



Economic outlook German Business in Japan 2020

Business Climate Survey of AHK Japan and KPMG in Germany



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



Imprint



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Of the German companies active in Japan...

63 %

were involved in **projects** with Japanese companies **outside Japan**, especially in the ASEAN region

47 %

generated sales with **Japanese companies outside Japan** to at least the same extent as in Japan itself

47 %

assign a **high or the highest priority** in the group to the business in Japan

89 %

regard the **high sales potential in Japan** as the most important reason for their presence in Japan

99 %

name the **stability of the economic relationships** with Japanese companies as a key benefit of their Japan business

94 %

generate **pre-tax profits**, of which 14% report profits of more than 10%

76 %

name **market size and customer demand** as the main reason for deciding to make an investment in Japan in comparison to other global markets

49 %

expect stronger **competition from Chinese companies in Japan**

70 %

state that Japan's **ageing population** is exerting a moderate or even considerable influence on their Japan business

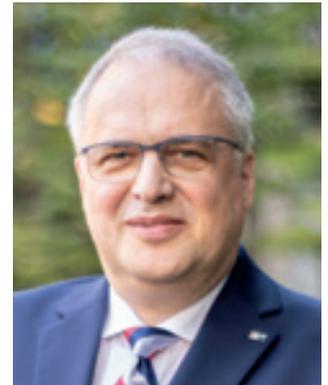
Dear readers,

The foreword to an outlook on the business climate is expected to include primarily statements on the short and medium-term trends in the economy. In the context of current developments, however, these statements lose any informative value and at the moment no serious source is able to estimate the precise impacts of the corona crisis, which was declared a pandemic by the WHO in the middle of March 2020. The only certainty is that, in a globalised world, nearly everyone is affected. This is especially true for export-driven and internationally interwoven industrial nations such as Japan and Germany. Reports on the actions that are being taken to stem the spread of the virus dominate the daily news. Restrictions on public life, factory closures or production cutbacks are resulting in disruptions to supply chains, production losses, dramatic changes in consumption habits and finally also the postponement of the Olympic Games in Japan to next year. No one can say how long this exceptional situation will last and whether we can expect several waves of the virus. After more than three months of this exceptional situation, China has been trying to find a way back to normality since the middle of March. However, the reverberations in other national economies will continue to be felt. Not every sector and not every company is affected to the same degree by the safety measures that have been implemented around the world. There are clear signs, however, that for some companies their very existence is at stake.

Even if the majority of companies are “flying by sight” at the moment and responding from day to day to developments, it is important not to lose track of long-term trends and challenges. And Japan – like other industrial countries, too – will have to confront a number of major challenges in the coming decades. These are the result in particular of China’s economic rise, the drifting apart of the two major national economies in the US and China, the protectionism and nationalism that is increasing around the globe, the ageing of Japanese society, the growing importance of sustainability and climate protection issues as well as digitalisation. The Japanese government has addressed some of these challenges by concluding free trade agreements with important trade partners, such as the agreement with the EU (JEFTA) that came into effect on 1 February 2019, and promoting forward-looking initiatives such as Society 5.0.

In these uncertain times, it has to be highlighted in particular that more than 90% of the German companies surveyed emphasised the stability of the economic environment and of business relationships as well as the safety and social stability that characterises Japan as the biggest advantages. Japan thus qualifies itself as a preferred partner of German companies.

The current situation offers agile companies that can act strategically and sustainably the opportunity to establish themselves more firmly on the Japanese market and with Japanese partners on third markets and to present themselves as reliable partners for the Japanese economy.



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



Andreas Glunz
Managing Partner
International Business,
KPMG in Germany

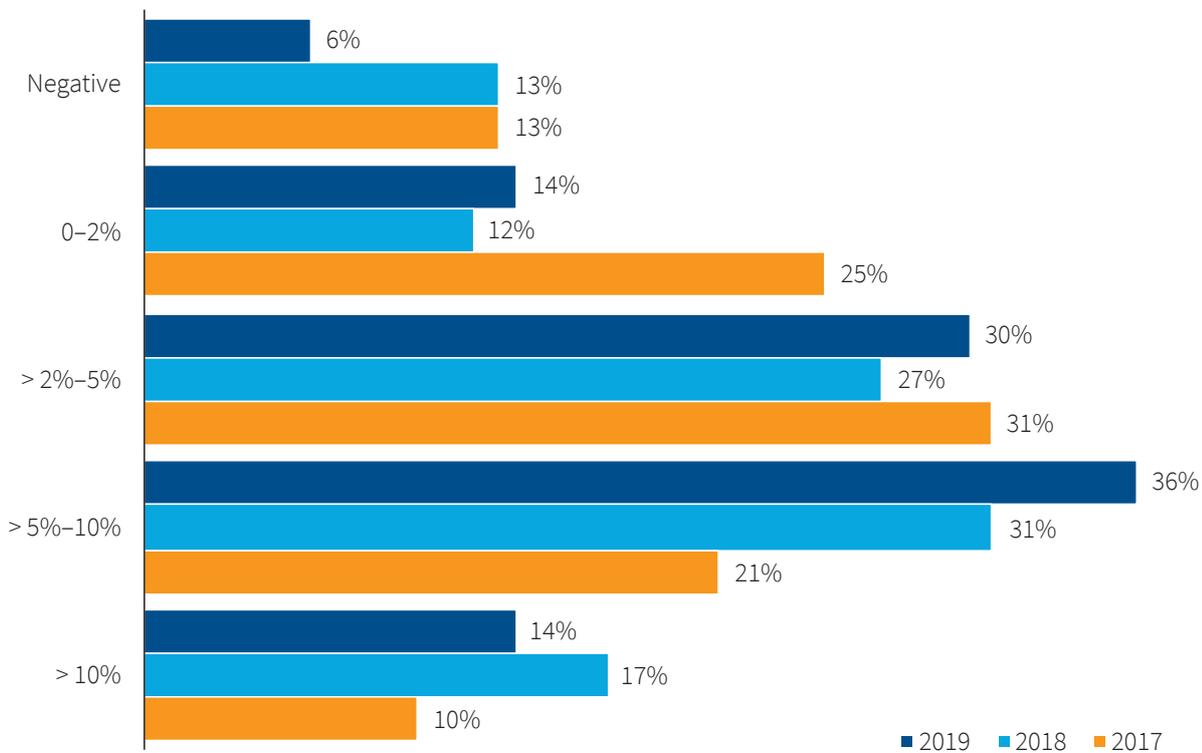
I Business activities in Japan

Economic relations between Germany and Japan have traditionally been very friendly and have surely intensified since the free trade agreement between the EU and Japan came into effect on 1 February 2019.

The statements on the companies' profitability turn out to be significantly more positive this year than in the two previous years. For example, 94 per cent of the German companies surveyed were able to generate a pre-tax profit in Japan in 2019.

In the last three years, the pre-tax profit margins were mostly in a range around the 5 per cent mark: 30 per cent of the reporting companies generate margins of between 2 and 5 per cent, while 36 per cent generate margins of between 5 and 10 per cent. The number of companies with margin in the range from 2 to 5 per cent increased by 3 percentage points this year and the number of companies in the range from 0 to 2 per cent rose by 2 percentage points. In contrast, 14 per cent (previous year: 17 per cent) of the companies surveyed generate pre-tax profit margins of over 10 per cent.

Average pre-tax profit margins in the last 3 years



46 per cent of the companies surveyed assign a high priority to the business in Japan and 1 per cent even assign it the highest priority for global group sales and consolidated net income. For another 46 per cent of the companies, the Japanese mar-

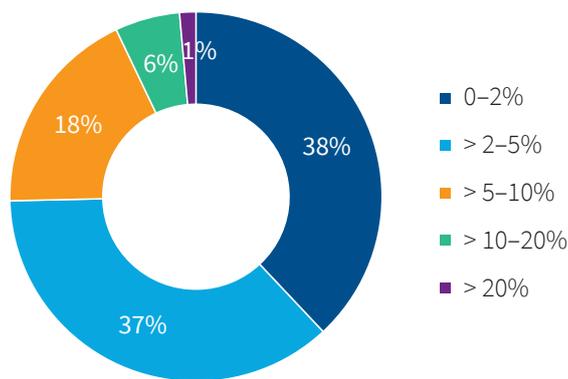
ket is of rather low priority and is seen as only one of many markets when it comes to global group sales and consolidated net income.

Relevance of the company's Japan business in terms of global group sales and consolidated net income



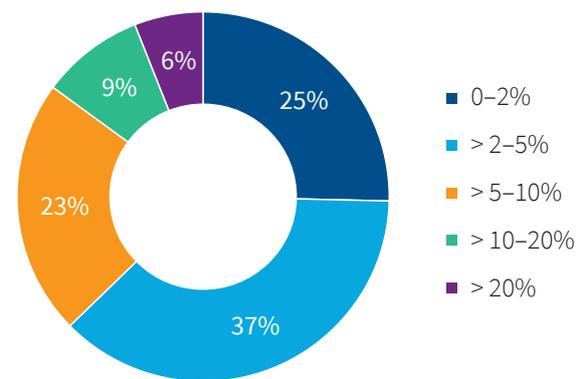
At 7 per cent of the companies surveyed (previous year: 16 per cent), the proportion of the group sales generated by the Japanese subsidiary is more than 10 per cent. At 75 per cent of the participating companies, the sales share recorded by the Japanese subsidiary accounts for only up to 5 per cent, which is a sign of the high degree of internationalisation of the German companies active in Japan.

Proportion of the global group sales accounted for by the Japanese subsidiary



At 15 per cent of the companies surveyed (previous year: 22 per cent), the proportion of sales with Japanese companies accounts for over 10 per cent of the global group sales.

