



Japan External Trade Organization

2016 Survey on Business Conditions of Japanese-Affiliated Firms in Russia

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Europe, Russia and CIS Division

Overseas Research Department

Japan External Trade Organization (JETRO)



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Summary points

Over 60% of firms expected a surplus, the largest figure to date; the percentage of firms expecting their business to expand also increased slightly

1. More than 60% of respondent firms expected a “surplus.” This fourth survey is the first time this figure has exceeded 60%.
 - ✓ The largest percentage of firms expected a surplus in 2016. The percentage of such firms first exceeded 60% in this the fourth survey (62.7%). Compared with the previous year, 80% of the respondent firms answered that they expect operating profits to “increase” or “remain the same.” The percentage of firms expecting operating profits to “decline” decreased by 15.2 points to 18.1%. This is because the Russian economy seems to have bottomed out and is beginning to recover. [P8, P9]
 - ✓ Regarding the factors behind improved operating profits, the percentage of firms answering “increased sales in local markets” increased by 22.4 points to 61.8%, reaching a majority. [P10]
 - ✓ Regarding their 2017 operating profit forecast, 54.2% of respondent firms forecast that their operating profits would “remain the same,” while the percentage of those forecasting that they would “decline” was 6%, about one-third of the previous year. [P11]

2. A majority expect their business to “expand.” Firms have expectations for the growth potential of the market.
 - ✓ Compared with the previous survey, the percentage of firms answering that their business will “expand” in the next one to two years increased by 7.2 points to 51.8%. The percentage of firms expecting to “maintain the status quo” was 47.0%, showing that nearly half of the respondents have cautious prospects about their business development. [P14]
 - ✓ Many of the companies are planning to expand their business due to “increased sales” and “high growth potential,” indicating that they think the future of the market is bright. [P15]

3. Major management challenges tending to improve
 - ✓ Many firms chose “fluctuations in the exchange rate of the local currency against the dollar/euro” and “fluctuations in the exchange rate of the local currency against the yen” under the category of financial, monetary, and foreign exchange problems. However, the percentage of such firms decreased by more than 10 points each. [P18]
 - ✓ Regarding local production problems, the percentage of firms choosing “underdeveloped logistical infrastructure” and “shortages of power supply and blackouts” decreased, indicating an improvement in infrastructure. [P20]
 - ✓ Regarding advantages in the investment environment, an overwhelming majority chose “market size/growth potential.” Regarding risks, the largest number of firms chose “volatility of exchange rates.” [P22]

4. Interested in the Eight-Point Cooperation Plan, Russian industrial diversification, improvement of the urban environment and development of the Far East
 - ✓ More than 60% of the respondent firms are interested in the Eight-Point Cooperation Plan that Prime Minister Abe proposed to President Putin at the Japan-Russia Summit Meeting in Sochi in May 2016. [P28]
 - ✓ Of the eight points, manufacturing industries are highly interested in “improved diversification and productivity of Russian industries,” while many non-manufacturing firms chose “developing industries in the Far East and making the region an export base toward Asia-Pacific region”, and “development of comfortable and clean cities that are easy to live in and support active lives.” [P28]



Overview of the survey conducted this year (1)

Purpose

To understand the actual conditions of Japanese-affiliated companies' operations in Russia and broadly publicize the results of the survey to the public

Targets

Japanese-affiliated companies operating in Russia (subsidiaries or branch offices in which Japanese entities directly or indirectly have a stake of 10% or more, excluding Japanese representatives' offices)

Period

October 7 to November 4, 2016

Response status

A total of 110 companies were asked to reply, and valid replies were received from 83 of them (valid response rate: 75.5%).

