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Decoupling or Business as Usual?
How Japanese Multinational Corporations Adapt to Political Risk in China

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Abstract

How are multinational firms (MNCs) and the global supply chains that link them to China adjusting to heightened political risks? Since the U.S.-China Trade War, COVID-19 supply chain shocks, and the Russian invasion of Ukraine, Western governments have increased efforts to encourage MNCs to divert investment from an increasingly authoritarian China toward politically reliable allies and partners. Using firm-level data on Japanese MNCs from 2012–2022, we examine competing predictions from “business as usual” and “follow the flag” theories. We introduce a typology of de-risking strategies: decoupling (exit from China), diversifying (investment outside China), and diverting (both exit from China and investment in friendly countries), contrasted with inaction. While most Japanese MNCs continue to operate in China, a majority have adopted at least one de-risking strategy over the past decade. Consistent with the “following the flag” theory, we find that national security-relevant MNCs are significantly more likely to engage in all de-risking strategies after controlling for firm size, experience, and China exposure.

Keywords: Foreign direct investment, political risk, firm exit, Japan, China

Introduction

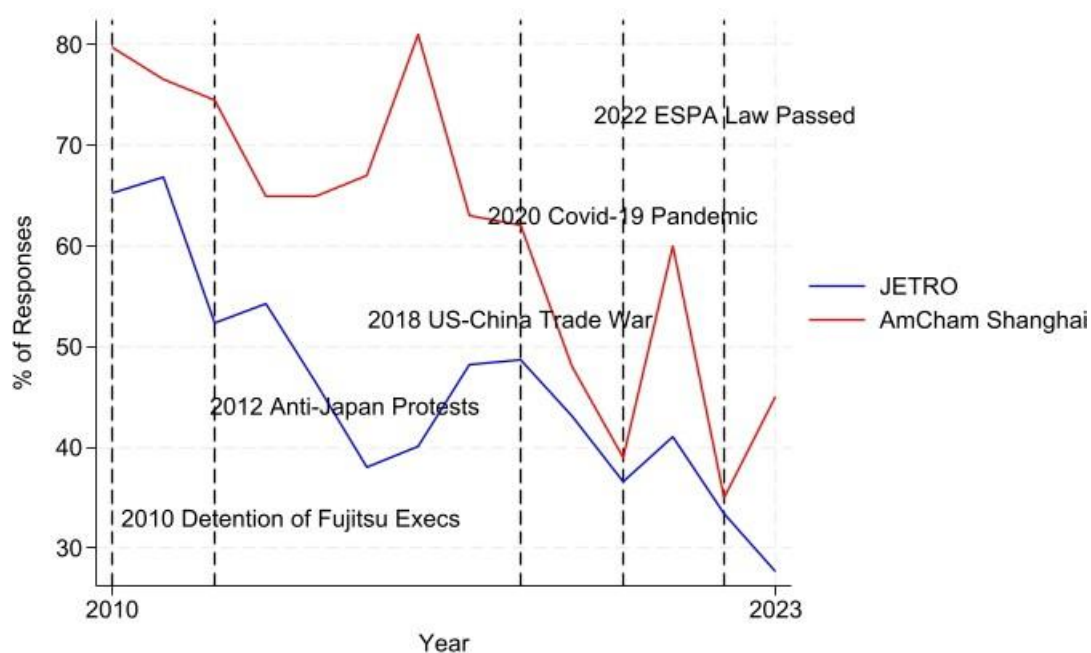
In recent years, concerns over national security, supply chain vulnerabilities, and technological competition have driven policymakers to call for economic "decoupling" or "de-risking" from China. Governments across the West advised businesses to reconsider the political risks of operating in China and consider "friend-shoring" production to less risky markets. However, implementing decoupling is complex and costly, as it involves disentangling deeply intertwined economic links. Exactly how much "decoupling" or "friend-shoring" from China has occurred is difficult to measure. Shifting foreign investment patterns take time to show up in national statistics and firm-level panel data on how the global operations of multinational corporations (MNCs) change over time is difficult to come by.

Policy discussions of decoupling and friend-shoring often conflate different types of economic behaviors and are vague on metrics. Most existing studies either focus on interpreting government intentions from policy documents or take one variable, be it trade flows, investment volume, or investor surveys, and use it as a proxy for a general trend of decoupling. MNCs can behave in ways that do not align with government policy or are not easily captured by any one measure. They can express rising concerns about political risks in China in surveys but drag their feet on taking costly actions to wind down their operations. They can continue operating in China while also ramping up investment elsewhere in the world.

Thus, efforts to capture de-risking with a single bilateral flow measure are akin to the parable of the blind men and the elephant, where each blind man's perception of the elephant varied based on the part they first touched. In doing so, they mistake a small part for the whole. Similarly, focusing on isolated examples of de-risking can lead to an incomplete understanding of the broader economic dynamic. Studying the behavior of all the subsidiaries of a set of MNCs over a period of time and mapping their shifting global footprint promises to be a better approach than any bilateral measure. This paper contributes a novel typology of de-risking that tracks the global investment behavior of China-exposed MNCs over time and across multiple countries.

The experience of Japanese investors in China provides valuable insights into whether

Figure 1: Willingness to Expand Business in China



and how much MNCs engage in "decoupling" or "friend-shoring" in response to growing political risks. Japanese companies were confronted with heightened political risk in China long before watershed events such as the US-China Trade War, the COVID-19 pandemic, and the Russian invasion of Ukraine made "de-risking" a hot-button issue across Western capitals and boardrooms. Japanese firms have faced rising political risk in China since the early 2010s and can thus serve as the canaries in the coal mine for the dynamics of de-risking from China. Japanese policy initiatives to enhance economic security have also had more time to develop than those of other like-minded governments.

Yet, despite a decade of rising political risk, it remains unclear how much Japanese firms are actually decoupling from China. Recent waves of Japan External Trade Organization (JETRO) surveys suggest that businesses have become much less bullish on China. Figure 1 illustrates the dramatic decline in investor confidence in China over the past decade using similarly worded questions from annual surveys by JETRO and the American Chamber of Commerce in Shanghai (AmCham Shanghai). Both questions report the percentage of businesses responding that they plan to expand within China in the next year. Japanese companies have been consistently less willing to

expand their business in China than their American counterparts since 2010. Japanese business confidence in China decreases noticeably following points of political tension: these include the 2010 detention of Fujita executives and alleged weaponization of rare earth exports, the 2012 anti-Japanese protests and boycotts, the intensification of the US-China trade and tech war in 2018 that prompted Japan to ban Huawei and ZTE in 2018, the COVID-19 pandemic from 2020-2023 which exacerbated supply chain resilience concerns and made possible the 2020 reshoring from China fund and the passage of the 2022 Economic Security Promotion Act (ESPA).

Despite high-profile government policies incentivizing Japanese companies to de-risk from China, scholars have generally found that 'businesses as usual' dynamics persist in China-Japan relations (Davis & Meunier 2011; Li & Liu 2019; Vekasi 2019a; Katada *et al.* 2023). Japan remains one of China's largest foreign investors, there is limited evidence of decoupling in trade and investment flows, and, compared to other international firms, Japanese MNCs were less likely to divest from China after the onset of the US-China trade war (Vortherms & Zhang, 2024). JETRO data also show that the rate of return on investments in China is one of the highest among the key markets where Japanese companies operate.¹ This paper uses new firm-level data to reconcile these competing expectations about whether and how quickly Japanese companies are de-risking from China.

Contributions

We contribute novel empirical insights to the debates over decoupling and friendshoring by examining how Japanese companies have adapted to political risks in China over the past decade. How likely are Japanese companies to exit China? Are firms following a "China plus one" strategy? And if so, are they more likely to "friendshore" by investing in political allies of Japan? Our paper seeks to contribute to the growing body of research on political risk and foreign direct investment by leveraging a newly constructed firm-level

dataset of Japanese MNCs and their international expansion from 2012-2022, a sampling window encompassing several highly salient political risk events. We build on the previous literature (Davis & Meunier, 2011; Li & Liu, 2019; Vortherms & Zhang, 2024) on the persistence of "business as usual" in face of political tensions by leveraging firm-level data and looking beyond dyadic economic ties.

We introduce a new typology of firm-level behaviors in response to geopolitical risk that identifies three distinct types of de-risking strategies: decoupling (exit from China), diversifying (investment outside China), and diverting (both exit from China and investment in friendly countries). The majority of Japanese MNCs in our sample engaged in at least one de-risking strategy over the past decade: diversifying (43%) was the most common strategy, followed by decoupling (20%), and diverting (18%). Only 19% of firms neither retreated from China nor expanded elsewhere. Additionally, we find that national security-relevant MNCs are significantly more likely to engage in all de-risking strategies after controlling for firm size, experience, and China exposure.

The results complicate the prevailing "business as usual" interpretation of Japanese MNC behavior and provide evidence that investment "follows the flag" at the firm-level. Even though full exit or decoupling from China is rare, most Japanese firms are gradually reducing their reliance on China and increasing investment in politically friendly destinations, especially in the United States. As such, these results suggest that "friend-shoring" could be taking place without "decoupling" from China.

Literature Review

Two bodies of academic literature offer conflicting perspectives on the prospects of corporate "de-risking" from China. On the one hand, the international relations literature

on "investment following the flag" holds that foreign direct investment (FDI) flows are generally greater between allies than between adversaries. These theories have not been tested in East Asia and, at first glance, appear to struggle to explain the boom in FDI in China over the past three decades. On the other hand, the "business as usual" literature draws on evidence from East Asia in recent decades and finds that foreign firms in the region have continued to prosper despite ever-present political risks, contrary to the prevailing de-risking narrative.

