Business Climate Survey
by AHK Japan

German Business in Japan 2018

German Chamber of Commerce
and Industry in Japan
在日ドイツ商工会議所

Content

Out of the German companies active in Japan...

87%
record a **profit** before tax.

73%
expect a **positive trend in business** in Japan over the coming 12 months.

87%
see the **stability and reliability of business relationships** as an important factor in location.

90%
understand the **recruitment of personnel** to be a challenge.

84%
consider the country to have **high sales potential**.

64%
are involved in **projects with Japanese companies outside Japan**.

Dear readers,

German industry in Japan continues to do well this year. In addition to the generally positive expectations with regards to the local economic trends in the coming months, the business potential with Japanese partners outside Japan in particular is considered to be especially promising. The following is particularly worth noting: The revenue that some German companies are achieving from business in third markets in addition to local business is up to four times higher than the local revenue in Japan.

Current global trends are contributing significantly to Japan's fast and vigorous progress: The "Comprehensive and Progressive Agreement for Trans-Pacific Partnership" (CPTPP) was concluded in March 2018 based largely on Japanese initiative and the ratification is ongoing. The final signing of the free trade agreement between the EU and Japan is scheduled for July 2018. Both sides are assuming a swift ratification process, meaning that this agreement is likely to enter into force in early 2019.

However, the developments relating to the Chinese "Belt and Road Initiative" on the one hand and the Japanese "Free and Open Indo-Pacific Strategy" introduced in the last decade on the other must be given more attention in the interests of German industry. Both initiatives can open up business potential, whereby the touchstones are transparency, human rights and environmental standards. With these, Japan is also promoting free and rule-based free trade. In this regard, it is important for German industry to look to Japan's large general trading houses and project developers. They are the drivers of Japanese globalisation and are often interested in the expertise of German companies.

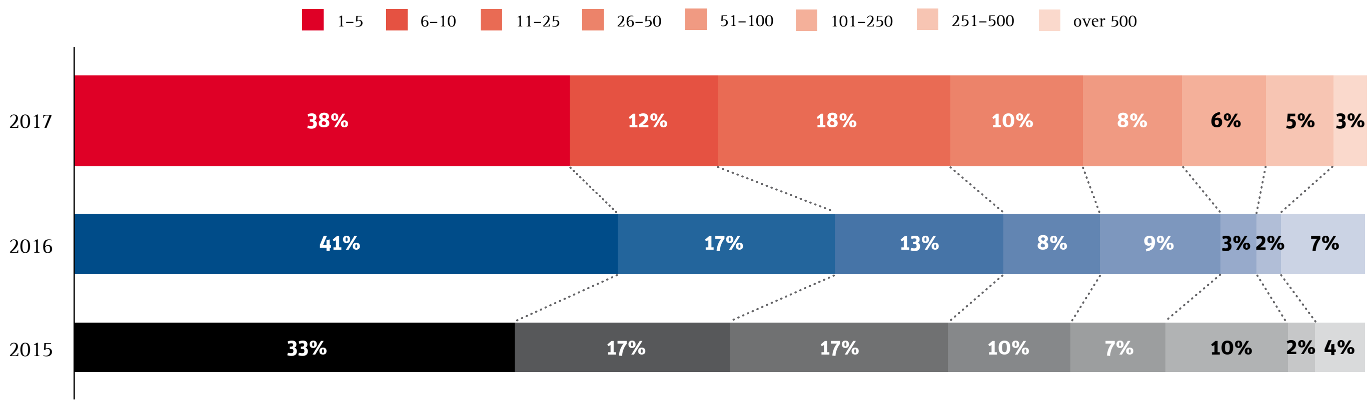
It is therefore recommended that German companies observe the way in which Japan deals with the trends in Asia and incorporate the lessons learned from this into their own Asian strategy.