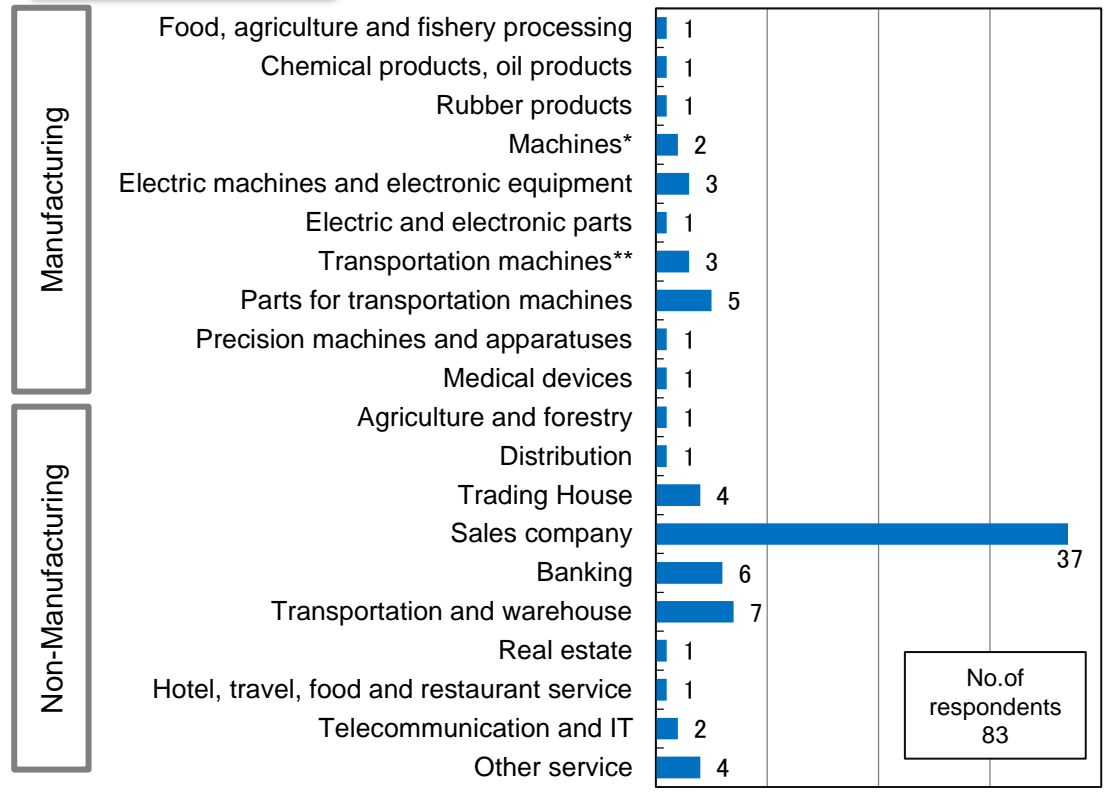
Remarks

- The survey was first conducted in 2013, and this year's is the fourth in its series.
- The total of figures for charts is not always 100% because they are rounded off.
- JETRO informed target companies of the URL for survey forms and asked them to complete the forms and return them, or transmitted questionnaires written in Japanese to those companies by email.

Forms of enterprise

	Number of companies surveyed	Fully owned or JV's with Japanese companies	JV's with non-Japanese companies	Branch	Unknown
Total	83	84.3	6.0	7.2	2.4
Manufacturing industries	19	73.7	15.8	10.5	0
Non-manufacturing industries	64	87.5	3.1	6.3	3.1

List of industries

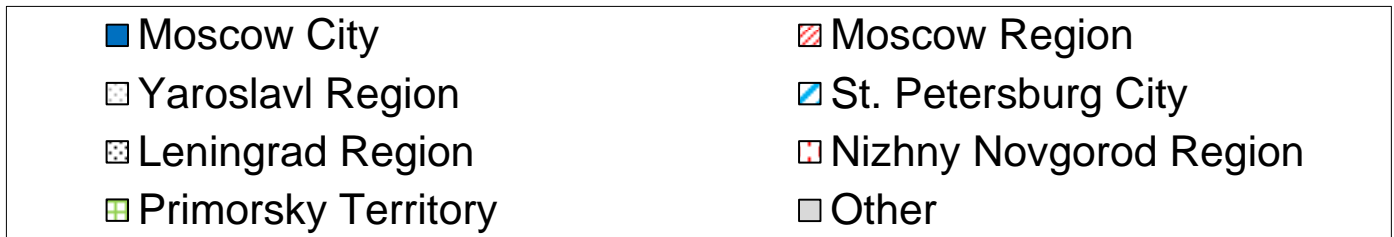
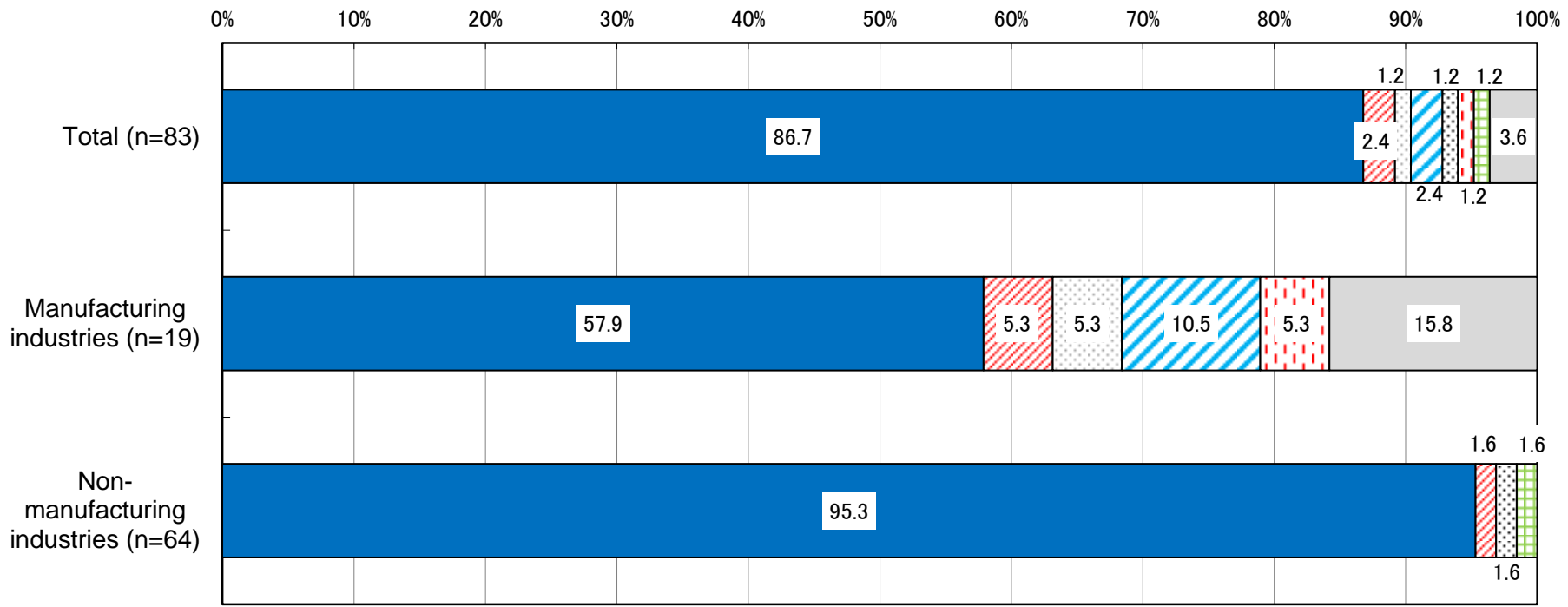