Following the flag

At the international level, security agreements between sending and host countries and the alignment of security interests encourage new flows of investment, which "follows the flag" of geopolitical relations (Drezner & Hite-Rubin, 2016; Biglaiser & DeRouen Jr, 2007; Rodman, 2001). Because trade and investment create security externalities, trade with allies benefits security relations while trade with adversaries increases security costs (Gowa & Mansfield, 1993). Historically, US FDI tends to "follow the flag," with higher rates of investment flowing to US allies (Biglaiser & DeRouen Jr, 2007), and greater bilateral FDI exchanges occur between security allies (Li & Vashchilko, 2010). Large-scale political disruptions in the host country, including violent conflict (Powers & Choi, 2012; Barry, 2018; Pandya, 2016) and trade wars (Dolan et al 2025; Vortherms & Zhang, 2024; Zeng and Zhang 2024; Zhang 2022) decrease investment. Additionally, foreign firms of the same nationality are likely to see the expropriation of a compatriot firm overseas as forewarning of their own fate, leading them to fight or flee as a group (Wellhausen, 2014).

A closely related literature focuses on the role of democracy in promoting FDI. This literature on regime type is quite a bit more complicated and focused on democratic institutions in the receiver, not the sender state (Li *et al.*, 2003; 2018; Jensen, 2012). There is also significant overlap between the U.S. alliance network and the set of democracies. In recent years, democracies across the globe announced initiatives to help diversify supply chains to protect their own supply chain vulnerabilities in response to rising geopolitical tensions with China and Russia.

The expectation from this set of top-down theories about FDI is that China's status as a non-democratic and non-allied country should deter foreign businesses and depress foreign direct investment. The following the flag literature would also predict that rising geopolitical tensions between China and US-aligned countries would result in an increase in "friend-shoring" FDI to allied or more geopolitically congruent countries.

Business as usual

A parallel literature is much more circumspect about the salience of political risks for MNC investment decisions and the impact of political tensions on economic flows. Davis & Meunier (2011); Li & Liu (2019) point out that weakening alliance ties or animosity between rivals would not produce a parallel shift in economic ties. They argue that the costs of supply chain movement are substantial for firms engaged in intra-industry trade and these relationship-specific sunk costs discourage fluid adjustment by economic actors to changing political circumstances, finding a null relationship between risk and exit. Foreign MNCs in China depend on its vast industrial base for suppliers and are embedded in regional supply chains. Production network relationships take years to forge and are very costly to replace. They conclude that in an era of globalization, "actors lack incentives to link political and economic relations," and thus investment can proceed "business as usual" despite political conflict (Davis & Meunier, 2011).

Other studies on Sino-Japanese relations confirm the "business-as-usual" expectation for FDI. Katada *et al.* (2023) find that, despite the determined efforts by the Japanese and South Korean governments to use an array of policy instruments to reduce economic dependence on China, there is only limited success in motivating businesses to return to their homeland. Song *et al.* (2020) find that positive political events such as leader visits can increase flows of FDI whereas diplomatic conflicts effects on investment are less pronounced. These bottom-up studies of economic behavior reveal that there is considerable a gap in translating policy intentions into economic reality.

Li & Liu (2019) find that trade in raw materials and intermediate goods were not affected at all by the Senkaku-Diaoyu dispute but that consumer products experienced

some declines, suggesting that consumer and corporate responses to political tensions may follow different logics. They extend the business as usual literature by moving beyond aggregate national FDI flows to examine differences between sectors. We extend this literature one step further by evaluating "business as usual" at the firm-level during a period of heightened political risk. We also look beyond the impact of political tensions on dyadic flows by examining how firms adjust their behaviors in third markets.

Firm-level risk calculus

The conflicting expectations between the "follow the flag" and "business as usual" literatures can be resolved by considering firm-level decision-making in response to political risk. Political risk is a primary determinant of FDI (Pandya, 2016). The effect of political risks on FDI inflows or firm entry is relatively well understood. Much of this literature focuses on the role of political institutions, particularly regime type (Li *et al.*, 2003; Jensen, 2003; Li *et al.*, 2018) and shared diplomatic agreements (Li & Vashchilko, 2010; Tobin & Rose-Ackerman, 2011; Kim *et al.*, 2016). Relatively less is known about the role of political risks in FDI outflows or divestment but this is an area of growing interest for the political economy literature (Barry, 2018; Vortherms & Zhang, 2021; Liu *et al.*, 2022; Wellhausen & Zhu, 2023).

Barry (2018) argues that firms are more sensitive to political risk before entering a market whereas firms already embedded in an environment will have a different strategic calculus where they must adapt to political risk. Anticipatory political risk reduces investment but barriers such as high levels of asset specificity or the failure to easily recover assets upon exit can make divestment difficult. In other words, a firm might be hesitant to enter a risky market but once it enters its options become much more limited due to sunk costs.

The business literature on risk and divestment also points to substantial variation across different firms. Ozkan (2020) argues that firm exit often stems not only from heightened political risk but from a misalignment of strategy and the risk environment. In their review of the divestment literature Schmid & Morschett (2020) finds that subsidiary-

level antecedents, such as mode of entry and financial performance, have stronger effects on the divestment likelihood than parent firm or host country characteristics like country risk. Thus, in determining how much Japanese MNCs take national security considerations into account when they invest overseas, we must look for patterns at the firm-level.

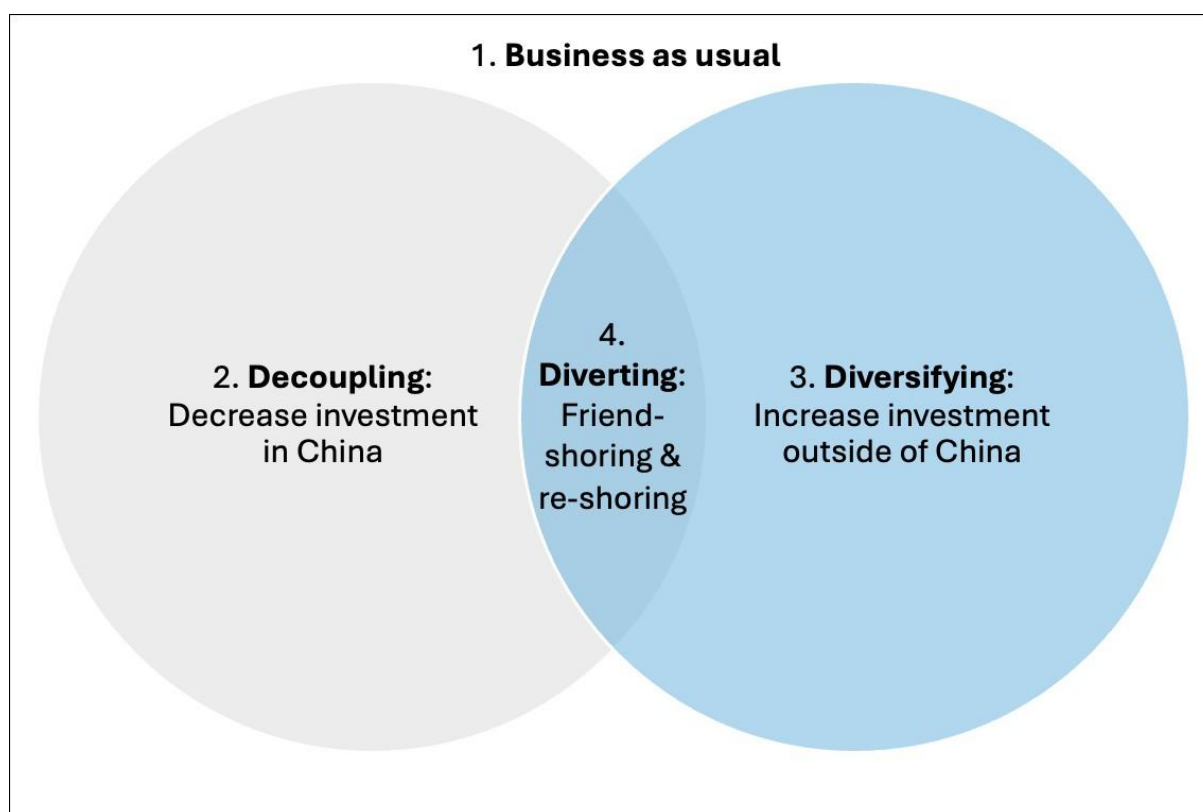
Additionally, more visible businesses such as retailer and consumer goods are more likely to be exposed to protests and have a higher risk perception compared to less visible component manufacturers (Vekasi, 2019b). Visible firms' fears are likely validated as the negative impact of sales as a result of political tensions between Japan and China have been the most pronounced for companies that produce the most visible products (Li & Liu, 2019).

Most existing studies focus either on explaining FDI inflows or FDI outflows, few consider both within the same framework. This is puzzling because the same MNC is responsible for decisions to invest in some countries and divest from other countries. This choice about how an MNC alters its global footprint in response to political risk is the focus of this study.

Theory

US and allied policymakers have converged around the need to pursue some form of de-risking from China and to promote friend-shoring or re-shoring in recent years. This consensus was evident in the May 2023 G-7 communique which announced that G-7 leaders "are taking concrete steps to. . . coordinate our approach to economic resilience and economic security that is based on diversifying and deepening partnerships and de-risking, not de-coupling" and to "reduce excessive dependencies in our critical supply chains". The consensus is also clear in the unprecedented number of China bills introduced in the US Congress since 2020 and in the passage of the landmark 2022 Economic Security Promotion Act in Japan (Cichanowicz & Zhang, 2025; Kuk et al 2022). But de-risking remains a nebulous term defined more by what it is not (ie. decoupling) than by what it is. Even if the intended direction of de-risking policy is clear at the aggregate level (ie. less China), the degree to which private economic actors are responding to rising geopolitical tensions in ways that policymakers want remains unknown.

Figure 2: Typology of Observable MNC De-risking Strategies



Clear definitions for these emerging policy concepts do not yet exist in the academic literature. Policymakers may prefer the greater degree of freedom offered by a vague term such as de-risking but more precise definitions are needed to determine whether economic reality has changed. Ultimately, it is firms—not governments—that make the key decisions about where to trade and invest, with government policies serving as important but secondary constraints shaping the range of viable options. Thus, we advance a new typology for measuring firm-level behaviors in response to geopolitical risk in Figure 2.