Marcus Schürmann
Delegate of German Industry and Commerce in Japan
CEO AHK Japan

I Overview: Business in Japan Continues to Be Profitable

Germany is an esteemed competitor as well as an important partner of Japanese industry and commerce. Business is continuing an upward trend and the willingness to collaborate even more intensively is likewise increasing – also with a view to being better positioned in relation to growing international competition. Bilateral trade continued to pick up in 2017. Germany, which is responsible for around 30 percent of the Japanese imports from Europe, supplied products worth approximately 19.5 billion euro to Japan according to Destatis – 1.2 billion more than in 2016. Japanese goods exported to Germany totalled 22.9 billion euro, almost a billion more than the previous year.

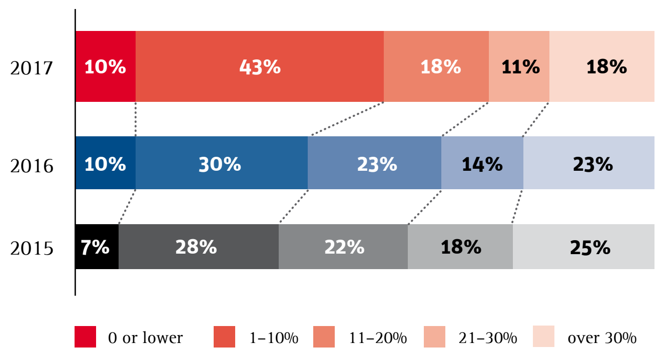
(Expected) revenue for the last 3 (financial) years
(in EUR millions; 1 euro = 130 yen)



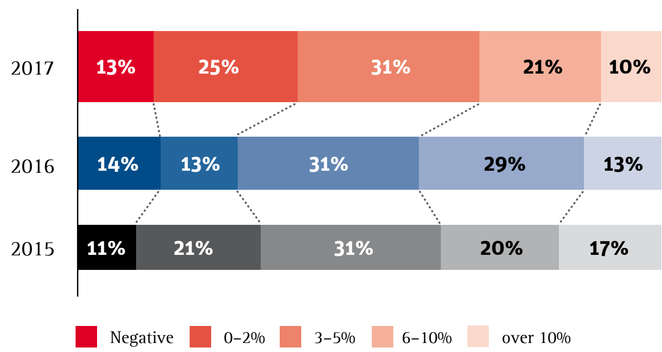
Overall, the companies that participated in the survey are making a profit in Japan and are happy with their business development. While the proportion of companies with a revenue of one to 50 million has remained relatively unchanged, as a whole the expected revenue has increased in comparison to 2016. However, the gross profit margin in the last three years has shifted into the single-digit percentage range.

The proportion of companies with a profit margin of over 11 percent has dropped by over 10 percent compared with the previous survey, but still remains high at 47 percent. Correspondingly, in the last three years, more companies have reported lower margins for pre-tax profit, whereby these margins now tend to be in the range of up to five percent.

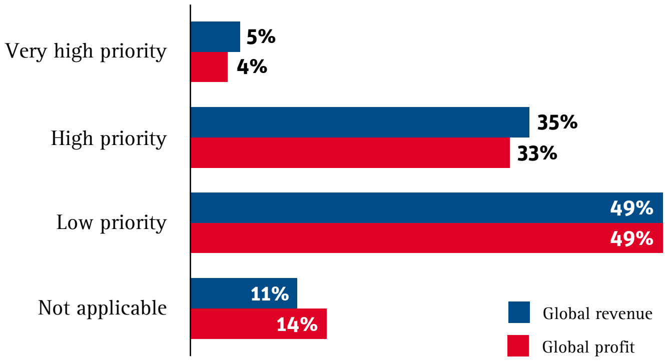
Average gross profit margins over the last 3 years