*including molds and power tools
 **motor vehicles and two-wheeled vehicles



Overview of the survey conducted this year (2)

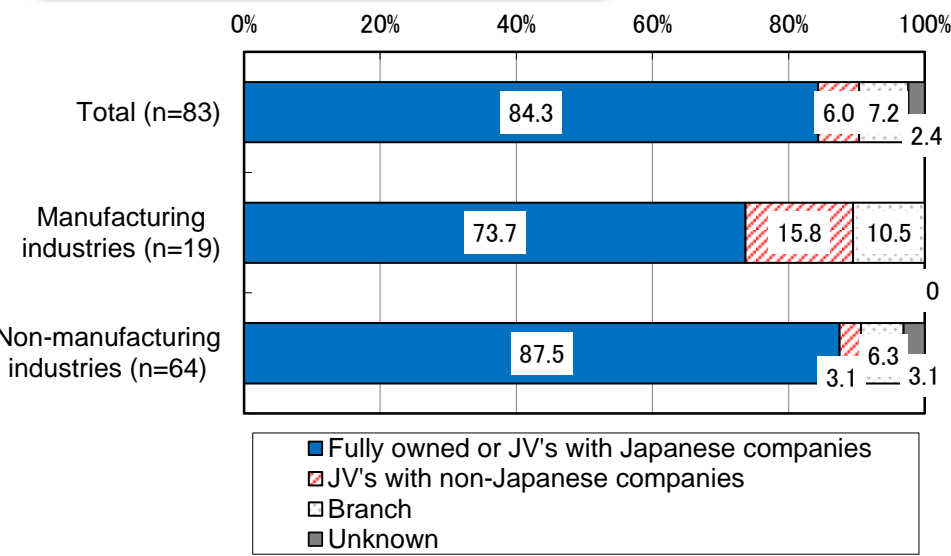
Federal subjects in which respondents are located



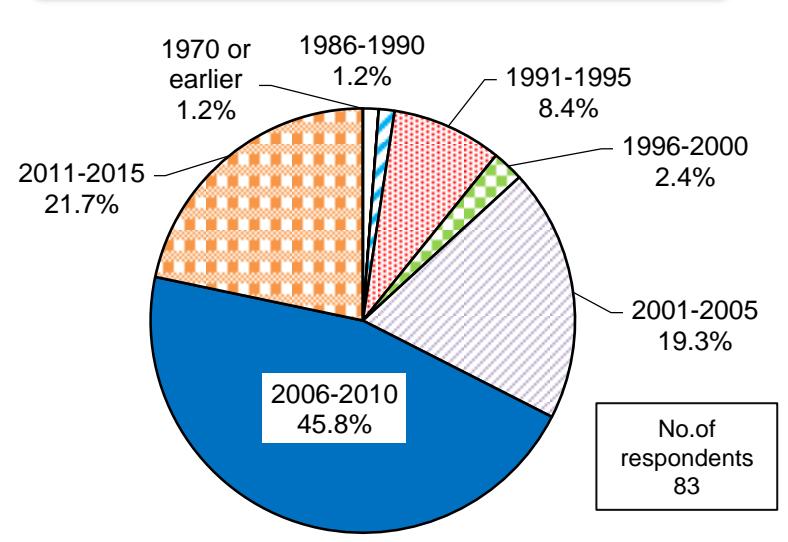


Overview of the survey conducted this year (3)