Proportion of the sales with Japanese companies worldwide in global group sales



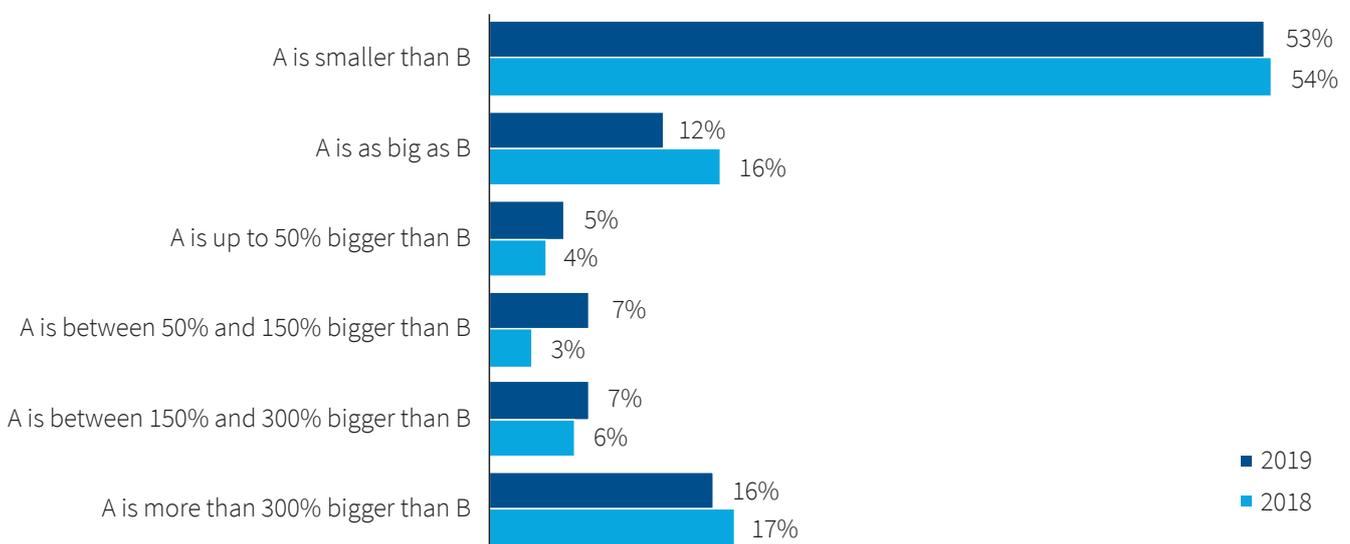
The diagram below compares the sales generated with Japanese companies outside the Japanese market in other parts of the world with the sales generated in Japan. At 47 per cent (previous year: 46 per cent) of the companies surveyed, additional sales with Japanese customers in other parts of the world are generated that are at least equal to the sales in

Japan itself. For 16 per cent of these companies, the sales with Japanese companies in other parts of the world is more than three times as high as in the Japanese market. The strategic importance of the Japanese market is thus confirmed once again.

Presentation of the relationship between (A) and (B)

(A) Sales of the group with Japanese companies worldwide (excluding the Japanese market)

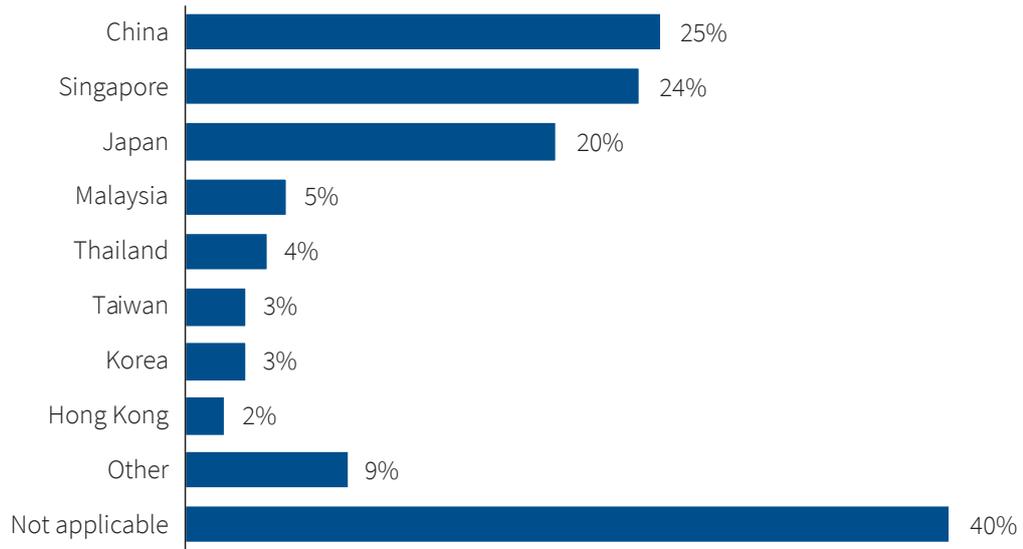
(B) Sales of the subsidiary in Japan



The importance of the Japanese market for German companies is also reflected in the choice of location for the regional headquarters of the group parent in Asia. Some of the headquarter functions are usually distributed across several locations. The rankings are headed by China, where 25 per cent of the sur-

veyed have assigned a central role and function to this location. Singapore comes next with 24 per cent. One in five of the companies taking part in the survey (20 per cent) is represented by a regional function in Japan.

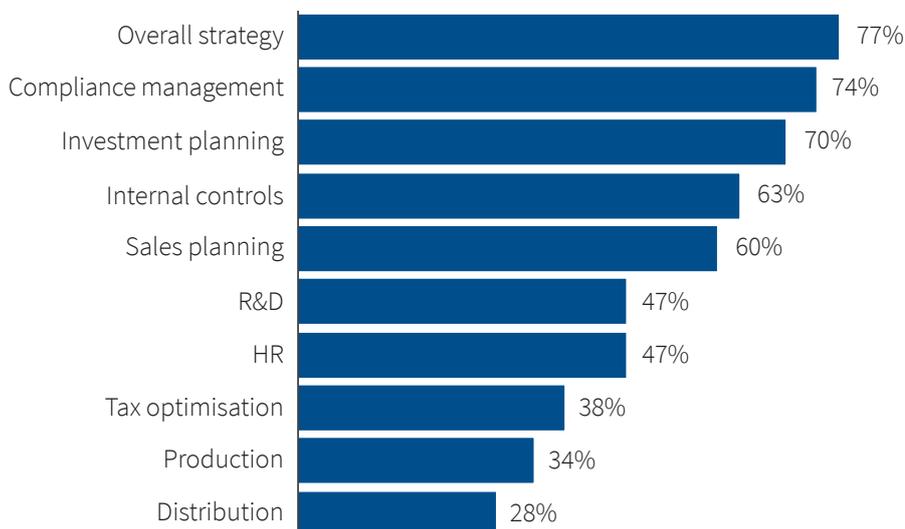
Locations of the Asia headquarters in the group



The German corporate headquarters grant their Japanese subsidiaries a relatively high degree of freedom of decision and action in many operating processes. The head office in Germany is least likely to be involved in decisions relating to distribution (28 per cent) and production (34 per cent) or in issues relating to tax optimisation based on local regulations (38 per cent). The German head office plays a stronger role,

however, in business decisions relating to overall strategy (77 per cent), in compliance issues (74 per cent) and in investment decisions (70 per cent). Furthermore, the majority of the German head offices retain decision-making authority in aspects involving the internal controls (63 per cent) and sales planning (60 per cent).

Involvement of the German parent company in business decisions of the local Japanese subsidiary



Nippon Eirich Co., Ltd. is a multidiscipline engineering manufacturer in materials processing technology, which is based upon the know-how obtained from German headquarters for many years. We have been acclaimed in Japan for a long time as a B to B company that provides industrial machinery. This is because German technology, high reputation in Japan and Japanese manufacturing “Monozukuri”^{*} have been successfully combined, thus producing high quality Japanese products.

– Masamoto Naito, Representative Director & President, Nippon Eirich Co., Ltd.

^{*}Monozukuri stands for the technological capabilities, the know-how and for the spirit of Japanese production.

II Opportunities and challenges

The Japanese market environment offers German companies numerous business opportunities. Of greatest importance and thus the main reason for maintaining a presence in Japan is the high sales potential. This business opportunity is important or even very important for 89 per cent of the companies. Next in importance is the sales potential with Japanese customers worldwide (67 per cent), followed by the monitoring of Japanese competitors (48 per cent). These three points have proved to be the most important reasons for investing in Japan in the past two years and have continued to increase in relevance in this year's survey. The strategic significance of the

business with Japanese customers worldwide play an important role for 47 per cent of the respondents. The importance of this aspect is thus underlined once more this year. 39 per cent of the respondents rate Japan as a benchmark. This represents an increase of 12 percentage points over the previous year and reflects at least in part a growing differentiation in German business when it comes to choosing target markets and partners. Japan continues to be considered less important as a location for performing research and development activities (24 per cent).

Top 6 reasons for maintaining a presence in Japan

	2020	2019	2018
High sales potential in Japan	89% ↗	87% ↗	84%
High sales potential with Japanese customers worldwide	67% ↗	54% ↗	53%
Monitoring Japanese competitors	48% ↗	37% ↘	39%
Strategic importance of the business with Japanese companies	47% →	47% ↘	59%
Japan as benchmark	39% ↗	27% ↘	39%
Research and development in Japan	24% ↗	23% ↗	21%

For German business, Japan's stability in the most varied of forms is a fundamentally outstanding location advantage. For example, 99 per cent of the companies surveyed rate the extraordinarily high reliability of their business relationships with Japanese partners as a key advantage. The stability of the economy is also rated especially high for 95 per cent of the companies. A very high degree of safety and social stabil-

ity is valued by 92 per cent of the respondents. In comparison with the previous year, the openness to technology and innovation has increased from 61 per cent to 80 per cent. This significant rise of 19 percentage points shows that the country has increasingly opened up and that cooperation with foreign partners has become more widespread in Japan on account of the trend in global digitalisation.

Top 7 advantages of the Japan business

	2020	2019	2018
Stability and reliability of business relationships	99% ↗	89% ↗	87%
Stability of the economy	95% ↗	84% →	84%
Safety and social stability	92% ↗	84% ↗	75%
Highly qualified employees	90% ↗	75% ↗	70%
Stable political environment	81% ↗	74% ↗	70%
Openness to technology and innovation	80% ↗	61% ↘	62%
Highly developed infrastructure	74% ↗	62% ↗	61%

The majority of the German companies surveyed are grappling in their Japan business with the lack of sufficiently qualified employees. 82 per cent of the respondents consider this to be the greatest fundamental challenge in the Japan business. The next biggest fundamental challenges are the shrinking population as well as a society that is ageing at the same time. This aspect, which is closely associated with the demographic change in Japan, is perceived to a moderate or even a strong degree as a challenge by 70 per cent of the German companies in the country that were surveyed. Only eight or nine per cent of the respondents see themselves totally unaffected by this development.