Average pre-tax profit margins over the last 3 years



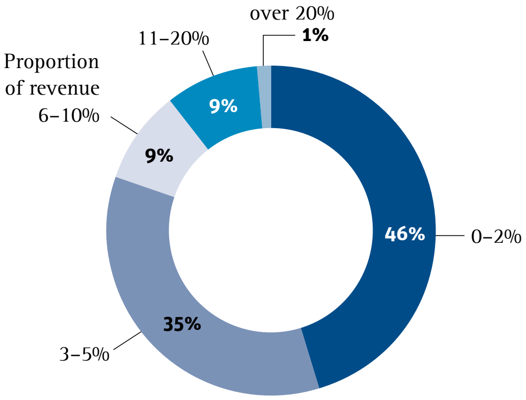
How important is business in Japan to the Group?



35 percent of the companies surveyed rate the contribution made by their Japanese subsidiary to the global group revenue as high, and five percent as very high.

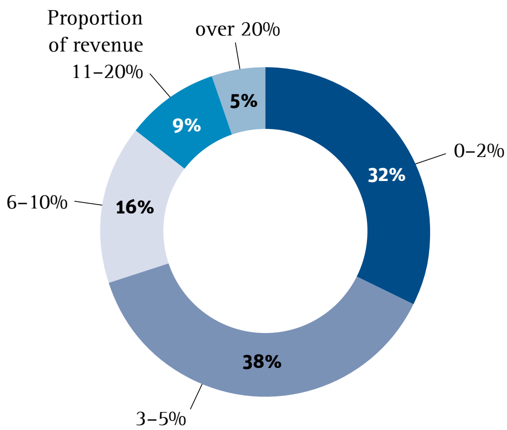
The situation is similar with regards to the global group profit; here, 33 percent of the companies surveyed rate the contribution by their Japanese subsidiary as high and four percent as very high.

Proportion of global group revenue derived from the Japanese subsidiary



The proportion of global group revenue derived from a Japanese subsidiary is over six percent for 19 percent of the companies surveyed.

Proportion of global group revenue derived from revenue with Japanese customers worldwide



For 30 percent of the companies surveyed, the revenue with Japanese customers worldwide accounts for at least six percent of the total revenue.

The ratio between
(A) the group's revenue with Japanese customers worldwide (excluding the Japanese market) and
(B) the revenue of the Japanese subsidiary

A is less than B.	**40%**
A is equal to B.	**12%**
A is greater than B.	**48%**
A is up to 50% greater than B.	**10%**
A is 50% to 150% greater than B.	**13%**
A is 150% to 300% greater than B.	**4%**
A is over 300% greater than B.	**21%**

Business and revenue potential with Japanese partners is often strategic in nature. It generally results from German companies endeavouring to get involved in international projects with Japanese customers and actively supporting and accompanying the decision-making processes in Japan and in cooperation with the national companies in the destination countries.

Thus 60 percent of the companies surveyed confirm that for every euro of revenue generated in Japan, at least one other euro of revenue is generated with Japanese customers in other parts of the world. For a third of this group, the additional revenue with Japanese customers outside Japan is at least four times the revenue in Japan itself.

II Insight: Opportunities and Challenges

There are many reasons to have a presence in Japan. In particular, the German companies surveyed value the sales potential in Japan and with Japanese customers worldwide; 84 and 53 percent respectively consider these two points to be of (high) importance. As the third largest national economy in the world with a first-class infrastructure, Japan is a promising starting point for German companies in Asia and therefore strategically very important, as expressed by 59 percent of the companies in the survey.

German industry in Japan rates the high stability of Japanese business and the reliability of business relationships (87 percent) even higher than in the previous year. The stability of the economy in general is an important advantage, as confirmed by 84 percent – almost 10 percent more than in the previous year. Social (75 percent) and political (70 percent) stability are further important advantages that make business with Japan especially attractive.

One particularly major challenge for German companies in Japan is human resources: 90 percent of the companies surveyed consider recruiting suitably qualified staff as difficult, whereby „qualification" here is understood to mean technical and linguistic qualifications. The dismissal of staff (43 percent) and retention of employees (39 percent) have developed into bigger challenges compared to the previous year.