We consider all the strategies inside the venn diagram to be forms of "de-risking", which we define as the process of reducing or severing economic dependencies on China due to concerns over national security, supply chain vulnerabilities, and technological competition. The most straightforward way to derisk is to reduce investment or decouple

(2) from China but this is also the most costly for the firm. An alternative way to derisk is to diversify (3) away from China, this strategy has been called "China plus one" and involves reducing relative exposure rather than absolute exposure by increasing investment outside of China. When businesses talk about derisking, this is often what they mean. Finally, the overlap of these two strategies is what we call diverting (4), which involves reducing investment in China AND increasing investment outside of China in a geopolitically less risky destination. Everything outside of the venn diagram we consider "business as usual" (1).

We believe that the intentions of policymakers in encouraging different forms of de-risking has been well studied (Cichanowicz and Zhang 2025; Farrell & Newman, 2023; Katada *et al.*, 2023), but whether these policies translate into compliant firm behavior needs further exploration. While the political consensus around de-risking and friend-shoring is growing, it is not yet clear whether investors are behaving in a way that aligns with the expectations of policymakers. The difference between "de-risking" and "decoupling" often appear largely rhetorical. Whether "friend-shoring," or deepening economic integration with trusted allies and partners, is a means to derisking or an end in itself also differ by politician or audience. We note that while the Biden administration toned down the decoupling rhetoric of the Trump administration, it has stepped up coordination with allies and partners such as Japan, South Korea, and the Netherlands on export controls to choke off access to advanced semiconductors by Chinese entities and kept all of the Trump era tariffs in place.

Business as usual

Foreign MNCs in China are attracted to its efficient industrial base, growing consumer markets, and pace of innovation. Political risk is often priced into their operations, limiting immediately observable behavioral shifts. However, firms vary in their level of local entrenchment, which affects their exposure to political risks (Vortherms & Zhang, 2024). Those with longer experience and larger investments face higher sunk costs but also possess greater political resources, making their decisions on trade and investment

contingent on how they incorporate rational expectations and uncertainty into their profit calculations. The unexpected onset or severity of conflict may prompt rational firms to exit if risks outweigh expected profits. Smaller firms, with lower capital investment and less experience, are more sensitive to political risk and more prone to failure. Business scholarship consistently finds that larger firms are more resilient, harder to liquidate, and more politically engaged. MNCs with significant amounts of capital sunk in China are more likely to have greater resources to mitigate political risks. They tend to have dedicated government relations teams and cultivate political ties, reducing their likelihood of exiting. Likewise, older firms with more experience managing political risks and deeper local connections are also more likely to remain despite elevated uncertainties.

We therefore expect firms with larger and older subsidiaries in China to be more likely to adopt a "business as usual" strategy, all else equal.

H1a: MNCs with more fixed-assets in China are less likely to pursue de-risking.

H1b: MNCs with more longer experience in China are less likely to pursue de-risking.

Decoupling

Decoupling involves foreign firms reducing exposure to China by fully or partially winding down investment in this market. Firms can directly reduce risk exposure in China by exiting China, or more likely scaling back operations by selling or closing subsidiaries.

Despite recent headwinds, China remains the world's second-largest economy with a large consumer base, strong infrastructure, and a deep supply chain ecosystem. However, of these advantages enjoyed by the China market, its appeal as a consumer market is probably the easiest to substitute with an alternative market such as Southeast Asia. Because production network relationships in China take years to forge and are very costly to replace, manufacturing companies should be less likely to resort to decoupling. By contrast, MNCs that offer services (ex. professional services, hospitality, wholesale & retail) can more easily find alternative third markets to replace China. Additionally, MNCs in the services sectors are more likely to be consumer-facing than MNCs engaged

in manufacturing and their national origin might become more of a liability as geopolitical tensions increase. Whereas manufacturing and services firms should be equally likely to pursue diversification, the incremental cost of decoupling from China should be lower for services companies.

Therefore, all else equal, we would expect MNCs in services to be the more likely to decouple or exit from China.

H2: MNCs operating in services sectors are more likely to decouple from China, all else equal.

Diversifying

De-risking from China can also be achieved by expanding in other overseas markets without reducing operations in China. Diversification offers MNCs the option of profiting from their China operations to serve that market while setting up parallel, China-free supply chains to comply with Western regulations.

This strategy should be most attractive to MNCs whose supply chains are deeply integrated with China. If alternative markets lack reliable infrastructure, skilled labor, or network of suppliers firms may choose to stay in China despite challenges. These firms might be unable to divest from China in the short term but may instead diversify production to countries in ASEAN, NAFTA, or South Asia.

Because production network relationships in China take years to forge and are very costly to replace, firms that are more dependent on China should be less likely to resort to decoupling but more likely to engage in diversification. We expect MNCs with supply chains that are deeply integrated with China, such as automakers, not to exit China but instead to pursue a "China plus one" strategy by diversifying investment in third countries.

H3: MNCs with greater supply chain dependence on China are more likely to diversify.

Diverting

Policymakers tend to focus most attention on de-risking strategies that involve diverting investments away from China and towards more politically reliable destinations. Diverting investment lies at the intersection of decoupling and diversification because it calls for MNCs to not only leave China but also invest in countries policymakers deem to be "friendly." The two most common strategies for diverting supply chains away from China are "friend-shoring", which relocates production to allied or geopolitically aligned countries, and "re-shoring", which brings manufacturing back to the firm's home country. These two strategies are often conflated with each other and with decoupling in media coverage.

Re-shoring

Re-shoring, the process of relocating overseas operations back to the home country, has gained renewed policy interest amid geopolitical tensions and supply chain disruptions. Since 2010, the Japanese government has passed a number of laws and introduced several subsidy programs to bolster Japan's economic security and supply chain resilience through re-shoring (Katada *et al.*, 2023).

However, for most Japanese MNCs, re-shoring remains a limited and often infeasible strategy. High domestic labor costs, limited domestic market growth, and the loss of economies of scale achieved through overseas production all make full repatriation of investment economically unattractive. While government incentives, such as METI's 2020 subsidies, signal growing political support for re-shoring, our data indicate that relatively few firms are taking this path.

We checked the 100 firms in our sample against the full list of Japanese firms that received the 87 2020 METI re-shoring and diversification subsidies during the pandemic and found a single match: Shin-Etsu Chemical received a subsidy to de-risk rare-earth magnets to Vietnam.² We also checked the

list of firms that have received supply chain resilience subsidies through the 2022 Economic Security Promotion Act (ESPA) and found seven matches: Mitsubishi Chemicals, Toyota Motor Corporation, and Shin-Etsu Chemical all received two subsidies each. Itochu Corporation, Mitsubishi Electric, Nissin Kogyo, and Panasonic all received a single subsidy each. It is hard to distinguish which of these firms are re-shoring rather than friend-shoring.³ The Toyo Keizai data does not include information on the extent of domestic business operations so we would need to locate a third source to estimate the true scale of re-shoring. For these reasons we do not breakout re-shoring in the typology or analysis.

Friend-shoring

Friend-shoring or ally-shoring is the practice of locating global supply chains in trusted allies and partners rather than relying on the lowest-cost supplier on the broader international market. National security concerns are more central to friend-shoring than decoupling and diversification. The end goal of friend-shoring is to make supply chains more secure and controllable. The logic of friend-shoring is most analogous to the follow the flag literature which suggests that foreign direct investment should be higher among alliance partners.

Although it is possible for Japanese companies to exit China and expand in markets that aren't considered "friendly", empirically only 2 MNCs out of 100 that exit China subsequently expanded elsewhere politically ambiguous.⁴ However, not all sectors or firms attract the same level of concern from policymakers about the need to friend-shore production. Japanese policymakers have promoted friend-shoring in rare earth metals in the face of rising geopolitical tensions, for example, but they do not care about friend-shoring the textiles industry. Additionally, the U.S. and its allies have adopted ever stricter export controls to prevent their companies from doing business with Chinese firms in strategic sectors. At the same time, governments have adopted industrial policies such as the CHIPS and Science Act to encourage companies to move high-tech production to their countries.

Thus, we expect MNCs operating in industries that Japanese policymakers have identified as strategic or vital to national security such as rare earths to be more likely to adopt friend-shoring as a strategy.

H4: MNCs operating in industries deemed vital to national security are more likely to both divest from China and invest in allied countries, all else equal.

Japanese Overseas Investment

The experience of Japanese MNCs with operations in China provides an excellent opportunity to test theories of business as usual from those of de-risking. Japan is one of the largest senders of FDI to China and also one of the earliest countries to adopt a strategy of FDI diversification away from China. Most Western governments only recently announced initiatives to help diversify supply chains to protect their own economic vulnerabilities, but the Japanese government has been trying to get its businesses to adopt a "China-plus-one" diversification strategy to reduce political risk exposure for over a decade. This study will attempt to use the global expansion of Japanese MNCs to measure the degree of de-risking and friend-shoring from 2012-2022.

Responding to Political Risks in China

Japanese business sentiment towards China has steadily declined since 2010. Media reports of Japanese companies closing down facilities in China proliferated as tensions over the Senkaku-Diaoyu dispute raised concerns about rare earth dependence. The Japanese government began calling for businesses to adopt a "China plus one" strategy to diversify supply chain operations by establishing additional production facilities or sourcing options outside of China while maintaining existing investments in China (Vekasi, 2019b). This strategy aims to mitigate risks associated with over-reliance on the Chinese market and manufacturing base, such as geopolitical tensions, rising labor costs, and supply chain disruptions.