The inadequate diversity in the workforce is named as the fourth largest challenge. 57 per cent of the respondents identify this as a moderate or even major challenge for their business activities. The measures that have already been implemented or are planned to promote diversity at the workplace and to recognise group and individual characteristics in the ethnically and culturally homogeneous country have to be

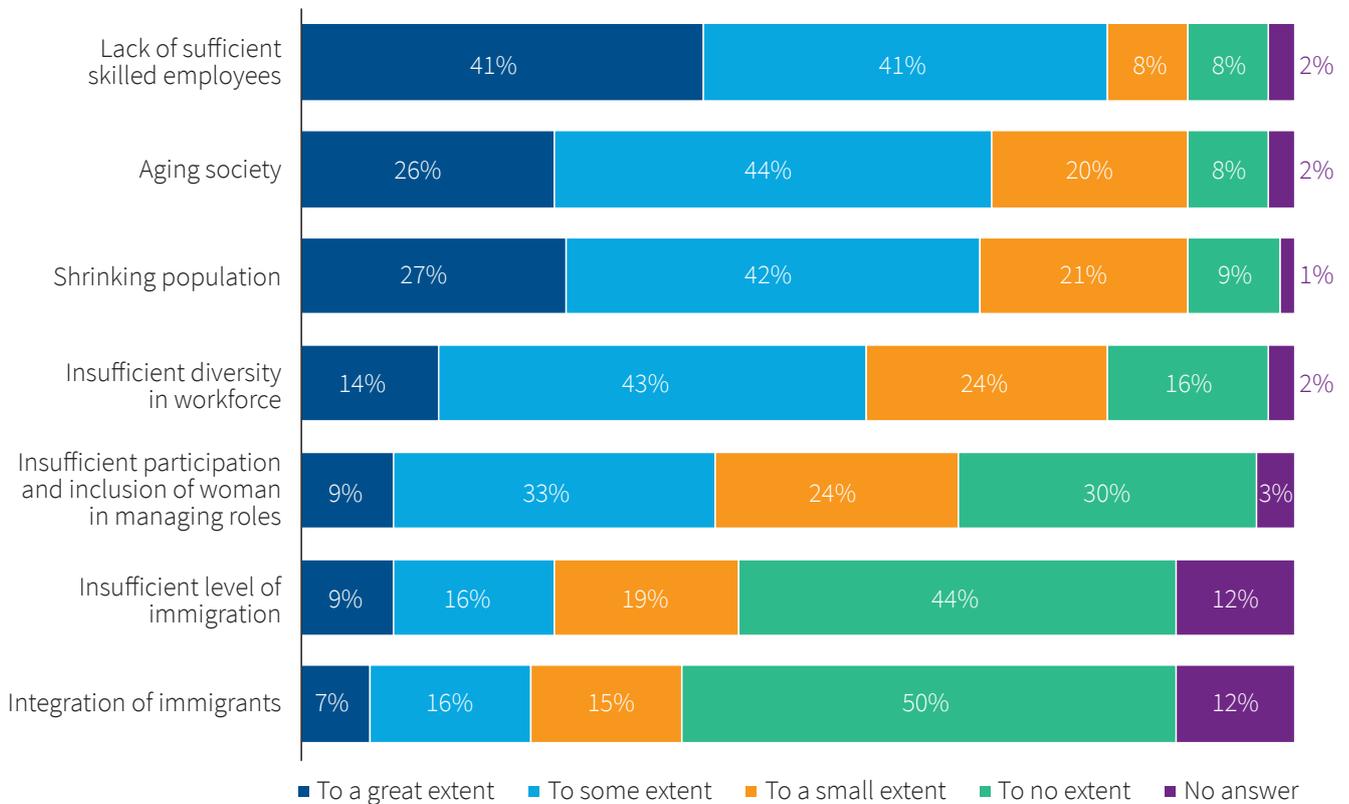
expanded even further in the view of the German companies in Japan. This is followed by an issue that also takes aim at a sociopolitical aspect: the insufficient participation and involvement of women in management positions. 42 per cent of the German companies in Japan consider this to be a significant or at least moderate challenge.

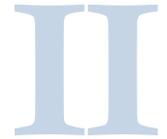
“The 34% of 5 million construction workers over 55 in Japan are worrisome for the industry. Aside from the aging population, it has also been difficult to secure young personnel for the construction industry these days; by highlighting the high cultural homogeneity and sincerity of German businesses, we were able to secure employees rather smoothly. It has been 13 years since fischer Japan K.K. has set up office in Japan and we will continue to contribute to the globalisation of the construction industry.

– Hirofumi Arai, Managing Director, fischer Japan K.K.

”

Top 7 challenges of the Japan business





The greatest current business challenge for the companies surveyed is the recruitment of trained employees who possess adequate professional and language qualifications. This aspect is perceived as the main problem, or at least as a problem, by 88 per cent of the respondents. At the same time, 45 per cent name staff retention as problematic.

Rising wage and labour costs constitute a problem for 51 per cent of the respondents. This value is 11 percentage points higher than the result in the previous two years and clearly shows that, in a situation of practically full employment (the rate of unemployment was approximately 2.4% at the time the survey was conducted) and of a very tight labour market especially for foreign companies, wage costs are rising, but productivity is not. The foreign exchange risk has gained in relevance in comparison with the previous year and is regarded as a challenge by 48 per cent of the companies (37 per cent in the previous year). The reason for this is the rising volatility in exchange rates and the related increase in import costs.

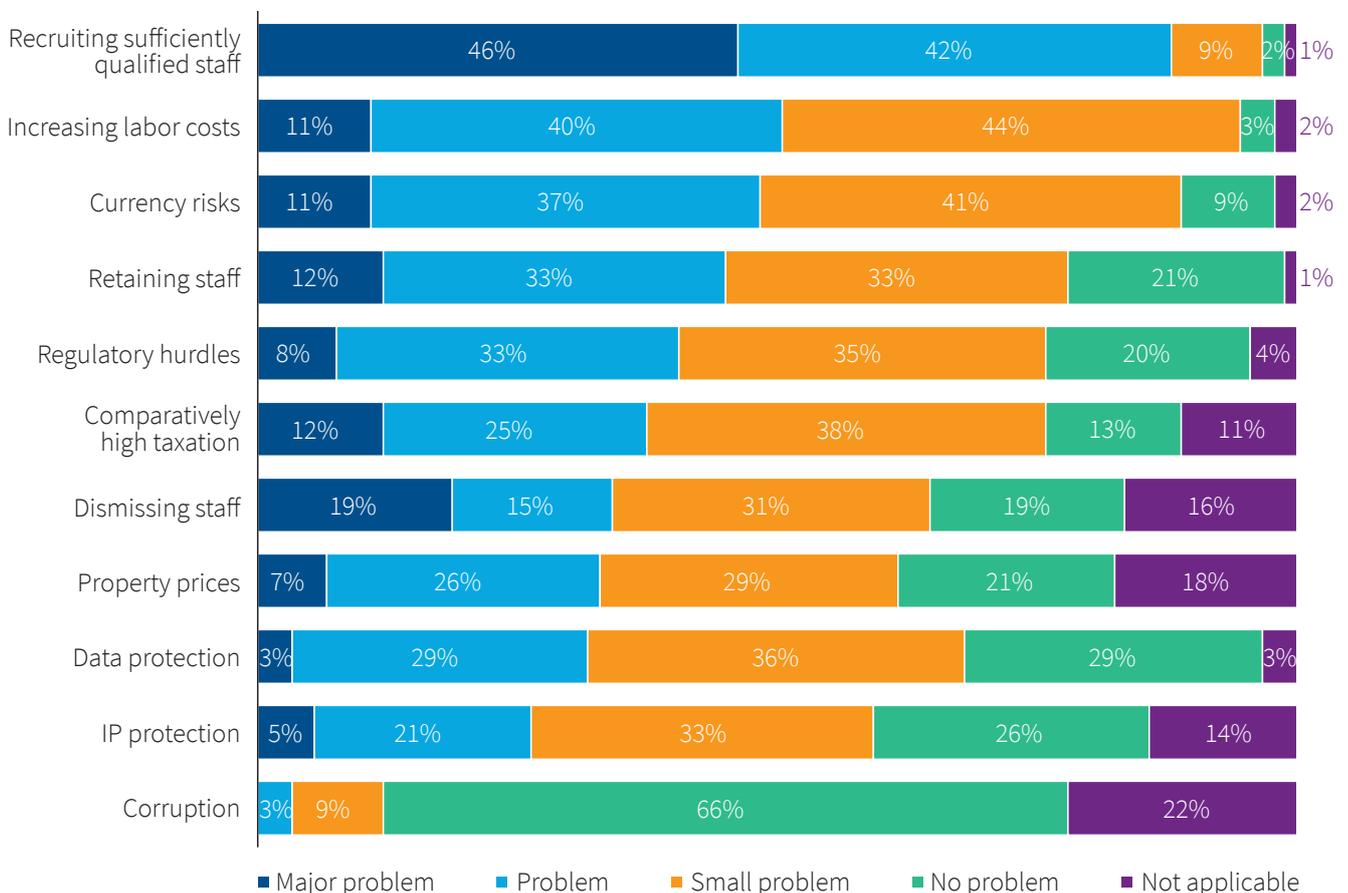
The relatively high tax rates in Japan are a major problem or at least a problem for 37 per cent of the companies. The opinions on this aspect are shaped by the impact of the consumption

tax hike that came into force in October 2019 (from eight to ten per cent), the second increase in five years. The receipts from the higher rate of consumption tax are intended to finance increasing social security costs, which are the result of an ageing and shrinking society. Even if the government and the central bank expect the consequences of the tax hike to prove less significant than in 2014, the fear of the German companies in Japan of an economic slowdown seems to resonate in this survey result.

Data protection is a challenge only for around one third of the German companies in Japan (29 per cent) and only three per cent of the respondents consider this aspect to be a major problem for their activities in Japan. What appears striking in this connection is the fact that Japan reformed its data protection legislation at the beginning of 2019 based on the EU model, and also in line with the data protection rules applicable in Germany (GDPR), and an almost identical level of data protection thus exists in the two economic areas.

As could be expected and is not surprising, corruption does not represent a business challenge for German companies on site – as was also the case in previous years.

Current business challenges



III

Business in third markets

Japan remains an important trade and investment partner for the ASEAN countries. The trade between the ASEAN region and Japan reached a value of USD 231.7 billion in 2018 and thus accounted for 8.2 per cent of the entire trade in goods of the ASEAN region. Japan is thus ASEAN's fourth largest trading partner. In 2018, Japan was ASEAN's third largest external source of foreign direct investment (FDI), where the FDI flows from Japan to ASEAN countries totalled USD 21.0 billion and thus accounted for 13.7 per cent of the total flow of FDI to the ASEAN region.