The companies surveyed are less concerned with some other criteria. Only 32 percent consider property prices to be problematic, for example. Data protection (21 percent) and protection of intellectual property (16 percent) – areas in which Japan already has extensive regulations comparable to those in Germany – are also seen by many companies as unproblematic. Corruption is only seen as a challenge by four percent.

Top 6 reasons to have a presence in Japan

		2018	2017	2016
1	High sales potential in Japan	84% ↘	87% ↘	91%
2	Strategic importance of business with Japanese companies	59%	–	–
3	High sales potential with Japanese customers worldwide	53% ↗	52% →	52%
4	Japan as a benchmark, e.g. for quality and service	39% ↗	35% ↗	34%
5	Observing Japanese competitors	39% ↘	42% →	42%
6	Research and development in Japan	21% ↘	24% ↘	25%

Top 7 benefits of doing business in Japan

		2018	2017	2016
1	Stability and reliability of business relations	87% ↗	82% ↘	85%
2	Stability of the economy	84% ↗	75% →	75%
3	Security and social stability	75% ↗	65% ↘	67%
4	Stable political environment	70% ↗	64% →	64%
5	Highly qualified employees	70% ↘	74% ↘	76%
6	Openness regarding state-of-the-art technology and innovation	62% ↘	67% ↗	59%
7	Highly developed infrastructure	61% ↘	69% ↘	71%

Top 7 challenges of doing business in Japan

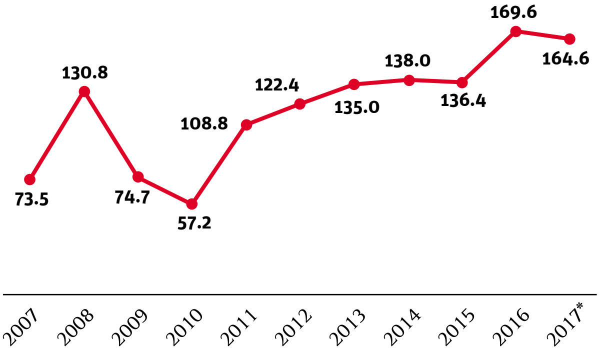
		2018	2017	2016
1	Recruiting qualified employees	90% ↗	80% ↗	78%
2	Currency risk	53% ↗	44% ↘	57%
3	Dismissing employees	43% ↗	29% →	29%
4	Regulatory hurdles	40% ↗	22% ↘	33%
5	Wage and non-wage labour costs	39% ↗	38% ↗	34%
6	Retaining employees	39% ↗	19% ↘	32%
7	Relatively high taxation	38% ↗	30% →	30%

Business with Third Markets: Partners on the Global Markets

The globalisation of Japanese industry and commerce continues. Foreign direct investment (FDI) has been well above the 130 billion U.S. dollar mark for several years now, and in 2017 an estimated 164.6 billion U.S. dollars was invested in projects abroad. Some years, Japan's FDI is more than the combined amount of FDI of China and Korea. Decisive drivers of globalisation include the general trading houses, which often take on the role of consortium leader in large projects outside Japan, and, where possible, also initially involve Japanese suppliers and equippers. Japan's policy fully supports these developments, thus making a significant contribution to the positioning of Japanese interests worldwide and supporting the globalisation efforts of small and medium-sized companies too.

Japan's globalisation efforts began back in 2007 with the formulation of the "Free and Open Indo-Pacific Strategy". This measure under Japanese foreign and foreign trade policy is intended to link Asia and Africa with the ASEAN Free Trade Area like a hinge in the middle. Here, Japan sees itself as a significant contributor to rule-based free trade and a guarantor of stability and peace, and as a key partner for the economic development of the countries within this geographical area – and ensures project sustainability as a supplier of quality infrastructure.