Foreshadowing the current de-risking conversation, these earlier policies suggested that

Japanese companies ought to lessen their risk from China by staying put whilst expanding into other markets at the same time (Iida, 2015). Meanwhile, direct government action was limited to the rare earths issue. In 2012, China accounted for around 90 percent of rare earths exports (Vekasi, 2019b) which meant that if China were to restrict exports to Japan - whose electronics industry rely heavily on them - with short notice Japan would have little recourse. Worries about Chinese economic coercion in the form of a rare earths embargo prompted Japanese policymakers to adopt a diversification strategy that drastically reduced Japanese dependence on Chinese imports to around 58 percent between 2010 and 2018 (Solis, 2021).

The Japanese government secured over 50 billion yen in subsidies to explore alternative supply chains for rare earths, aiming to reduce its dependence on Chinese exports.⁵ Immediately following waves of anti-Japan protests, even in the short term FDI expansion in China slowed from 2012 to 2013 whilst investment expanded more rapidly in ASEAN member states during the same time period.⁶ Even after the initial waves of Japan-specific risks subsided, Japanese businesses have become far less likely to self-report that they expect to expand further into China.⁷

Despite past actions by the Japanese government to provide incentives for firms to de-risk from China, the magnitude of these efforts should not be overinterpreted. Although the relationship between government and industry is closer in Japan than in the United States, subsidies by Japan's Ministry of Economy, Trade and Industry (METI) aimed at derisking are not unilateral decrees but instead a choice that firms can freely make. These early subsidies and warnings to industry from METI were largely disregarded by businesses due to their modest value as well as the continued high return on Chinese investment leading credibility to the business-as-usual literature.⁸ Although rare earths diversification represents a win for Japan relative to the vulnerabilities that still exist in other developed states, Japan's reliance on other states such as Australia for rare earths still represents a vulnerability because of Australia's continued reliance on China. A major pull factor keeping businesses in China has also been their relatively higher return on investment compared to other parts of the world.⁹ Underscoring the difficulty of

operationalizing a China-plus-one strategy can also be seen by the relative increase of wages in other rival investment destination states such as India and Vietnam.¹⁰

Though early efforts led by actors within Japan such as METI to derisk had limited success, changing attitudes in Tokyo and the passage of a new Economic Security Promotion Act (ESPA) in 2022 suggest that more movement can be expected. The 2023 detention of a pharmaceuticals executive in China for espionage alarmed the Japanese business community more so than earlier detentions of Japanese nationals due to the executive's perceived closer ties in China. Notably, when interviewed about the incident, the chief executive said that although they will be diversifying their supply chains, complete decoupling will not be considered.¹¹ Independent of government action, large firms have also begun to establish new divisions for economic security such as Mitsubishi Electric creating such an office as early as October 2020 and others like Panasonic and Denso doing so in 2021 (Igata, 2025).

Moving beyond the scope of former prime minister Shinzo Abe's traditional national security preferences, thanks to politicians like Akira Amari and catalysts abroad in the form of detentions of Japanese nationals and COVID vaccine nationalism, economic security has become in vogue with the recent passage of ESPA economic security law. This act created a framework for companies to outline specific plans to shore up supply chains and can call on the government to provide funds to assist in implementing in these new policies. Other similar top-down efforts have been recent government efforts to pay out subsidies to firms to cut their reliance on Chinese factories.¹² Even subnational prefectural assemblies such as Kanagawa's have been outlining their own government initiatives towards managing political risk and minor political parties have been adopting similar language. Politicians, rather than bureaucrats, appear to be leading these new changes as well as firms that are taking economic security issues more seriously (Igata & Glosserman, 2021).

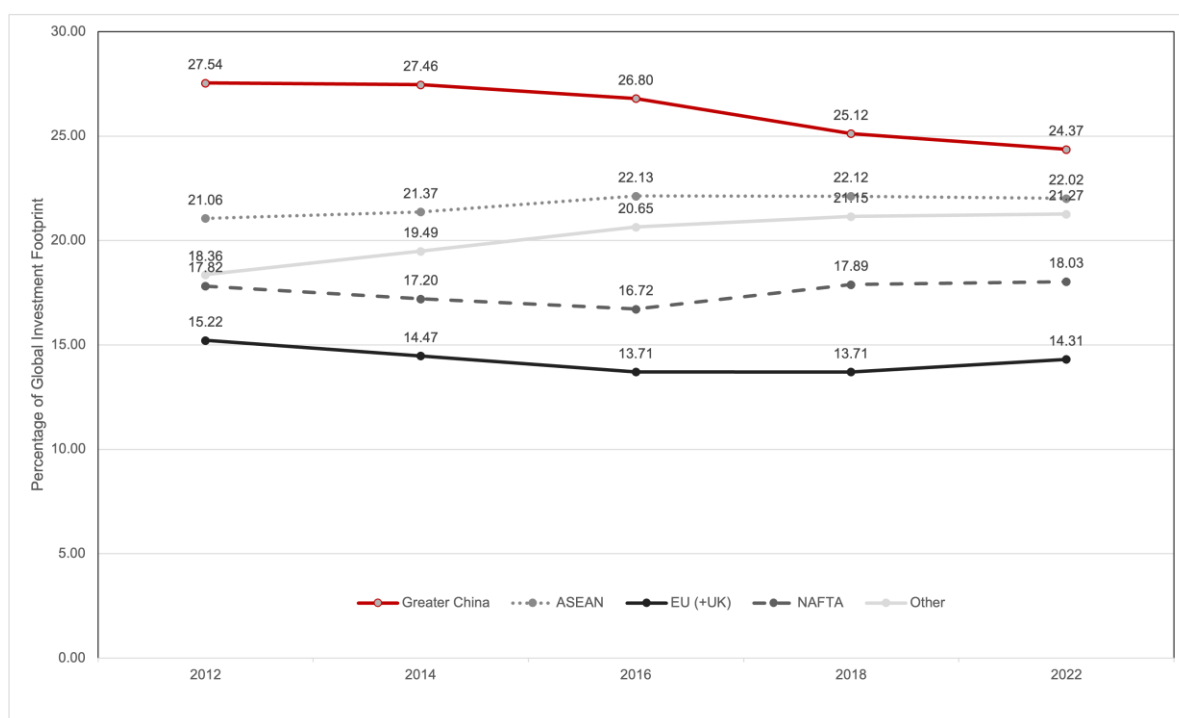
China Share of Japanese Overseas Operations

In sum, there is plenty of policy interest in de-risking from China in Japan and some anecdotal evidence to suggest that Japanese firms are increasingly willing to talk the talk about diversify away from China. However, the economic evidence that businesses are walking the walk of de-risking is much more mixed.

Japanese firms have made substantial investments in China since the 1980s but the Japanese government was the earliest adopter of de-risking policies. The vast majority of Japanese overseas capital stock falls into one of four buckets: Greater China (China, Hong Kong, Macau), NAFTA, EU, and ASEAN.¹³ In 2012, these four regions accounted for 88.62 percent of total overseas capital and 78.76 percent of all subsidiaries. By 2022, these four regions still accounted for 83.77 percent of capital and 75.80 percent of subsidiaries counted. As Figure 3 shows, Greater China remains the largest destination for Japanese overseas investment despite decreasing slightly from 2012 to 2022. Over the same period, the percentage of subsidiaries in Europe and the USMCA countries (referred to as NAFTA in this paper) remains fairly steady. ASEAN appears to be the prime beneficiaries of diversification from China. Business as usual seems to hold at the aggregate level, at least until after 2018.

Foreign firms are generally loathed to retreat from the China market for fear of ceding market share to their competitors. Despite concerted government initiatives to promote de-risking, not all firms may be affected by the changing political risk environment in the same way. Thus, the determinants of divestment may depend on several heterogeneous factors. More visible businesses such as retailers are more likely to be exposed to anti-Japanese protests and have a higher risk perception than those unlikely to suffer direct damage from protests like less visible manufacturers (Vekasi, 2019b). The negative impact of political tensions on sales has been the most pronounced for visible products that can be more easily identified by consumer boycotts (Li & Liu, 2019). Size is also an important consideration. On the one hand, larger firms like Mitsubishi, Mitsui, and Toyota are bigger targets for political risk. On the other hand, these large firms with more diverse global holdings may have a higher capacity to divest in response to political risk. How Japanese companies have responded to rising political risk in China and political pressure

Figure 3: Change in Japanese Investment Stock by Region



from Tokyo and Washington should provide valuable insights into the scope and pace of de-risking we can expect to see in other Western MNCs over the next decade.

Research Design

To examine how Japanese MNCs are adapting their global expansion strategies to political risk in China we create a novel dataset on de-risking by combining two separate firm-level datasets.

Data

The first is the Foreign-Invested Enterprises in China (FIEC) Dataset (2014-2019) which was constructed by Vortherms & Zhang (2021) using registration data from the Ministry of Commerce in China. This dataset contains information on 15,114 Japanese companies in China. From the FIEC database we take a weighted random sample of 100 Japanese firms operating in China in 2017. The sample is weighted by the size of registered capital and

the date of their establishment. A stratified sample reduces sampling variance and yields a more representative sample. The sampling frame has a clear skew with many small firms. Stratification allows us to select a sample with greater representation of capital investments. Size and registration date were chosen as stratification variables to reduce sampling variance based on findings from Vortherms & Zhang (2021).

These 100 China-based subsidiaries from FIEC were then matched by hand to their parent companies in Japan in a process that involved running their names and addresses through search engines and collecting their Japanese website addresses. We then look up the parent company in the Japanese Overseas Investment Yearbook (Kaigai Shinshutsu Kigyo Soran Kaishabetsu), a set of data books published by Toyo Keizai Inc., the leading Japanese provider of economic and business data. The yearbooks contain detailed subsidiary-level data from annual surveys of 33,147 Japanese parent companies operating in approximately 140 countries worldwide.

Because of data availability, we were initially able to match 68 Japanese MNCs with a presence in China from FIEC to parent company entries in the Toyo Keizai surveys. In response to reviewers, we supplemented this data by expanding the sample of FIEC firms such that we reached a final count of 100 Japanese firms that are in both samples. The full list of firms in the sample can be found in the Online Appendix.