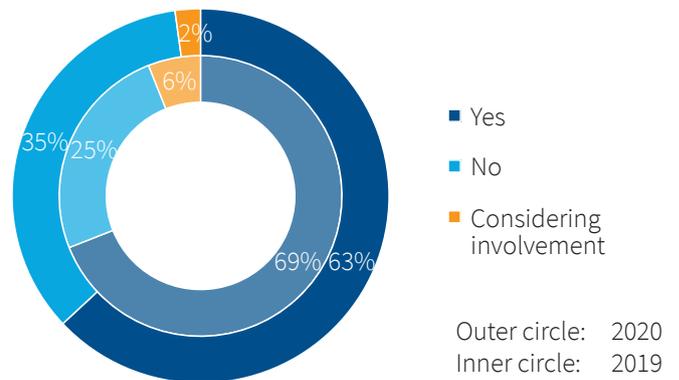
The European Union and Japan signed an infrastructure agreement at the end of September 2019 to co-ordinate transport, energy and digital projects between Europe and Asia. The "EU-Japan Connectivity" strategy represents another significant expansion of the bilateral economic partnership agreement beyond the EU and Japan and is intended to be developed as an alternative to China's Belt and Road Initiative. For German business in Japan, opportunities may thus increasingly develop in the medium term to work with Japanese partners on projects in third-country markets.

63 per cent of the German subsidiaries were or are involved in business activities with Japanese partners outside Japan in third countries. Although this figure represents a decline of 6 percentage points from last year's survey, it has nevertheless remained at a high level since our survey in 2017. This development underlines the global focus and international connections of Japanese industry.

ASEAN is the region here in which the majority of the surveyed companies (53 per cent) are currently involved or are planning to participate in projects. China holds second place with 34 per cent, just ahead of Europe (33 per cent). 25% of the respondents are involved in projects in North America.

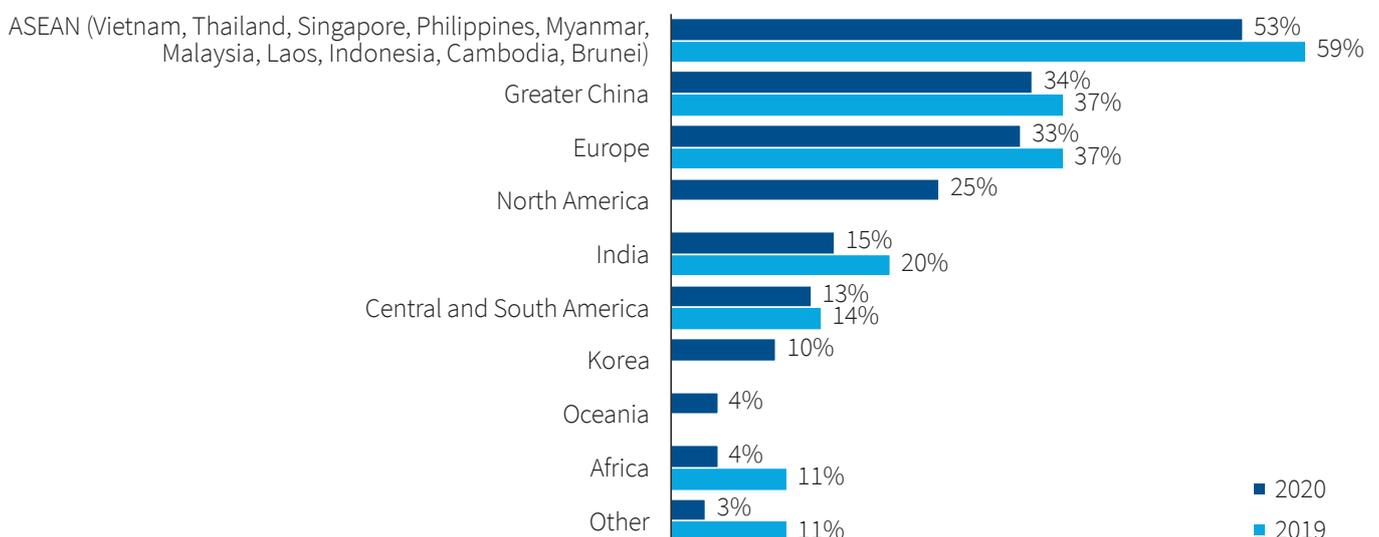
In this connection, the package of measures launched by the Japanese government to cushion the impacts of the corona crisis is striking: a sum of USD 2 billion* will be made available to encourage Japanese companies to bring their production back to Japan. USD 218 million* is being provided to relocate permanent establishments of Japanese companies from China to third countries. These developments may also have a positive influence on the business opportunities of German companies with Japanese partners in third markets.

Involvement of Japanese subsidiaries in projects/business activities with Japanese partners outside Japan



The growth markets of India (15 per cent) and South America (13 per cent) could also be important markets in the future because of their potential for growth. Oceania and Africa represent less relevant regions for the companies surveyed.

Regions in which projects are planned, are currently in progress or have already been executed



Similar to the previous year, a good half of the companies (53 per cent) mention as the main reason for participating in projects with Japanese companies in third countries the use of their global sales and service networks. This factor has continued to gain in importance in the last two years and has once more increased by two percentage points over the previous

year. Easier access to foreign markets records the strongest growth as a key reason for participating in third-country markets with Japanese companies (43 per cent, a gain of nine percentage points). Another advantage of the co-operation in third countries is the increasing strategic importance of the Japanese subsidiary (30 per cent).

Main reasons for participating in third-country projects with Japanese companies

	2020	2019	2018
Use of an in-house global sales and service network	53% ↗	51% ↗	43%
Easier access to foreign markets thanks to internationalisation	43% ↗	34% ↗	25%
Rise in the (strategic) importance of the Japanese subsidiary	30% →	30% ↗	19%
Saturation of the Japanese market	17% ↗	13% ↗	10%
Opportunity to achieve higher margins	5% →	5% →	5%

For decades, the technical sales expertise in Japan has been essential for us to successfully work on projects internationally with Japanese business partners. Joint activities in the areas of infrastructure expansion, plant engineering and mobility are being planned and decided in Japan, to then later be implemented worldwide. This distinct third-party business is one of a kind and has high strategic value that goes far beyond simple business volume in Japan.

– Nikolaus Boltze, President & Country Representative, thyssenkrupp Japan K.K.

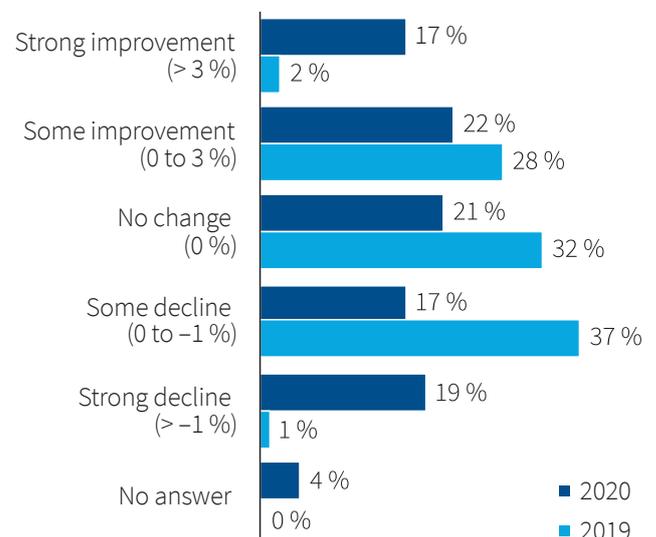
IV Uncertain outlook

The outlook for the Japanese economy is mixed again this year and the range of expectations has expanded once more. The answers here reflect the general conditions in February 2020 and were not yet affected by the corona crisis at that time.

Almost two out of five companies (39 per cent) see a moderate or strong improvement in the development of the general economy in Japan in the coming year. This represents an increase of 9 percentage points over the figures in 2019. Specifically, the number of statements from participants that expect a strong improvement in the economy of over 3 per cent has risen by 15 percentage points.

At the same time, almost one in five companies (19 per cent) anticipate a sharp decline of more than minus 1 per cent in the Japanese economy in the next 12 months. This is an increase of 18 percentage points.

Outlook for businesses in Japan for the coming 12 months



Globalisation is the most important factor influencing the companies' business activities in Japan. 81 per cent of the companies surveyed mention it as the largest influence on their particular activities on the market. This represents a further increase of six percentage points over the previous year. The high rating suggests that the growth in global protectionism in combination with newly introduced customs and other trade barriers are having a considerable impact on the business of all international corporations. The digitalisation of services and industries affects almost three quarters of the companies (71 per cent). This significant growth of 12 percentage points in comparison with 2019 shows clearly that digitalisation is now affecting every business process. Please refer in this regard to the statements in our spotlight on "Impact and further development of digitalisation".

Third place in 2020 is occupied by demographic change – 64 per cent of the companies mention this aspect, coupled with the very limited immigration in Japan, as one of the greatest challenges in the country. Moreover, demographic change brings with it changes in customer requirements and demands. In comparison with the previous year, the importance of demographic change has increased by two percentage points. A moderate increase in importance has been experienced by the influence of the integration of Asia's national economies on the business activities in Japan: the relevance of this issue has increased from 52 per cent in the previous year to 57 per cent this year. Sustainability, urbanisation and monetary policy are regarded as rather less significant influencing factors in comparison with the those mentioned above, with each recording values of less than 50 per cent.

Top 7 influences on business activities in Japan

	2020	2019	2018
Globalisation	81% ↗	75% ↘	86%
Digitalisation	71% ↗	59% ↘	77%
Demographic change	64% ↗	62% ↘	69%
Asia's integration	57% ↗	52% ↘	71%
Sustainability	47% ↗	46% ↘	56%
Urbanisation	31% ↘	32% ↘	42%
Monetary policy (quantitative and qualitative easing)	30% ↗	27%	k. A.

The mixed expectations for the 2020 financial year are also reflected in the investments planned by German companies in Japan. While almost two out of three of the companies surveyed are planning investments in the next three years, 35 per cent are unwilling or unable to provide any information on their investment plans. The group of companies that have

provided the data is dominated by the companies that are looking to invest less than EUR 5 million a year in the Japan location. In contrast, a small group representing three per cent of the German companies in Japan is planning a considerable investment volume of EUR 50 to 100 million annually for the next three years.

