. Japanese companies became suppliers of sensors (sight, sound, smell, taste, etc.) used as input interfaces and actuators (motors and other devices) used as output interfaces. Materials, components and devices that are essential for the production of digital products are other strengths of Japanese companies.

Success in these markets demands a diverse array of technologies that competitors cannot match. Japanese companies have a big advantage because of their ability to use expertise in materials and other fields in order to combine a variety of know-how for creating innovative products. By shifting emphasis to these activities, Japanese companies ended the need to use prices to compete. Their new business model is underpinned by a focus on sectors where companies have outstanding technologies and quality. The same business model can probably be used in the service sector and other business fields, too. This is a valuable strength of Japanese companies.

Further growth in the use of the internet is certain to give people even more freedom to choose what they want to do. The result will be greater demand for goods and services with excellent quality and advanced technologies. These are business fields where Japanese companies excel.

Stock market will focus on Japanese supremacy

In late September and early October, the Nikkei Average was up for 16 consecutive days for the first time ever. Behind this upturn were three crucial factors: (1) global economic growth and a worldwide stock market rally, (2) record-high earnings at Japanese companies, and (3) the recovery of Japan’s economy. Furthermore, Japanese stocks have the lowest valuations in the world and the government is enacting measures to encourage risk-taking. There is no longer any reason not to buy Japanese stocks. Apparently, we are seeing the beginning of a powerful second phase of the Abenomics rally that will extend into 2018. Investors around the world have been overlooking Japanese stocks due to the absence of high-tech mega-players. But now these investors are likely to take another look at Japan as they turn their attention to the success of the country's niche players.