To examine how Japanese MNCs reacted to periods of heightened political risk in China, we leveraged Toyo Keizai yearbook data from 2012, 2014, 2016, 2018, and 2022. These years are selected because they represent time periods covering before and after two of the largest contemporary political risk shocks to Japanese investments abroad. The years 2012 and 2014 cover the protests and consumer boycotts related to the Senkaku-Diaoyu territorial dispute which spurred the initial policy debate in Japan about the potential need for diversifying their supply chains. The 2018 and 2022 time span covers the period related to the start of the US-China Trade War as well as the political risk associated with zero-covid policies that affected business conducted there. The former political risk is exclusive to Japan and the latter more generalizable to other foreign firms

that conduct business in China. Although some of these shocks will likely not propagate immediately for all investments in China, if any firms are to relocate as a response to them then there should be some evidence of movement in the short term.

Data Structure

Combining the FIEC data (China only) and the Toyo Keizai data (global) allows us to examine to what extent these Japanese companies exited China, diversified away from China, and potentially expanded to other markets such as those in more politically friendly environments. We first combined these two datasets to build a time-series subsidiary-level dataset on the global expansion and retreat of Japanese MNCs.¹⁴

For ease of analysis, we then collapse this larger subsidiary-level dataset to a parent company-level panel dataset containing 100 observations. Doing so allows us to code each parent company's behavior between 2012-2022 according to our de-risking typology. The analysis below draws exclusively on the panel dataset where the parent company is the unit of analysis.

From the Toyo Keizai yearbooks, we gathered parent company characteristics such as the address of the company headquarters, the year and month of establishment, capital stock in a given year, the name of the representative of the company, a description of its services, as well as the number of employees.

Dependent variables: De-risking Strategies

De-risking, decoupling, diversification, and friend-shoring are all nebulous and contentious terms. Governments in Japan, the United States, and Europe are all trying to reduce economic reliance on China but differ on the details of what de-risking policies they are adopting. It is also difficult to know why a company chooses to exit or enter a new host country, much less whether this decision was influenced by government policies. We consider decoupling, diversifying, and diverting to be three collectively exhaustive strategies for firms to de-risk. We take a first-cut approach to categorizing and measuring these strategies by coding each parent company based on changes to their network of

global subsidiaries.

Business as Usual: Firms that neither exit nor expand are coded as being "business as usual." We consider these firms are not taking any observable measures to de-risk from China. We create a categorical variable where business as usual is the reference category and coded as 1. For example, Shoei Foods does not exit China nor does it expand elsewhere since 2012 so it is classified as business as usual. 19 out of 100 MNCs are coded as adopting a business as usual strategy.

Decoupling: We use the subsidiary exit measure from the FIEC dataset as our measure for decoupling. A firm is coded as decoupling if the parent company closes at least one subsidiary in China according to the FIEC data AND does not open any new overseas subsidiaries elsewhere.

All foreign-invested enterprises in China are required to report annually to the Ministry of Commerce. Firms report their name, foreign business investors, addresses, industry, business practices, and amount of registered capital by June of each year. Vortherms & Zhang (2021) codes a subsidiary as exiting if they report in one year but do not report in subsequent years. For example, according to FIEC, Pioneer Corporation closed a subsidiary in China in 2018. Since the Japan-based Toyo Keizai doesn't report any new investments in other parts of the world after this decision this corporation is coded as decoupling. 20 out of 100 MNCs are coded as adopting a decoupling strategy.

Diversifying: We use the Toyo Keizai subsidiary-level data to construct our measure of diversification. A parent company is coded as diversifying if it expanded anywhere outside of China during our sampling window (2012-2022) AND if they did not exit from China. We wanted to make sure that diversifying and decoupling are mutually exclusive. Diversifying means not reducing its presence in China but still hedging against risk by following the "China plus one" strategy that the Japanese government has encouraged since the early 2010s. Kose Global kept both of its China subsidiaries open but made new investments in India, Brazil, Indonesia, and the United States from 2013 until 2016. So this firm can be coded as diversifying because its relative dependence on China decreased significantly due to new investments. 43 out of 100 MNCs are coded as adopting a

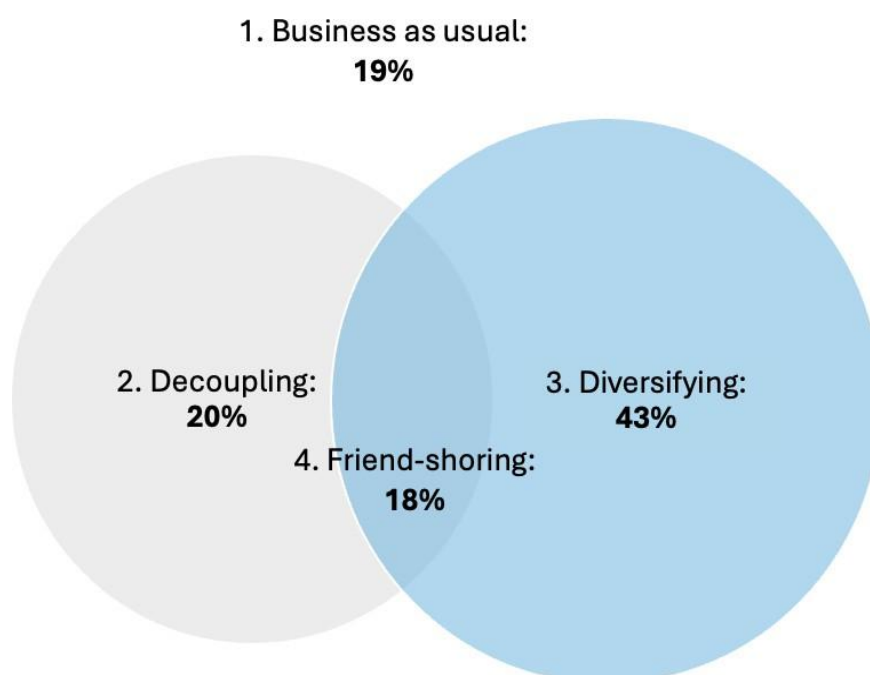
diversifying strategy.

Diverting/Friend-shoring: If a firm exits China, we also check to see if it has opened up new investments elsewhere in the time since it left China. We create our measure of friend-shoring to capture the set of firms that exit China AND also make a new investment in a place geopolitically aligned with Japan then it is categorized as friendshoring. For example, Marubeni-Itochu Steel Inc exited China in 2021 but in the same year opened up a new investment in Canada, a state with the fourth most joint military exercises with the Japan Self Defense Forces, so this firm is categorized as a friendshoring firm.

This was the most difficult measure to construct because defining who is a friend of Japan to measure "friend-shoring" is not straightforward. Japan only formally has one treaty ally since the signing of the Treaty of Mutual Cooperation and Security between the United States and Japan in 1960. Article 9 of the Japanese Constitution, often referred to as the "Peace Clause", renounces war as a sovereign right of the nation and prohibits the maintenance of a military for aggressive purposes. This constitutional provision significantly curtails Japan's ability to participate in formal military alliances or engage in collective defense arrangements. While the interpretation of Article 9 has evolved and Japan has participated in a greater range of collective defense activities, Japan still lacks any formal treaty allies other than the United States.

However, just as Japan operates a capable military (the Japanese Self Defense Forces) even though Article 9 prohibits Japan from maintaining "land, sea, and air forces, as well as other war potential," it interprets Article 9 to permit increasing participation in various forms of security partnerships in recent decades (Liff, 2017). Under the leadership of Shinzo Abe, Japan has increased the frequency, diversity, and intensity of military exercises (Smith, 2019). Scholars have noted that these exercises can be interpreted as efforts to balance against and deter a rising China. They are a show of unity with potential defense partners such as India to counterbalance China's influence in the Indo-Pacific region (Liff, 2016; Mastro, 2022). They are also a way to increase interoperability and defense coordination with existing partners such as the United States and Australia.

Figure 4: Japanese MNC De-risking Strategies



We opted to create a rough ordinal measure for military exercises because Japan conducts a large number of infrequent goodwill exercises with tiny countries like Palau and the Solomon Islands as well as regular large-scale joint exercises with partners like the United States and Australia.

These are costly signals of resolve that should increase business confidence in the political reliability of the partner country to Japan. The number of joint military exercises serves as a behavioral measure of friendship where we consider regular (2 or more) military exercise partners to be geopolitically aligned with Japan, these include: the United States, Canada, Australia, Thailand, Vietnam, South Korea, India, the United Kingdom, France, the Netherlands, Germany, Spain, Singapore, New Zealand, and Indonesia.¹⁵ 18 out of 100 MNCs are coded as adopting a friend-shoring strategy. Though a distinct category from friend-shoring, all but 2 of our MNCs that are coded as diversifying are relocating to at least one country that is conducting such drills with Japan. For further discussion on constructing this measure and a visualization of the data see Appendix A and Figure 5.

Returning to the typology we introduced in Figure 2 for these four types of firm-level behaviors in response to geopolitical risk, we can summarize the primary strategy adopted by each of the MNCs in our sample in Figure 4. The most common strategy adopted by Japanese MNCs was diversifying

(43%), with decoupling (20%), business as usual (19%) and friend-shoring (18%) all having a similar number of parent companies adopting these strategies.¹⁶

It is important to remember that these percentages reported in Figure 4 were estimated from a small sample representing 3-5% of Japanese MNCs in China and should be interpreted with a sizable margin of error when applied to the entire population.¹⁷ One way to interpret these figures is that between 60-80% of Japanese firms in China have adopted some form of de-risking over the past decade. But another interpretation is that, even after a tumultuous decade of geopolitics and growing government pressure to leave China, the vast majority of firms still operate subsidiaries in China as of 2022 and some 41% have even expanded their China operations. This is a pattern of derisking without decoupling.