Outlook on planned investments by German companies in Japan



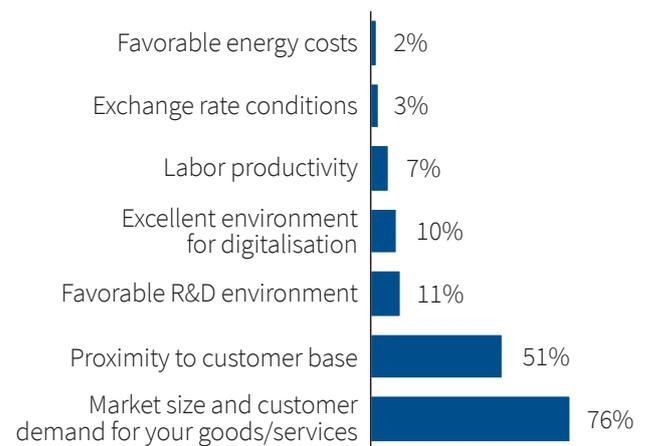
IV

Asked about the most important reasons for a decision to invest in Japan in comparison with other global markets, the respondents in this year's business climate survey paints a very clear picture. Three out of four of the German companies surveyed (76 per cent) identify the country's market potential as the primary reason for expanding their commitment in Japan. With a population of almost 126 million, Japan is one of the largest individual markets in the world and very focused on the future. Moreover, its consumers are regarded as affluent and its industrial customers as technologically very demanding.

A good half of German companies in Japan (51 per cent) are looking for proximity to their customer base through investments. Improving their customer service, maintaining sales and service staff on site and creating opportunities for direct customer interactions are all intended to enhance customer loyalty and to provide the local Japanese subsidiary with strategic competitive advantages. But local needs and country-specific requirements for products and services can also be more quickly recognised and catered for by creating closer proximity to the customer base.

Of less relevance for investments in Japan are the general conditions prevailing in Japan for research and development, the environment for digitalisation issues and labour productivity. Exchange rate conditions and energy costs appear to play a subordinate role in investment decisions in Japan.

Reasons for investing in Japan in comparison with other global markets



V Spotlights



Impact and further development of digitalisation

At the end of the 20th century, Japan was one of the leading nations in technology in the world, defining with its products the development status of many industrial sectors and regarded with its inventions as a trailblazer for many of the digitalisation activities that can be seen today. Even today, the country is still perceived as a technological pioneer, especially in the sectors of the manufacturing industry, in which Japan continues to be a world leader. In the meantime, however, key innovations for example in the field of software development of the commercialisation of platform technologies are more consistently being driven by Silicon Valley in the US or by China. Many of Japan's leading innovators have also had to change dramatically and have not infrequently turned from the driver to the driven.

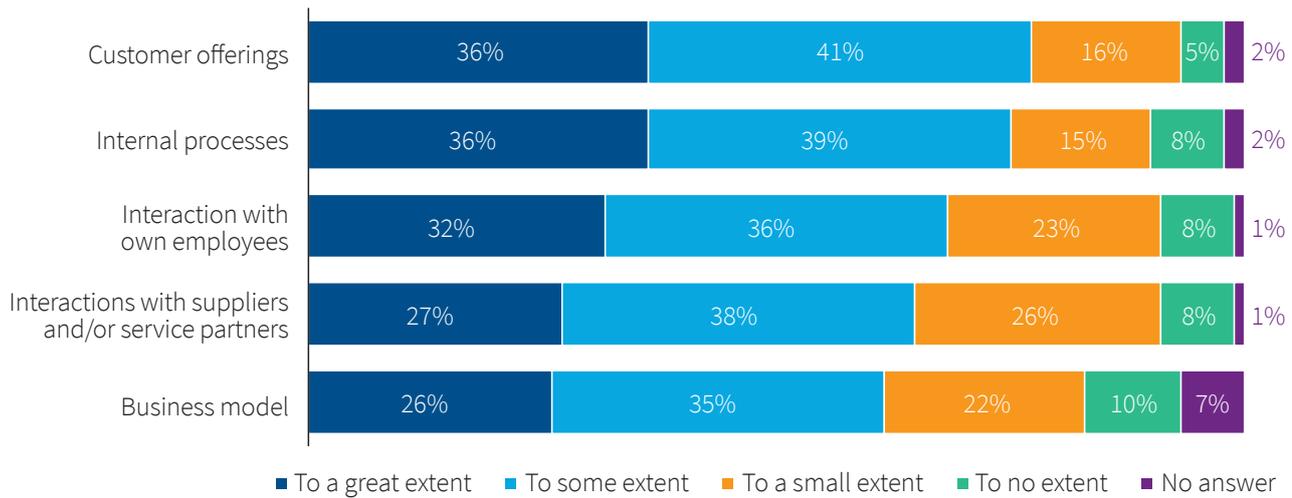
The affinity for and acceptance of technology among broad parts of the Japanese population can also be found in many everyday digital applications – both in private and professional life. In Japan, digitalisation has for a long time affected not only traditional IT companies, but companies in every industry and sector. These technological developments come thick and fast and are changing the way in which decisions are taken, how goods are manufactured and how products and services reach the market. While the digital transformation is creating new products and services, it has also changed established market logic. With the impacts of digitalisation on companies and their day-to-day business continuing to expand, no company can evade its reach.



The majority of the companies surveyed are feeling the impacts of digitalisation in every core aspect of their business: the clearest consequences (77 per cent) can be seen in the way in which customer offers are structured. Furthermore, three quarters of the respondents (75 per cent) expect a ma-

ior impact in all internal processes in the company. A further 68 per cent and 65 per cent of the companies indicated that digitalisation is having an effect on their interaction with their own employees and with suppliers and service partners respectively.

Impacts of digitalisation on business activities

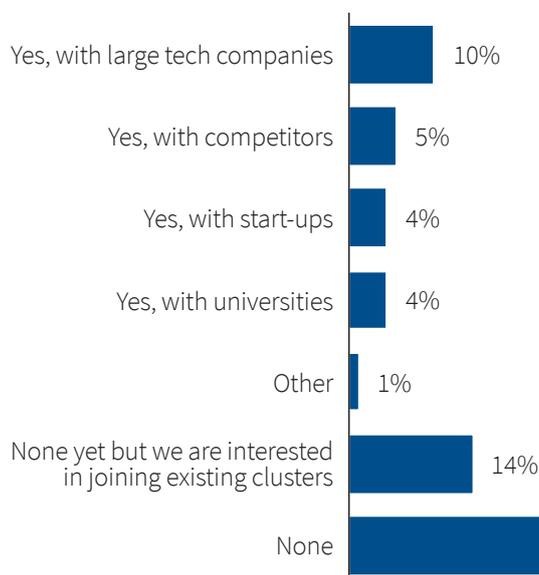


Beyond their own endeavours, co-operation with external partners offers companies additional opportunities to promote digital innovations and to develop new technologies for German companies in Japan. However, 67 per cent of the companies in Japan that were surveyed indicate that they do not pursue any co-operation to promote digital innovations with a third party. On top of that, a further 14 per cent of the companies surveyed are not involved in any innovation part-

nership, but at least expressed an interest in participating in an existing innovation cluster.

Only 23 per cent of the German companies in Japan are working with a partner on digital innovations, and they co-operate most frequently with technology companies (10 per cent) or competitors (5 per cent). Only 4 per cent co-operate with universities or start-ups.

Co-operation to promote digital innovations



“Kärcher is the leading provider of high quality and highly efficient cleaning systems, offering cleaning and washing devices and services. Through digitalisation and sales on IoT platforms, we continuously make cleaning around the world more efficient. We believe that digitalisation is a priority in the customer focus of our company.”

– Hachiro Sato, President, KÄRCHER JAPAN CO., LTD.



Society 5.0

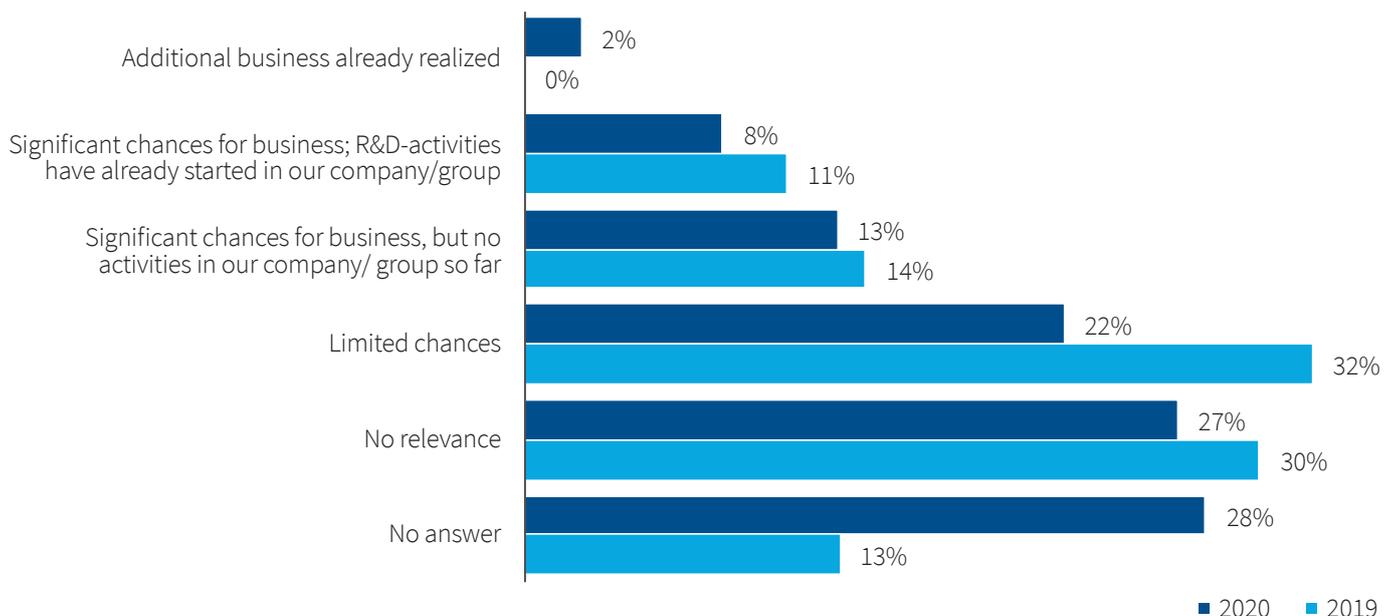
Society 5.0 is the concept of a “Super Smart Society” – a completely networked and efficient society – in which diverse social challenges can be solved by integrating the innovations from the fourth industrial revolution (e.g. the Internet of things, big data, artificial intelligence (AI), robots and the sharing economy).

Japan is a pioneer in the concept of Society 5.0. The concept pursues the transition from a technology-based perspective to a perspective that focuses on people’s needs. Japan has long been known for its skills in technological innovation and has demonstrated its strengths over the long term through its expertise in the fields of robotics and the Internet of things (IoT).

In its continuing efforts to drive ahead with the “Society 5.0” initiative, the government intends to turn the focus towards using digitalisation to improve the quality of life in Japan.