Japan's direct investment abroad
(in USD billions)



**Estimate or forecast*

Source: Japan External Trade Organization, Japan's Outward FDI by Country/Region (Balance of Payments Basis, Net and Flow), 2018.

Top 5 reasons for third-country projects with Japanese companies

		2018	2017
1	Use of own sales and service network	43% ↗	40%
2	Greater accessibility due to more international character of business	25% ↗	18%
3	Increase in importance of Japanese subsidiary	19% ↘	20%
4	Saturation of domestic Japanese market	10% ↗	8%
5	High margins can be achieved	5% ↗	3%

This is why around 7000 Japanese companies are already in the ASEAN Free Trade Area and have a significant influence on the relevant countries. Development aid with an impact on vested economic interests is therefore of high importance. Japan is a key partner of the Asian Development Bank (ADB) and reviews investment opportunities in projects by the Chinese Asian Infrastructure Investment Bank (AIIB), provided that standards relating to human rights and the environment are complied with and transparency is given.

These trends are extremely relevant for German companies in Japan, especially those in the engineering and plant engineering, industrial equipment, construction and automotive supply industries. The strategic importance of Japan's involvement has increased significantly. In addition to the handling of the local Japanese market, for many companies in these industries, projects relating to third markets now play a prominent role. 64 percent of the companies surveyed support this assessment. Having Japan as a location and operating a German subsidiary in Japan itself are therefore of high strategic importance, since relevant decisions – including for markets outside Japan – are made in Tokyo. Since large German companies, along with small- and medium-sized companies, are represented in numerous countries in the region, in the interaction between the Japanese customer and the relevant offices of the German project partners, the best possible support can be provided. For Japanese companies, German suppliers are often preferred partners.

III Outlook: Business Expectations Remain Positive

The outlook for the Japanese economy continues to be good for 2018. Although many economic research institutes are forecasting slightly lower economic performance than last year, both small- and medium-sized businesses are still expecting the business climate to improve further according to Japanese reports and surveys.

According to the current survey, German companies are also optimistic. 61 percent of companies surveyed expect an improvement, while 10 percent actually expect a very strong improvement in business over the coming six months. Over a period of 12 months, the outlook for business is better still: 51 percent of companies expect an improvement, 22 percent even a strong improvement.

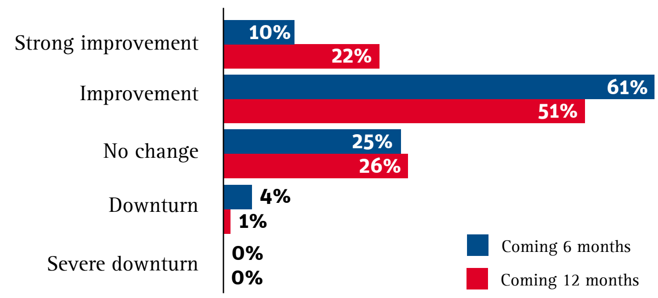
Stability also plays a role in the outlook for economic trends in Japan: 51 percent of German companies do not expect to see any change in the Japanese economy in the coming six months, while 43 percent think the economy will pick up. With regards to the coming 12 months, 48 percent of companies in the survey predict improved growth, while 40 percent do not expect a change. For both periods, four percent of companies expect very good economic trends.

86 percent of companies surveyed name globalisation as the most important influence on their business activities in Japan; around a third of these even rate this as having a strong influence. Compared to the survey from the previous year, this value has risen by 11 percent and underlines Japan‘s importance as a global player.

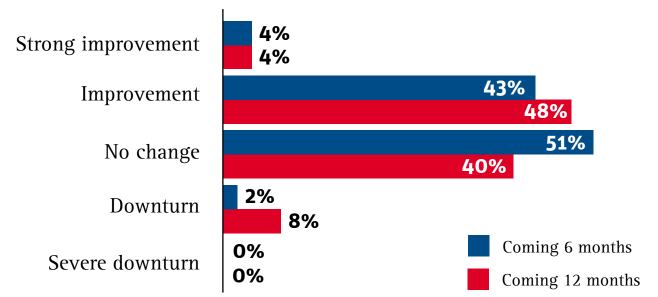
77 percent of the companies surveyed rate the digitalisation of industries and services as having even greater importance for business development compared to the previous year. The demographic change, too, will affect business in Japan – a view supported by 69 percent.