Independent variables: Firm-level Characteristics

China Fixed Asset: To construct this measure we take Toyo Keizai data about the subsidiaries that each multinational company has in China. This variable is a count of how many subsidiaries each MNC has in the People's Republic of China (PRC) in the earliest year in our data. We opted to use the count rather than a continuous measure like capital stock to minimize losing observations due to missingness in the capital stock data. It is safe to assume that a parent company has greater fixed asset investment sunk in China if it operates a larger number of subsidiaries there. In this sample, the average MNC operates about 7 subsidiaries in China.

China Dependence: To construct this measure we use the Toyo Keizai data to count the number of subsidiaries that each MNC has in China and divide that by the total number of subsidiaries that company has throughout the world. This gives us a percentage that each MNC depended on China. In this sample, the average Japanese MNC depended on China for 33 percent of their global operations in 2012. This is likely to be an underestimate because this measure does not capture the

relative size or productivity of a company's operations in different countries, just the count.

China Experience: The extant literature suggests that some firms may be more resilient to geopolitical tensions if they have been invested in another state for a longer period of time. We code experience as the number of years a firm has been active in China. For example, a firm that opened its first investment in China in 2000 would be coded as 12 because that firm would have been operating from 2000 until the start of our sampling window (2012). On average, parent companies have been operating in China for around 15 years.

Services: The type of sector in which a parent company conducts business also determines their exposure to political risk and the cost of relocation. To account for firm heterogeneity we code each MNC using the industrial classification used by the Statistics Bureau of Japan.¹⁸ This is an indicator variable that equals 1 if the parent company is listed as operating in the services sector in our sample. The services sector include businesses such as construction, finance and insurance, professional services, and wholesale and retail.

National Security: In May 2020 the Ministry of Finance identified 518 companies as being "national security-relevant" and thus became subject to more stringent foreign investment requirements. Roughly 14 percent of all publicly listed Japanese companies were included.¹⁹

We created an indicator variable for national security that equal 1 if any of the firms in our sample are subject to these new requirements, meaning that the Japanese government deemed them to be national security relevant. These firms include: AGC Inc., EIZO, Fujifilm Holdings, Kyocera Corporation, Hitachi Metals, Ltd., Mitsubishi Chemicals, Mitsubishi Electric, Mitsui Chemicals, Inc., Mitsui Co., Ltd., Nippon Paper Industries Co. Ltd., Nippon Steel, Oji holdings, Okuma Corporation, SBI Holdings, Sharp Corporation, Showa Denko, Sinwa MFG. Co.,Ltd, TDK Corporation, Toshiba Corporation, Toppan, and Toyota Motor Corporation.²⁰).

Size: Overall firm size matters, as larger MNCs are more likely to afford the

high costs associated with relocation or expansion, while smaller firms with investments in China may have fewer options. We measure size using total invested capital reported by each parent company in 2012. In this sample, the average parent company reports an investment of 69.4 billion yen.²¹

In Table 1 we show descriptive statistics for the **100** parent companies we analyze.

Table 1: Descriptive Statistics for Sample of 100 Japanese MNCs

Continuous variables				
	Min	Max	Median	Mean
China Fixed Assets	0	65	4	6.68
China Dependence	0	1	.25	.33
China Experience	0	71	15.5	15
Size (Logged)	16.81	27.73	23.92	23.49
Size (Yen)	2.00e+07	1.10e+12	2.46e+10	6.94e+10
Discrete variables				
Categories	No		Yes	
National Security	79%		21%	
Services	78%		22%	

Results

We estimate a multinomial logit regression to provide insights into the factors influencing firms' strategic responses to growing geopolitical risks in China between 2012 and 2022. The model estimates the likelihood of a parent company adopting one of three alternative strategies— decoupling (model 2), diversifying (model 3), or friend-shoring (model 4)— relative to the reference category of maintaining "business as usual" (not displayed). The results are summarized in Table 2 which incorporate robust standard errors and the sampling weights that we used to construct our original sample of firms from the China-based FIEC dataset.

Table 2: Multinomial Logit Regression Results: Determinants of Decoupling, Diversifying, and Friendshoring

	Unweighted Sample			Weighted Sample		
	Decoupling (2)	Diversifying (3)	Friendshoring (4)	Decoupling (2)	Diversifying (3)	Friendshoring (4)
China Fixed Assets	0.0808 (0.117)	0.0956 (0.120)	0.135 (0.121)	0.0267 (0.0949)	0.0559 (0.0942)	0.111 (0.0958)
China Dependence	-0.894 (1.452)	-0.582 (1.209)	0.202 (1.670)	-0.645 (1.525)	-0.193 (1.449)	-0.102 (2.411)
Experience	0.0418 (0.0579)	-0.0207 (0.0537)	-0.0203 (0.0578)	-0.0460 (0.0779)	-0.0218 (0.0579)	0.00219 (0.0733)
Services	-1.355 (0.973)	-0.0915 (0.676)	-0.348 (0.823)	-0.0855 (0.968)	0.671 (0.830)	0.624 (1.032)
National Security	15.03*** (0.691)	14.77*** (0.564)	16.52*** (0.661)	14.82*** (0.823)	13.76*** (0.673)	16.04*** (0.752)
Size (logged)	0.154 (0.198)	0.204 (0.164)	0.396 (0.255)	0.438 (0.304)	0.275 (0.195)	0.485 (0.323)
Observations	100			100		

"Business as usual" is the reference category. Robust standard errors in parentheses.

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

We find no support for H1a or H1b, which anticipated that higher fixed asset investment in China and longer experience in country should reduce the likelihood of a firm adopting a derisking strategy over business as usual. The coefficients on for experience is negative but not statistically significant.

Similarly, we find no support for H2, which predicted that MNCs operating in services sectors should be more likely to decouple from China. The coefficient for services is negative rather than positive though not robust.

H3 posited that firms with greater dependence on China should be more likely to diversify. China dependence has a coefficient that is also trending in the opposite direction of our expectation but is also not statistically significant. In contrast to the null results for H1-3, the regression results provide strong support for H4, which predicted that national security relevance is a key driver of friend-shoring among Japanese multinational corporations (MNCs). Across both unweighted and weighted models, firms identified as important to Japan's national security are significantly more likely to pursue not only friendshoring but also decoupling and diversifying. The large and statistically significant coefficients for the National Security variable (all significant at the 1% level) is evidence that Japanese firms deemed to be strategic by the government do appear to be "following the flag" in their investment behavior.

Another way to interpret these findings is that, for the majority of Japanese firms - the 79% that were not classified as national security-relevant, none of the standard firm-level predictors (such as China exposure, fixed asset investment, experience, or sector) significantly explain whether they pursue a de-risking strategy. These firms do not appear to be systematically responding to political risk in the way that “follow the flag” theory would predict. While "business as usual" is becoming more difficult to sustain due to rising political risk, normal non-national security firms are not necessarily redirecting investment to politically preferred alternatives, such as allied countries. This suggests that for the bulk of firms, de-risking decisions are shaped more by idiosyncratic and firm-specific constraints that probably have little to do with politics. Firms that were more exposed to China in 2012 were surprisingly not more likely to engage in de-risking than less exposed firms. It is likely that much of the observed de-risking, particularly the diversification, may be less a coordinated shift in grand strategy than a fragmented, uneven response to a rapidly changing business environment. But for national security-relevant firms, politics definitely appear to be driving decoupling and friend-shoring.

Conclusion

As geopolitical tensions reshape global trade dynamics, policymakers and scholars alike grapple with defining emerging concepts such as de-risking, decoupling, and friend-shoring. While policymakers often use these terms interchangeably, we advance a typology to categorize different "derisking" strategies that multinational corporations (MNCs) adopt in practice.

We find that, over the past decade, the majority of Japanese MNCs (as many as 81%) have de-risked in some way while most continue to maintain significant operations in China. Puzzlingly, the regression results suggest that dependence on China, experience in China, and exposure to China all fail to explain what type of de-risking strategy a parent

company might take. These null results could be due to a lack of statistical power from the relatively small sample size. Instead, we find that firms subject to national security considerations in Japan are the most likely to be decoupling and friend-shoring away from China. This sizable minority of firms very much appears to be "following the flag." Using our new measure for Japanese geopolitical affinity, we find evidence for friend-shoring: among firms that closed down a subsidiary in China, about half did not expand elsewhere, while those that did primarily shifted operations to the U.S., Canada, ASEAN and other nations that conduct bilateral military exercises with Japan. A vast majority of the firms that did not leave China but did diversify investment elsewhere chose to expand in such allied states as well.

These findings lend partial support to both the "business as usual" and "following the flag" theories for firm behavior in response to political risk. At the aggregate level, Japanese FDI in China appears relatively resilient to political risk, declining only slightly from 27.54% in 2012 to 24.37% in 2022. This 3 percentage point decline is certainly much more gradual than the 30 percentage point decline in the business confidence survey data. But when we disaggregated FDI to firm-level behavior, we see that the majority of Japanese firms have slowly adopted some form of de-risking by decoupling, diversifying, or friendshoring. This is especially true for national security-relevant firms.

Ultimately, the question is no longer whether de-risking is occurring or not—but rather how much, and why firms are pursuing some strategies over others. This paper takes a first-cut at these questions. Our findings highlight the growing role that national security concerns are playing in international political economy. Future work might further investigate how firms weigh geopolitical concerns against economic incentives and whether government pressure or market logic ultimately drives relocation decisions. Additional data could also be collected for a larger sample of Japanese MNCs or on firms from other advanced industrial economies for comparative analysis. Finally, more case-based or interview-based qualitative analysis could help illuminate how decisions are made within firms and how de-risking unfolds over time.

End Notes

¹JETRO Global Trade and Investment Report 2021

²Of the 87 subsidies in this program, 57 were for re-shoring and the remaining subsidies were for diversification. Curiously, Shin-Etsu is coded as business as usual in our data. As of 2022, the parent company has neither left China nor opened any new subsidiaries in Vietnam despite taking this 2020 subsidy, according to Toyo Keizai.