Society 5.0 offers considerable business opportunities for a good fifth of the companies surveyed (21 per cent). Eight per cent of these companies have already launched R&D activities targeting Society 5.0 in their company or group. Two per cent have already been able to generate additional business as a result of the initiatives for Society 5.0. For around half of the companies surveyed, however, this initiative involving a new form of society is of no relevance (27 per cent) or offers only limited opportunities for their business (22 per cent).

Impact of the Japanese “Society 5.0” initiative on the companies’ business



EU-Japan Free Trade Agreement (JEFTA)

The free trade agreement between Japan and the European Union (JEFTA) came into force on 1 February 2019 and affects approximately 40 per cent of the global trade. When this economic partnership agreement came into effect, 90 per cent of the customs tariffs on EU exports immediately ceased to apply and this ratio could even rise to up to 97 per cent after various transition periods elapse. As a result, up to EUR 1 billion in customs duties annually could cease to apply for companies in the EU in comparison with the provisions that were previously in force for exports to Japan. EU companies export goods worth over EUR 58 billion and services valued at more than EUR 28 billion to Japan every year. The elimination of customs duties means that German and other European

exports of goods to the Japanese market will become more competitive. The improved export conditions are intended to make it easier especially for export-oriented companies to tap new business opportunities.

Foreign trade statistics for the period from February to November 2019 as well as observations by the German Chamber of Commerce and Industry in Japan (AHK Japan) confirm the positive expectations arising from JEFTA and corroborate the consolidation of the co-operation between companies of the two economic areas. In the first ten months after the agreement was implemented, EU exports to Japan grew by 6.6 per cent in comparison with the same period in the previous year.

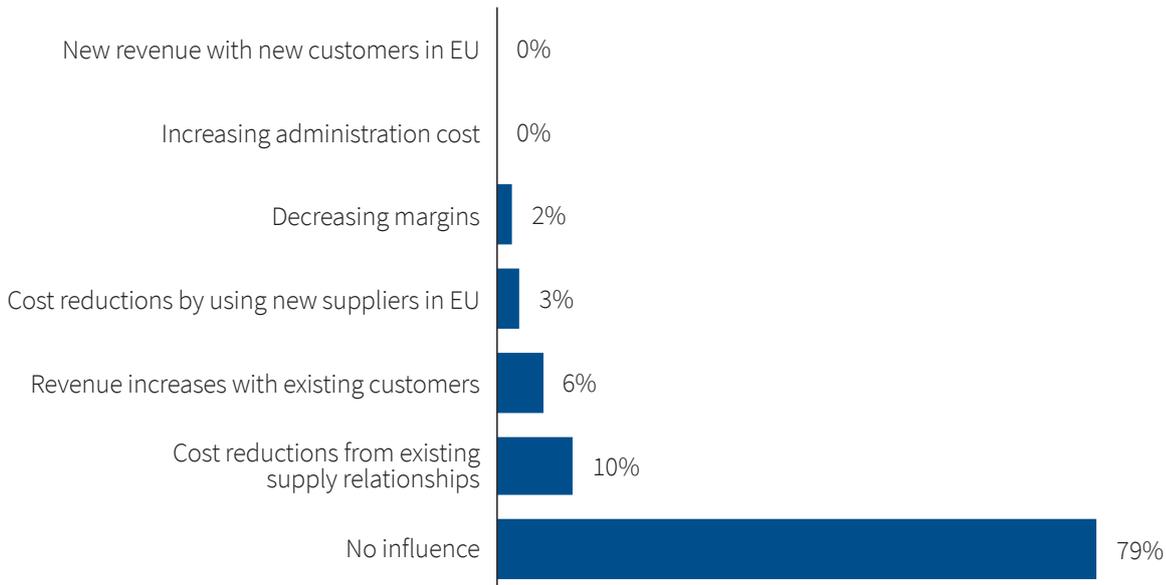


This exceeds the growth of the last three years based on Eurostat data of on average 4.7 per cent by almost two percentage points. Exports of agricultural products, but also electrical machinery as well as telephones and telecommunication equipment have all experienced especially strong growth. With regard to the elimination of non-tariff trade barriers, the automotive and automotive supplier, chemicals and pharmaceutical sectors are also likely to benefit from JEFTA.

Of the German companies in Japan that were surveyed, however, only 19 per cent report a positive influence from JEFTA on their business activities in the country. One in ten companies indicate that cost reductions can be realised from existing supplier relationships. Six per cent of the participating companies were able to increase their sales with existing custom-

ers and another three per cent indicated that they were able to achieve cost reductions thanks to the use of new suppliers from the EU. A large majority (79 per cent) of the German companies in Japan, however, do not see any influence from the EU-Japan free trade agreement on their business activities in Japan. This high value can be explained only by the fact either that the companies on site in the country are not yet adequately informed about the advantages of the Japan-EU free trade agreement or that customs duties do not have any significant impact on the business relationships that for many companies have already been in place for several years and that result from the industry representation of German business in Japan. However, only two per cent of the respondents reported suffering negative impacts as a result of a decline in margins.

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



Sustainability

A particular feature of JEFTA is the obligation of the contracting partners to promote sustainable development, in which not only economic and social, but explicitly also ecological aspects have been included. For the first time, a trade agreement includes a detailed chapter on climate protection, in which for example the signatories expressly, although not without restrictions, commit to the Paris Climate Agreement. Sustainable action is becoming an increasingly significant subject of discussion in the field of Japanese politics and economics, while the general population is paying more attention to the consequences of climate change. Initiatives launched by Shinzo Abe's administration pursue the goal of driving environmental protection and economic growth on an equal footing. In this connection, the Japanese government presented its long-term strategy for combating climate change (the Long-term Strategy for Low Emission Development) in June 2019, which is intended to be implemented through investments in

sustainable economic management and innovations. Thanks to the country's high energy efficiency, Japan can already point to comparably low CO₂ emissions today. It should also be noted in this connection, however, that the primary focus here is placed on technological solutions for promoting sustainable action.

To assess Japan's climate policy and the national climate protection performance in an international context, the Climate Change Performance Index (CCPI), which is drawn up each year by the German environmental and development organisation Germanwatch e.V., can be used for example. Data from 57 countries and the 28 EU member states was collected and compared for the CCPI 2020. As the first three places are left vacant in principle, the 2020 ranking features 61 places. Japan occupies 51st place in the CCPI 2020 (previous year: 49th place), Germany ends up in 23rd place (2019: 27th) and the

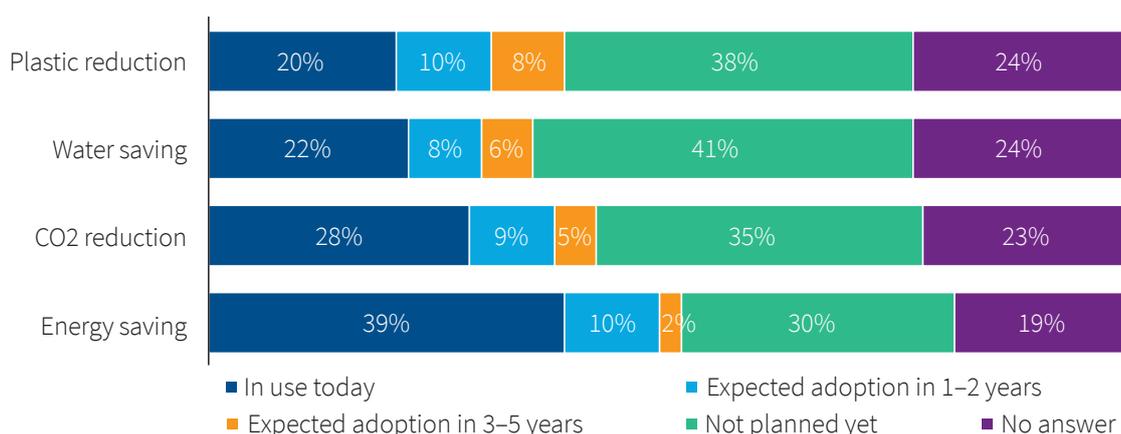
EU 28 as a whole are ranked 22nd (2019: 16th). The rankings are headed by Sweden (4th place) and Denmark (5th place). The CCPI initiators criticise Japan's unambitious targets for reducing emissions and energy consumption and call for an improvement in the general political conditions for expanding the use of renewable energies.

We asked the German companies in Japan to what extent sustainability programmes and projects have already been realised in Japan, what were the triggers for implementation and what was the source of appropriate initiatives. The most frequently implemented sustainability projects of German companies in Japan involve programmes for saving energy. 39 per cent of the participants report that programmes are already in use today. A further 10 per cent of the German com-

panies indicate that the expected start of projects of this kind is anticipated in the next one to two years. Almost one in two companies state, however, that projects to save energy have not been planned or did not provide any information on this subject. The relatively high response under "no information" can also be interpreted to mean that the surveyed companies have not engaged in the issue so far or see questions of sustainability to be the exclusive responsibility of their parent company.

28 per cent of the participants report sustainability programmes for reducing CO2 in their industry. Nine per cent indicate that these projects are expected to start within the next one to two years and a further five per cent report an expected start date within three to five years.

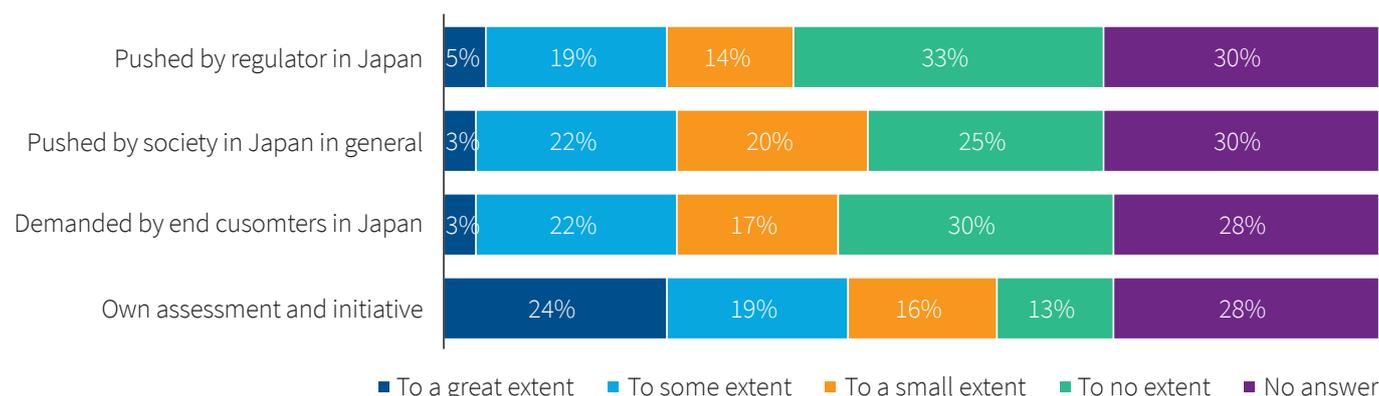
Use of industry-wide sustainability projects in Japan



According to the information provided by the companies surveyed, the most significant trigger for implementing sustainability programmes is in-house initiatives. 43 per cent of the German companies in Japan state that they have launched sustainability programmes in the company to a significant or certain degree as a result of their own assessments and in accordance with their corporate principles.