71 and 56 percent of German companies respectively think that their business in Japan will be influenced by Asian integration and sustainability. The topics of resource scarcity, governmental reforms and urbanisation seem to be less significant: Less than half of the companies surveyed consider them important influences.

Outlook for the development of German business in Japan



Outlook for the development of the Japanese economy



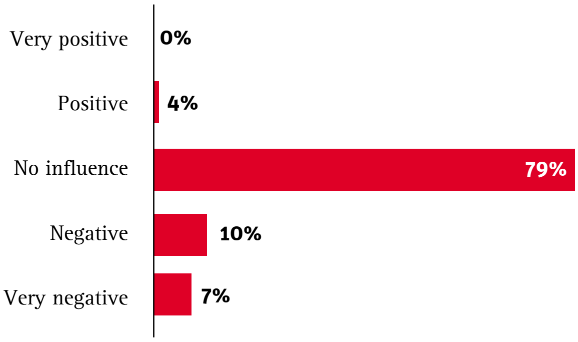
Top 8 influences on business activities in Japan

		2018	2017	2016
1	Globalisation	86% ↗	75% ↘	78%
2	Digitalisation of industries and services	77% ↗	72% ↗	57%
3	Integration of Asia	71% ↗	66% →	66%
4	Demographic shift	69% ↗	64% ↘	65%
5	Sustainability/ renewable energy	56% ↗	54% →	54%
6	Resource scarcity	49% →	49% ↗	41%
7	Government reforms	45% ↗	42% ↗	35%
8	Urbanisation	42% →	42% ↗	36%

Focus: North Korea

In the second half of 2017, North Korea attracted global attention as a result of nuclear weapons tests and an aggressive war rhetoric, which shook up the regional security balance. As a direct neighbour to the east, Japan was and still is required to respond calmly to potential provocations.

Influence of the developments in North Korea on the business situation in Japan



In February 2018, North Korea used the Winter Olympic Games in Pyeongchang as an opportunity to re-establish a dialogue with South Korea, the USA and other countries. Despite some positive indicators, the overall situation continues to be seen as volatile.

The majority (79 percent) of the German companies surveyed do not consider themselves to be affected by the developments in North Korea and do not expect any impact on their business. Only 17 percent fear a negative impact on their business.

Focus: EU-Japan Free Trade Agreement

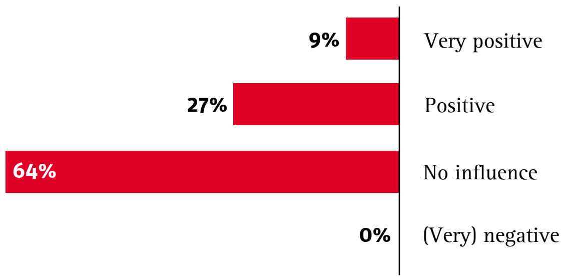
Cabinet Public Relations Office, Cabinet Secretariat.

Joint press conference between the EU and Japan in July 2017

The negotiations between the European Union and Japan on a free trade agreement are complete; the agreement is expected to be signed in the summer of 2018. The Japan-EU Economic Partnership Agreement (JEEPA) is set to enter into force in 2019 and will cover around 37 percent of the value of global trade. This sends an important signal against the recent increase in protectionism.