³Of these firms, two are recorded as business as usual, however, given that all of these subsidies were announced in the year 2023 or later it's possible that they may de-risk later like the other firms in our sample. One of the firms with a subsidy is coded as decoupling and the remaining four are coded as friend-shoring.

⁴In 2020 THK exited China and has since expanded in the Cayman Islands in 2021, Yazaki Corporation exited China in 2018 and has since expanded in Myanmar in 2019. Both are coded as decoupling based on our typology.

⁵"FACTBOX-Japan budgets \$650 mln for rare earths, resources," Reuters, 2011,
<https://www.reuters.com/article/idUSTOE704042/>

⁶JETRO Global Trade and Investment Report, 2013

⁷JETRO Survey of Business Conditions of Japanese Affiliated Companies Overseas 2021, 2023

⁸Interviews by one of the coauthors in Tokyo in summer of 2023

⁹JETRO Global Trade and Investment Report 2021

¹⁰JETRO Survey on Business Conditions of Japanese Companies Operating Overseas (Asia and Oceania) 2022

¹¹"Japanese pharma boss rules out China exit after executive's arrest ", Financial Times, 2023, <https://www.ft.com/content/4fb65320-3c6a-4a8a-a56a-89a5cb40e069>

¹²"Japan Starts Paying Firms to Cut Reliance on Chinese Factories", Bloomberg, 2020, <https://www.bloomberg.com/news/articles/2020-07-18/japan-to-pay-at-least-536-million-for-companies-to-leave-china?embedded-checkout=true>

¹³According to our data, Australia (640,721,948,210 yen in 2022) is the largest FDI recipient that does not fall into one of these four buckets. Japanese investment in India has increased rapidly to 221,249,168,000 yen in 2022 but that sum is still only 8 percent of Japanese capital stock in China).

¹⁴The yearbooks contain information for each subsidiary listed under the parent company on the foreign address of operation, the name of the subsidiary, capital stock, number of employees, consolidated sales as well as a brief description of the services that it provides. This dataset contains 10,661 subsidiary-years. MNCs in the sample operated on average 7.12 subsidiaries in China out of an average of 33.46 subsidiaries globally. However, there is a considerable amount of missingness or lack of variance across different years.

¹⁵Though many studies operationalize geopolitical closeness by using UN affinity voting, we found that this common cross-national measure did not fit the Japan case. We show in Table 3 in Appendix B that, according to UN vote data, European states would be considered geopolitically close with Japan whereas BOTH the United States and China are

geopolitically distant from Japan. When viewed with the volume of investment in Figure 6 in Appendix B, we can see that Japan is investing more yen into geopolitically distant rather than like-minded states when measured with UN affinity.

¹⁶ In Appendix C we show how these strategies differed from the first wave of de-risking in 2012-2016 (Figure 7) and the second wave of de-risking that occurred from 2018-2022 (Figure 8). The Business as usual category varies quite a bit from Figure 4 to Figures 7 and 8. That's because many firms' de-risking investment decisions occurred in either the front window or in the second window of political risk. Figures 7 and 8 show that our inferences from firm-level decisions can change depending on how long of a time frame you want to view them from.

¹⁷See Appendix C for a detailed discussion of the likely margin of error around each de-risking strategy.

¹⁸Statistics Bureau of Japan, Industrial Classification used in the 2016 Economic Census for Business Activity, <https://www.stat.go.jp/english/data/e-census/2016/industry.html>

¹⁹UN Trade and Development (UNCTAD), Investment Policy Hub, <https://investmentpolicy.unctad.org/investment-policy-monitor/measures/3520/japan-ministry-of-finance-released-a-list-of-companies-deemed-important-to-national-security->

²⁰You can find a list of all 518 firms with such investment restrictions within the following Nikkei article ("Gaishi kisei, jū ten shinsa 518-sha Toyota ya Sofutobanku G", Nikkei, 2020, <https://www.nikkei.com/article/DGXMZO58881950Y0A500C2EA4000/>)

²¹The unlogged measure for size has a right skew so we log it in our analysis to give it a normal distribution. That said, whether we use a logged or unlogged measure does not change either sets of our models.

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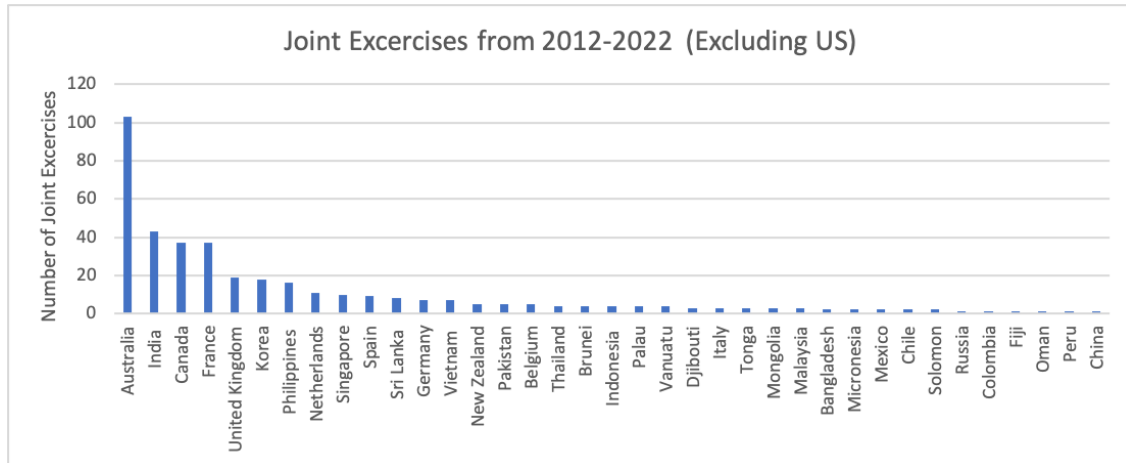
Appendix A

We use Japanese Self Defense Force (JSDF) reports to count Japan's major military exercise partners since 2011. With efforts by the late Prime Minister Shinzo Abe, the JSDF has greatly enhanced its capabilities as well as the scope of its mission. From members of the QUAD, to Five Eyes English speaking nations as well as many states dotting the Pacific Rim, Japan has steadily began expanding the role that the JSDF plays beyond Japan's territorial waters and exercise with partners other than the United States with greater frequency since 2015.

To create a variable measuring the activities that Japan conducts with friendlier states and non-US allies, we look to formal releases by the Japan Maritime Self-Defense Force. For every case we find online we code for the year the event occurred as well as the corresponding country code and create a time-series of the number of bilateral exercises that the Japanese navy conducts with friendly nations each year. Below is the total number of exercises conducted bilaterally during our sampling window for our multinational corporations.

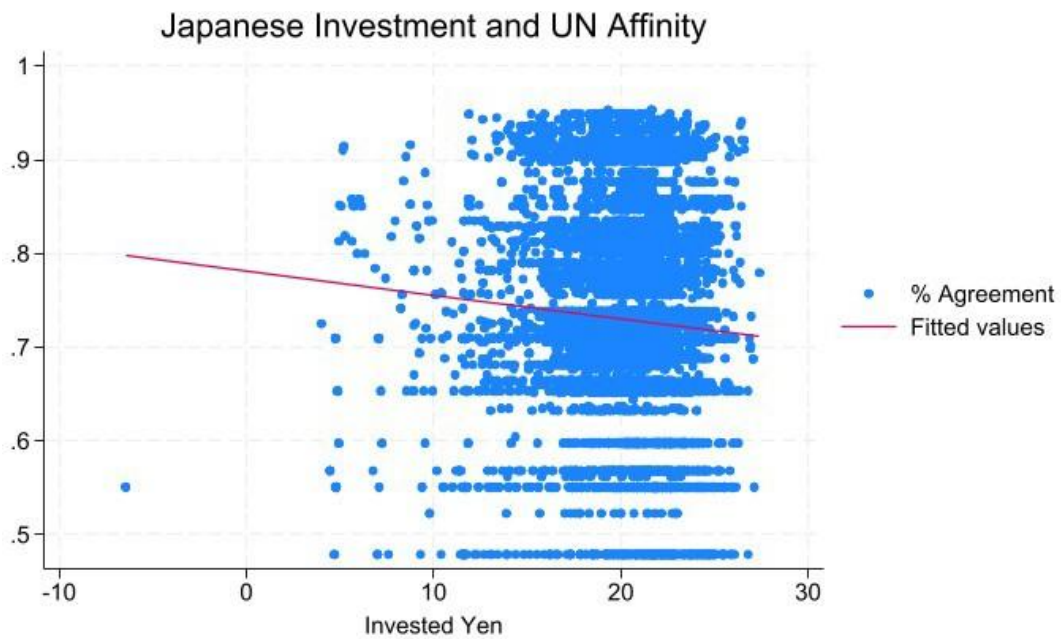
The United States is the most common partner in Japan's military cooperation exercises and is excluded from the figure. The average number of exercises by country is 19.26 but when the US exercises are subset out the average number drops to 10.57. Prior to 2020, the only bilateral exercises in our dataset are found in the QUAD, Five Eyes countries (US, UK, New Zealand, Canada, and Australia) as well as Mongolia and the Philippines. However, after 2020 the scope of the JMSDF's security cooperation exercises rapidly expands to include many Pacific Island nations, several ASEAN and European powers which happens to coincide with the Japanese government more carefully considering economic security issues.