The demands of Japanese end consumers, the pressure from society in Japan and the initiatives of the regulatory authorities currently play a subordinate role in the debate on triggers. Only around a quarter of the companies indicate that one of these groups mentioned above prompted the implementation of sustainability projects in the company.

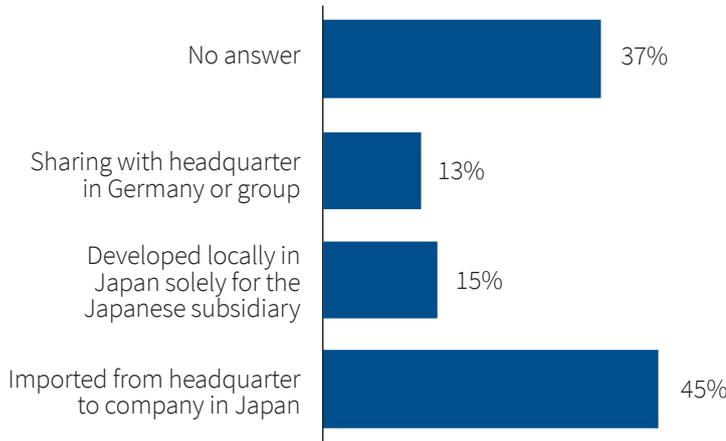
Triggers for sustainability projects in the company



The initial impulses for sustainable ideas and projects originate most frequently at the head office in Germany. 45 per cent of the companies state that they have imported these

topics from the group headquarters Another 15 per cent have developed sustainable ideas on site explicitly for the needs of the Japanese national subsidiaries.

Origin of sustainable ideas



“Due to their high efficiency, our fans are already installed in all major data centres for ventilation and cooling. Because of the implementation of the Japanese “Building Energy Efficiency Act” – with the goal of converting all new business buildings into “Zero Energy Buildings (ZEB)” by 2030 – we are anticipating further growth potential for new projects, but also an increasing number of retrofit and upgrade projects.”

– Armin Schnell, Managing Director, ebm-papst Japan K.K.



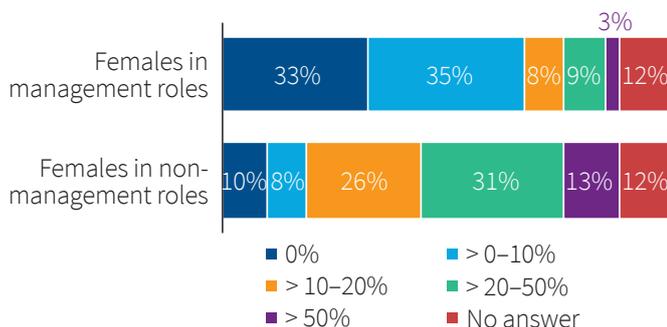
Structure of employment and diversity in the workforce

Inadequate diversity in the workforce is mentioned as the second largest challenge at the moment for German companies in Japan. This aspect is gaining in importance especially in connection with the demographic change taking place in the country. An ageing society and the persistently low birth rates is exerting an ever more massive influence on the labour market. In 2018, Japan recorded a natural population decline of over 440,000 people and thus continued a negative trend that started 10 years ago. In order to counter this development of a shrinking (working) population, the country is increasingly opening up to migration and encouraging the participation of women in the world of work. Of Japan’s approximately 126 million residents, 2.6 million were foreigners in 2018, which corresponds to a proportion of approximately 2.1 per cent. This ratio appears low in an international comparison, but for Japan, where the two per cent mark was exceeded for the first time only in 2018, it represents progress. In Germany, the proportion of fellow citizens from abroad was close to 13.4 per cent in 2019. The general conditions have also been improved when it comes to involving women in working life.

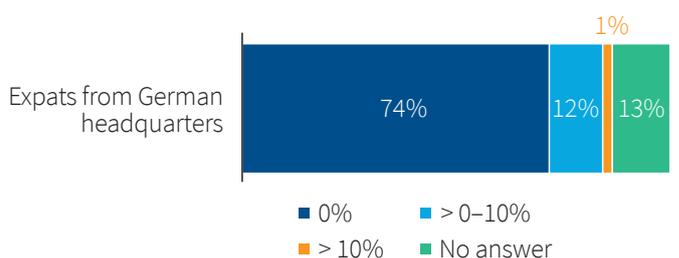
In addition to stricter legislation on equal rights, measures include expanding the availability of day care centres and providing more flexible work models in order to make it easier for mothers to resume their careers for example. These measures will be able to point to success, however, only if traditional social values are rethought, prejudice and discrimination are overcome and the integration of all people in the country is advanced in a labour market offering equal access.

Although two out of three companies surveyed consider the inadequate diversity in the workforce to be a challenge for the success of their business in Japan, women and in particular foreign workers from Asia and Europe play a rather subordinate role here. One in three companies does not have any women among its management staff and one in ten companies does not have any female employees at all. Even the possibility of compensating for the labour shortage by employing Asian or European workers is not used by the majority of the companies.

Structure of the female workforce

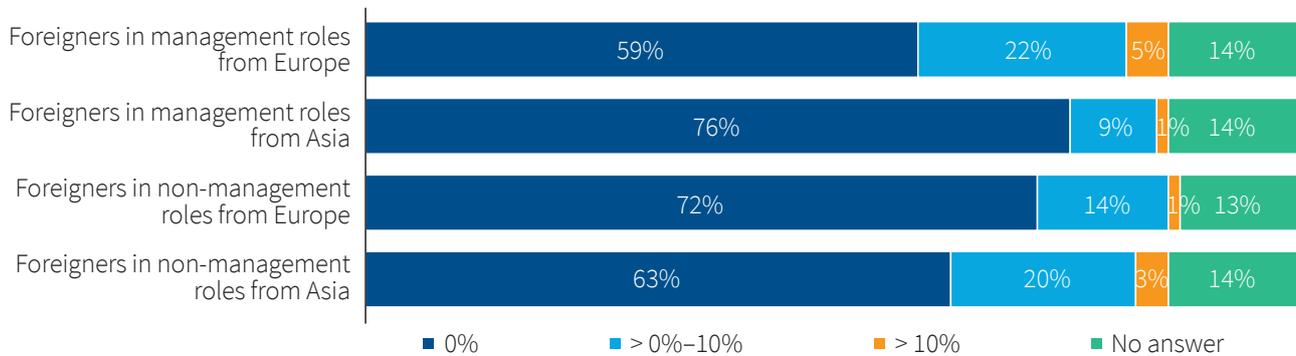


Workforce structure of expats from the head office in Germany





Structure of the foreign workforce



Chinese competition

Meetings at the highest level, more frequent bilateral consultations and joint initiatives to deepen economic relationships accompany the mutual efforts of Japan and China to improve their relations. A smouldering territorial dispute, China’s growing political, economic and military might and historical conflicts that have not fully healed describe some of the aspects that make the planned rapprochement a challenge.

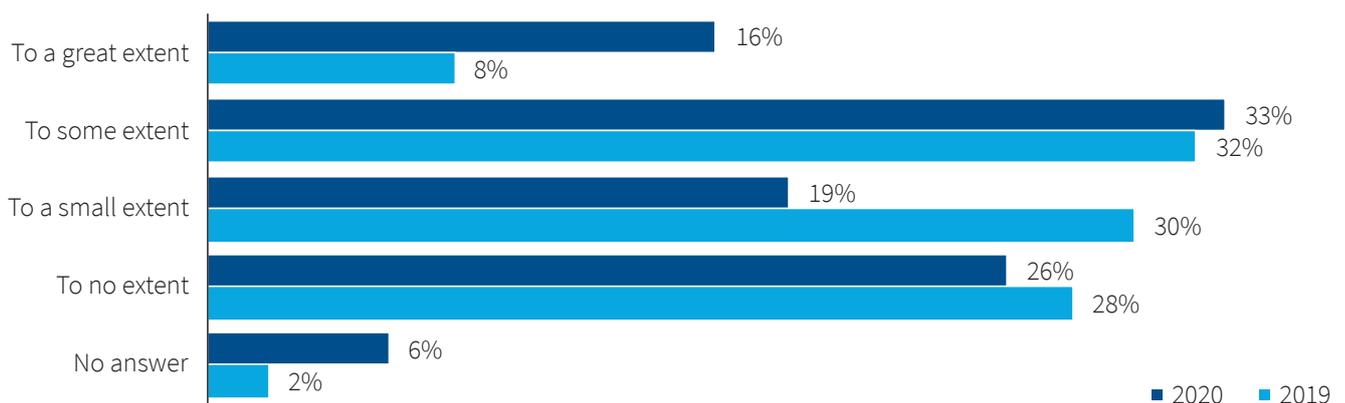
The strong economic interdependence of the two countries can be seen in the 33,050 Japanese companies that have a registered office in China (Ministry of Foreign Affairs, 2018) and a trading volume worth more than USD 317.6 billion in 2018 (<https://wits.worldbank.org>), which is 1.3 times higher than the volume of trade between Germany and China of USD 237.2 billion. Against this background, it is surprising that, according to a survey published by the Ministry of Economy, Trade and Industry (METI) in June 2018, only 337 Chinese companies have set up subsidiaries in Japan. 33 per cent of these companies are wholesalers, followed by companies in the telecommunication and service industries.

As far as the competition with Chinese companies in Japan is concerned, almost half (49 per cent) of the companies sur-

veyed report increasing competition with Chinese products, of which 16 per cent note a considerable degree and 33 per cent a moderate degree of competition. Almost one in five companies (19 per cent) see only minor competition from China and 26 per cent report no impact at all for the Japanese market. In comparison with the previous year, the doubling of companies affected to a considerable degree and the sharp decline (minus 11 per cent) in companies affected only to a minor extent is particularly striking. This shift in the perception of Chinese competitors on the Japanese market may also be a consequence of the trade dispute between China and the US and the resulting trade diversion effects as well as the search by Chinese companies for alternative sales markets.