Generally speaking, the conclusion of this agreement is considered a positive move. The majority (64 percent) of the German companies in Japan surveyed do not expect any significant immediate impact on their business. This is primarily linked to the fact that German companies have been adapting to the prevailing general conditions for some years now and have found a way to operate at a profit. 36 percent of companies are still expecting a positive to very positive change in their business. The outlook is good for newcomers in the agricultural and foodstuff industry in particular. By eliminating high customs duties – something Japan is currently planning for foods such as cheese and beef (around 40 percent for each) – according to the European Commission, exports of food to Japan could grow by 170 to 180 percent.

Influence of the EU-Japan free trade agreement on the business situation in Japan



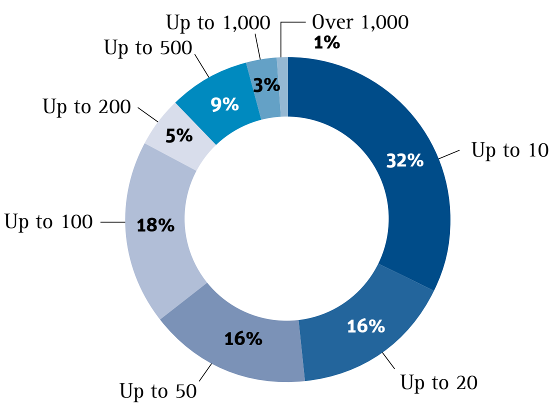
IV Perspective: Profile of the Companies Surveyed

A total of 400 companies were sent the annual business climate survey by AHK Japan, 77 of which have answered it in full. This corresponds to a return rate of 19.3 percent. A large majority of the companies surveyed are small- and medium-sized companies. 32 percent of the companies in the survey employ up to 10 people, while a further 32 percent employ up to 50 people. The remaining 36 percent have over 50 employees.

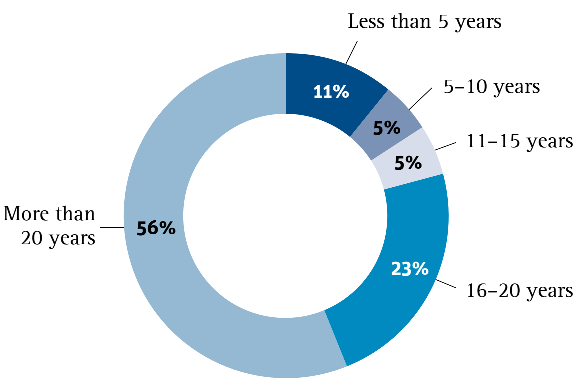
56 percent of participants have been based in Japan for over 20 years, 33 percent between five and 20 years. Just 11 percent of the companies surveyed have been represented in Japan for less than five years.

The sector distribution of the companies surveyed corresponds to the strengths in Germany's industry. Nearly a quarter (23 percent) of companies surveyed are involved in engineering and industrial equipment; automotive suppliers follow in second place with 14 percent. A large majority (90 percent) of German companies in Japan concentrate on their role in sales and service. Trend scouting (25 percent), production (21 percent), procurement (16 percent) and research and development (13 percent) were some way behind.