Figure 5: Japan Friend Measure



Appendix B

Figure 6: Investment and UN Affinity



State	UN Vote Agreement Percentage
Netherlands	91.4
United Kingdom	85.1
Indonesia	66.5
United States	65.3
China	59.8

Table 3: UN Vote Affinity with Japan in 2022

Appendix C

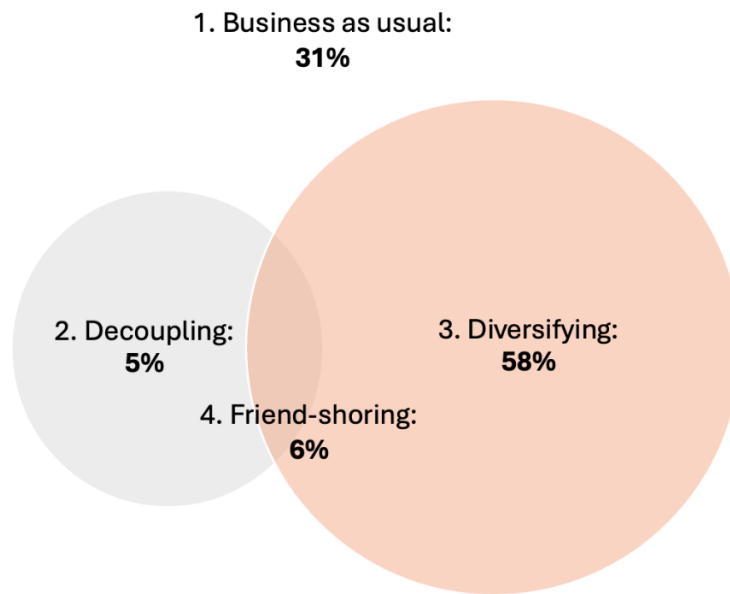


Figure 7: Japanese MNC De-risking Strategies (2012-2016)

The sample of $n=100$ is relatively small for a population of 15,000 Japanese FIECs. We estimate that the margin of error with a traditional 90-95% confidence is around plus or minus 9.8. This means that a finding that 19% of parent companies in the sample engaged in decoupling means that the population of FIECs is likely decoupling at between 9-29%.

To examine how Japanese firms react to periods of heightened political risk, we leveraged data from the 2012-2022. The 2012 and 2014 surveys cover the anti-Japanese

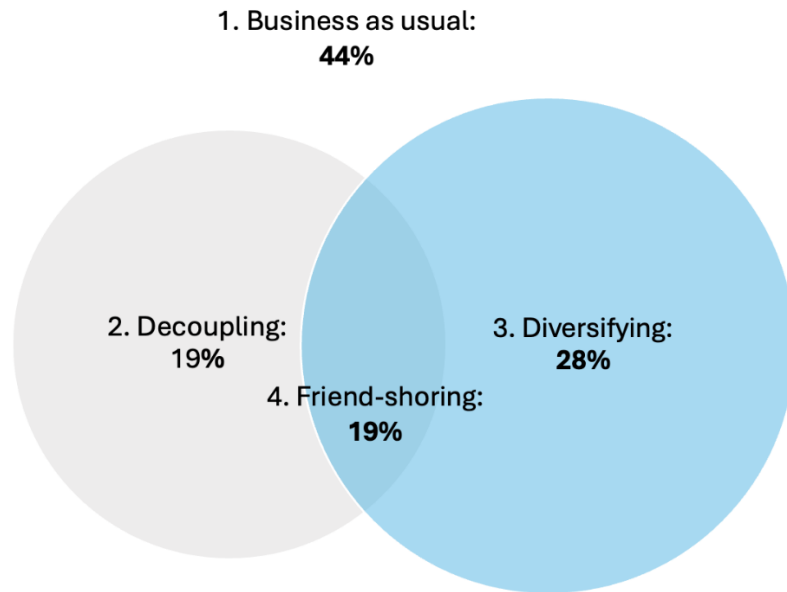


Figure 8: Japanese MNC De-risking Strategies (2018-2022)

protests and consumer boycotts related to the Senkaku-Diaoyu territorial dispute which spurred the initial policy debate in Japan about the potential need for diversifying their supply chains (Figure 7). The 2018 and 2022 surveys cover the period related to the mounting US-China trade war and the political risk associated with the disruptive zero-covid lockdowns (Figure 8).

Online Appendix

MNC Name	Sample Weight	Typology
AEON	5.475553	Diversifying
A.L.M.T. Corp. (アライドマテリアル)	0.8357317	Diversifying
Aisin	3.69004	Business as Usual
Aoyama Trading Co., Ltd.	0.4847775	Business as Usual
ARKRAY, Inc	0.4831621	Diversifying
Asahi Shigyo Co., Ltd.	0.4181338	Business as Usual
DAIKEI CORPORATION	0.0379016	Business as Usual
DAIKO ADVERTISING INC.	0.5154907	Diversifying
Daiwa House	4.505774	Friendshoring
EIZO	0.6685981	Diversifying
F.C.C. Co.,Ltd.	1.220688	Diversifying
Ferrotec Holdings Corporation	3.903819	Business as Usual
Furukawa Co. Ltd.	0.5498201	Decoupling
Hitachi Zosen Corporation	1.607097	Decoupling
Itochu Corporation	0.6103438	Decoupling
JXTG Nippon Oil & Energy Corporation (ENEOS)	1.548181	Friendshoring
Kantatsu Co., Ltd.	1.924923	Business as Usual
Kobayashi Pharmaceutical Co., Ltd.	1.093064	Decoupling
Komatsu Limited	3.033132	Decoupling
Kose Global	1.509907	Diversifying
Marubeni-Itochu Steel Inc.	2.400492	Friendshoring
Mitsubishi Chemicals	3.286791	Friendshoring
Mitsubishi Electric	4.743113	Friendshoring
Mitsui & Co., Ltd.	5.201123	Friendshoring
Morimatsu	2.231556	Business as Usual
NAIGAI Co.,Ltd.	0.240765	Decoupling
NICHICON CORPORATION	2.379558	Diversifying
NIPPON PAPER INDUSTRIES CO., LTD.	1.292715	Friendshoring
Nippon Tanshi Co., Ltd.	0.4429375	Decoupling
NIPRO CORPORATION	3.920396	Business as Usual
Nissei Co., Ltd.	0.6256089	Friendshoring
Nissin Kogyo Co., Ltd.	0.4457321	Business as Usual
Okuma Corporation	0.5772676	Friendshoring
Panasonic	7.131713	Friendshoring
Pioneer Corporation	1.996425	Decoupling
Rengo Co., Ltd.	2.403038	Friendshoring
SANKYO KASEI CO.,LTD	0.2673668	Diversifying
Santen Global	1.381647	Diversifying
SBI Holdings	1.897179	Diversifying
Sharp Corporation	3.520983	Diversifying
SHOEI FOODS	0.8368612	Business as Usual
SINWA MFG. Co.,Ltd	0.2523903	Diversifying
SUGINO MACHINE LIMITED	0.7290139	Business as Usual
Sumitomo Chemical Company, Limited	4.562587	Diversifying
Sumitomo Wiring Systems LTD.,	0.1500068	Diversifying
TSUMURA & CO.	1.618198	Business as Usual
TAKAGISEIKO CO.	0.7290139	Business as Usual

TAKEMOTO OIL & FAT CO., LTD.	0.7012317	Business as Usual
TDK Corporation	1.823557	Diversifying
THK Co., Ltd.	3.860153	Decoupling
TMEIC	1.00452	Diversifying
TOA Electric & Industrial Co., Ltd	0.5950983	Friendshoring
Toshiba Corporation	1.985175	Diversifying
Toyo Tire & Rubber Co., Ltd.	2.792948	Diversifying
Toyota Motor Corporation	7.131713	Friendshoring
TS TECH CO.,LTD.	0.2990062	Decoupling
Yachiyo Industry Co., Ltd.	0.6303604	Diversifying
Yazaki Corporation	1.179296	Decoupling
ZENSHO HOLDINGS CO., LTD.	1.220688	Diversifying
Lawson	3.982169	Diversifying
Sekisui House	7.131713	Decoupling
Suntory Holdings	3.347675	Business as Usual
Toppan	1.965774	Friendshoring
Tokyo Marine Nichido	1.673918	Diversifying
Natoco	0.9356167	Diversifying
Seikoh Giken	0.6587763	Business as Usual
Aikitec Co., Ltd.	0.8264095	Business as Usual
DIC Corporation	2.873623	Diversifying
Nippon Steel Trading Co. Ltd	2.068413	Friendshoring
KYOCERA CORP.	3.747357	Decoupling
Fujifilm Holdings Corporation	3.644174	Decoupling
JFE SHOJI TRADE CORPORATION	1.520086	Diversifying
Shin-Etsu Chemical	2.844522	Business as Usual
Oji Holdings Co., Ltd.	6.46092	Decoupling
Fujitsu	2.154987	Decoupling
ANEST IWATA CORPORATION	0.540779	Decoupling
Suzuki	2.238135	Friendshoring
Riken Vitamin Co. Ltd.	1.608604	Diversifying
Nihon Tokushu Toryo Co., Ltd.	0.8145868	Diversifying
Hino Motors Ltd.	2.695385	Diversifying
7-11	2.625539	Diversifying
Bando Chemical Industries, LTD.	0.66562	Diversifying
Yamaguchi Seisakusho Co. Ltd	0.6589165	Diversifying
The Yokohama Rubber Company, Ltd.	3.678806	Diversifying
Yakult Honsha Company, Limited	3.303533	Diversifying
Kanebo Cosmetics	3.060223	Business as Usual
Daiichi Sankyo	2.700268	Diversifying
Nippon Life	2.205023	Diversifying
House Foods	2.182495	Diversifying
Metal One	1.649975	Diversifying
Showa Denko	2.330324	Friendshoring
AGC Inc.	6.850779	Friendshoring
NIDEC CORPORATION	2.512	Diversifying
MURAKAMI CO., LTD.	0.468987	Decoupling
Hitachi Metals, Ltd.	3.298471	Decoupling
Nippon Electric Glass. Co., Ltd.	3.972539	Diversifying
Kokuyo Co.	2.505169	Diversifying
MITSUI CHEMICALS, INC.	2.310355	Diversifying
ADEKA Corporation	1.972962	Diversifying
NIDEC-SHIMPO CORPORATION	1.265636	Decoupling