The price of the goods and services offered is stated as the most important competitive advantage enjoyed by the Chinese companies on the Japanese market. But advantages in procuring raw materials, speed and adaptability are also mentioned by the participants in this connection. It is additionally pointed out that some of the Chinese companies now meet quality and service standards on a par with those of industrial nations. A few participants even mention technology as a key advantage of their Chinese competitors.

Extent of increasing competition with Chinese companies on the Japanese market



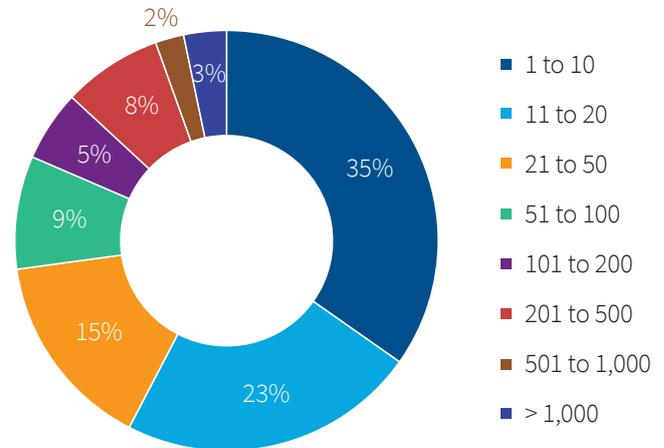
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Profiles of the companies surveyed

A total of 392 companies were sent the annual business climate survey and given the opportunity to respond between 20 and 28 February 2020. The survey focuses on the economic outlook for German companies in Japan and the challenges they face in terms of the growth prospects for their companies.

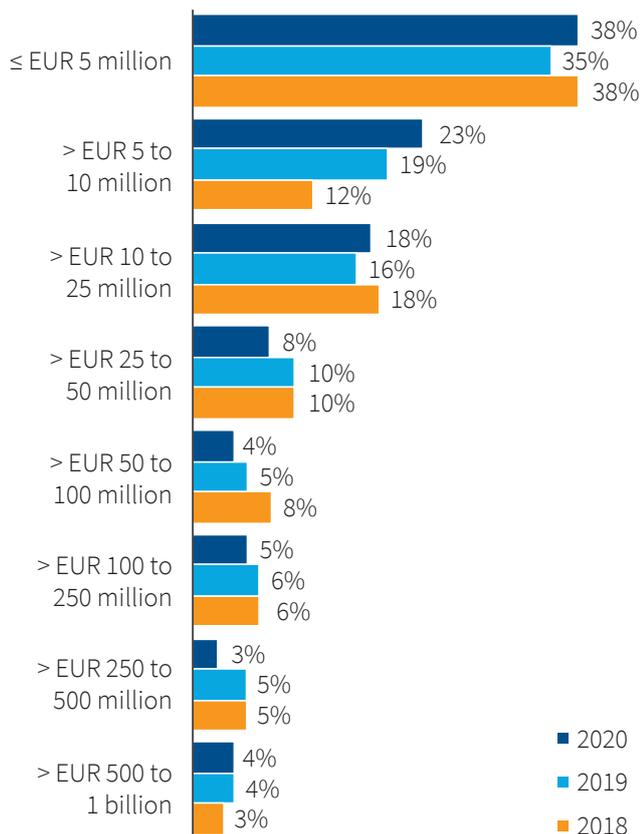
A total of 92 companies took part in the survey, which represents a response rate of 23.5 per cent. The majority of these companies were small and medium-sized enterprises. 35 per cent of the companies employ up to 10 staff; another 38 per cent employ between 11 and 50 staff. The remaining 27 per cent have more than 50 employees.

Number of employees in Japan



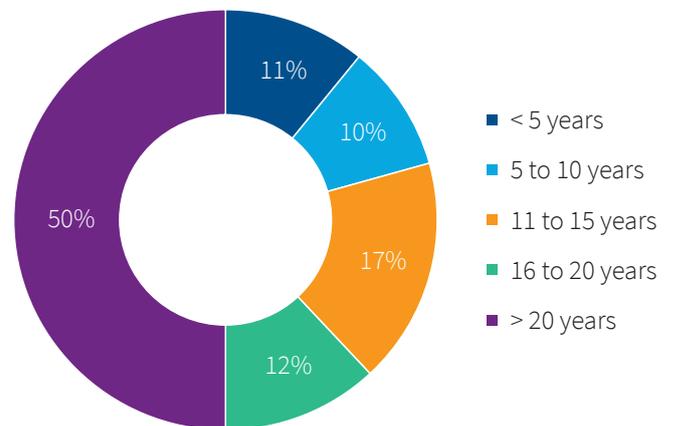
12 per cent of the companies surveyed generate sales of more than EUR 100 million (2019: 15 per cent; 2018: 14 per cent) and are therefore regarded as relatively large. The proportion of very small companies with sales of less than EUR 5 million that take part in the survey currently accounts for 38 per cent.

(Expected) sales for the last 3 (financial) years
(exchange rate EUR 1 = JPY 121)



50 per cent of the companies have been represented in Japan for more than 20 years, which is comparable with the figures in the previous years, and are therefore extremely familiar with the market and have been for a long time. 39 per cent have been present in Japan for between 5 and 20 years, while only 11 per cent have been active there for less than 5 years.

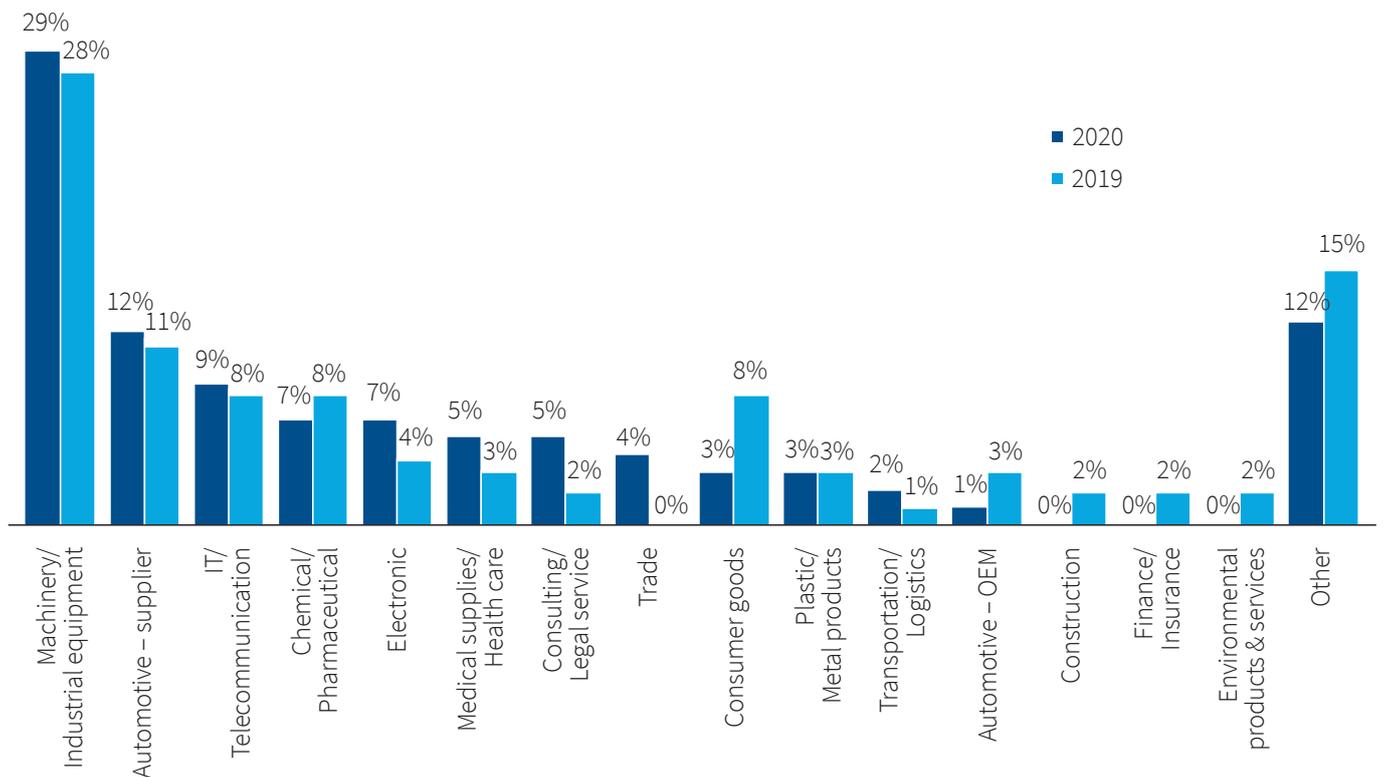
Duration of the presence in Japan



The breakdown by sector is characterised by the following structure: almost one third of the companies work primarily in the field of mechanical and plant engineering. Automotive suppliers make up a proportion of 12 per cent of all sectors

and thus occupy second place. They are followed in third place by companies involved in information technology and telecommunications, accounting for 9 per cent.

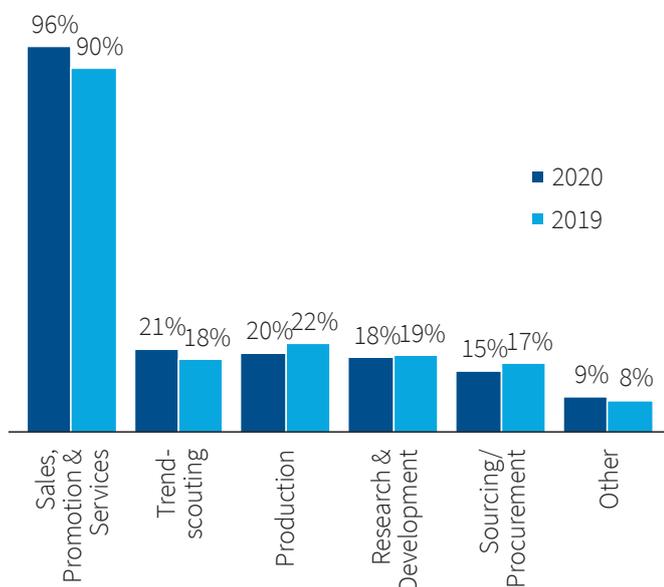
Breakdown by sector of the companies surveyed



The focus of the business activities is sales and service activities, which 96 per cent of companies are involved in. These are

followed by trend scouting (21 per cent), production (20 per cent) and research and development (18 per cent).

Business activities





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

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