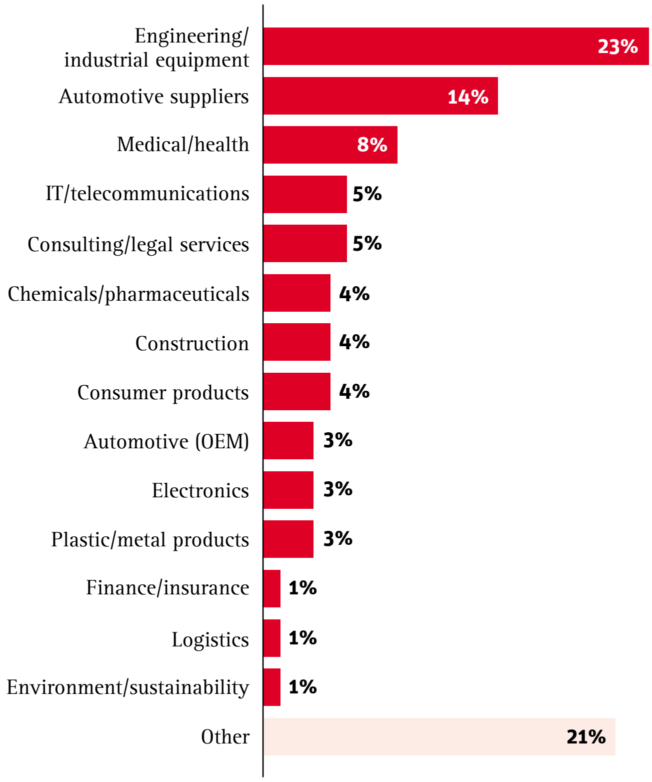
Number of employees in Japan



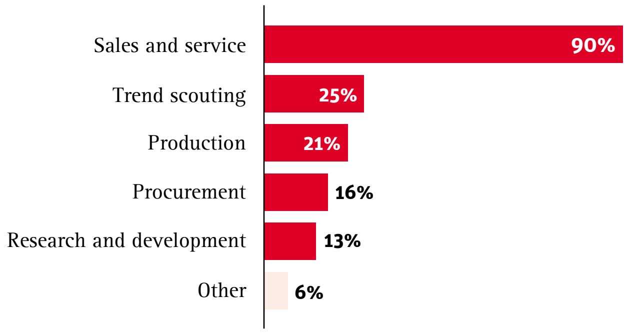
Time present in Japan



Sector distribution of the companies surveyed



Business activities



Japan is ...

competitive

51 Japanese companies feature in the Fortune Global 500 – a ranking of the top 500 companies worldwide as measured by revenue in „Fortune“ magazine. 18 of these companies have their headquarters in Tokyo[1].

global

In 2017, Japan invested **164.6 billion U.S. dollars abroad**, which equates to an increase of around 52 percent since the triple disaster in 2011[2].

open

The number of tourists in Japan has risen dramatically over the last few years: In 2017, **28.7 million** people visited the country – nearly 20 percent more than in the previous year. If the number of visitors continues to grow at this rate, Japan could reach its target of **40 million** tourists per year by 2020[3].

liveable

According to the „Global Liveability Report“ by the Economist Intelligence Unit from 2017, **Tokyo and Osaka are ranked 13th and 14th** in the list of the most liveable cities in the world. In Asia, these two major cities are therefore ranked **number one**[4].

ingenious

Between 1901 and 2017, Japan has won a total of **25 Nobel Prizes** – 11 for physics, seven for chemistry, four for physiology or medicine, two for literature and one for peace. Japan is therefore ranked **number one** in Asia[5].

sustainable

According to the 2018 Global Environmental Performance Index carried out by Yale University, Japan is **ranked 20th** out of 180 countries, making it **number one** in Asia[6].

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[1] *Source: Fortune, „Global 500“, 2017.*
[2] *Source: Japan External Trade Organization, Japan's Outward FDI by Country/Region (Balance of Payments Basis, Net and Flow), 2018.*
[3] *Source: Japan National Tourist Organization, Foreign Visitors & Japanese Departures, 2017.*
[4] *Source: The Economist Intelligence Unit, “The Global Liveability Report 2017“, 2017.*
[5] *Source: Ministry of Education, Culture, Sports, Science and Technology, “Science Statistics Outline 2018 Version“, 2018.*
[6] *Source: Yale Center for Environmental Law & Policy, Yale University, Center for International Earth Science Information Network, Columbia University, in collaboration with the World Economic Forum, “2018 Environmental Performance Index“, 2018.*

Imprint

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Gefördert durch:

Bundesministerium
für Wirtschaft
und Energie

aufgrund eines Beschlusses
des Deutschen Bundestages

Design, Production, Printing:
NeXXus Communications K.K., Tokyo
Title photograph: istockphoto.com/vichie81