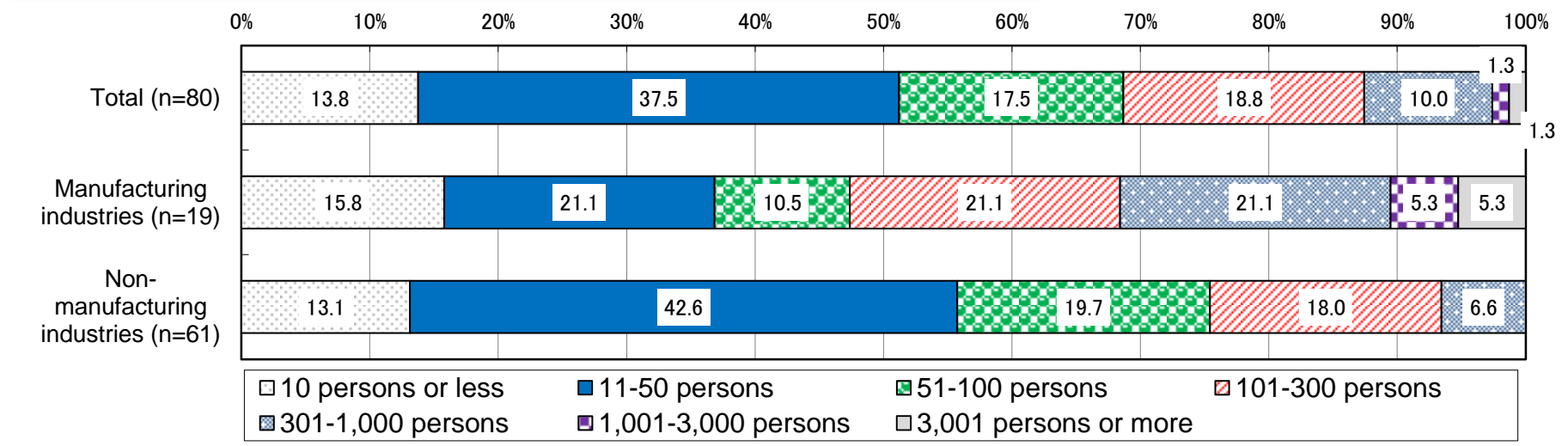
Form of enterprise of respondents



Year in which respondents were established



Respondents' number of employees (manufacturing/non-manufacturing)





1. Operating profit forecasts (1)

Summary points

□ 2016 operating profit forecasts

- A majority of the respondents, whether from manufacturing or non-manufacturing, answered that they are expecting an operating profit surplus. At 62.7% in this the fourth survey, it was the first time for the answer to receive more. Compared with the previous year, about 80% of the respondent firms answered that they expect operating profits to “improve” or “remain the same.” The percentage of firms expecting operating profits to “decline” decreased by 15.2 points to 18.1%. This is because the Russian economy seems to have hit the bottom and is beginning to recover.

□ Factors for improved operating profits

- The number of firms choosing “increased sales in local markets” was the largest of the factors behind improved operating profits. Because of the increase in the number of firms feeling an improvement in business sentiment, the percentage of firms choosing this answer increased by 22.4 points to 61.8%, reaching a majority for the first time since the 2014 survey. The percentage of firms choosing a reduction of various costs (other expenditures [e.g., administrative and energy costs] or procurement costs) decreased by 15 to 20 points compared with the previous survey. Some of the firms that chose “other” are planning to improve operating profits by raising prices.

□ Factors behind declining operating profits

- As factors behind declining operating profits in 2016, the percentage of respondents choosing “decreased sales in local markets” and “exchange rate fluctuations” was 66.7% and 60.0% respectively. Compared with the previous year, the percentage of firms choosing “exchange rate fluctuations” decreased by 11 points.

□ 2017 operating profit forecasts

- The percentage of firms expecting operating profits in 2017 to “remain the same” was 54.2%, the largest, and increased by 16.6 points compared with the previous survey. The percentage of firms choosing “increase” fell by 4.3 points, while the percentage of firms choosing “decrease” fell by 12.3 points.

- Because “2016 operating profit forecasts” in the 2015 survey are almost the same as “2016 operating profit forecasts (compared to results in the previous year),” operating profits in 2017 are expected to be almost the same as the forecasts. Although many firms are cautious, the percentage of firms choosing “decrease” dropped to one-third of that in the previous year, indicating an improvement in business sentiment.

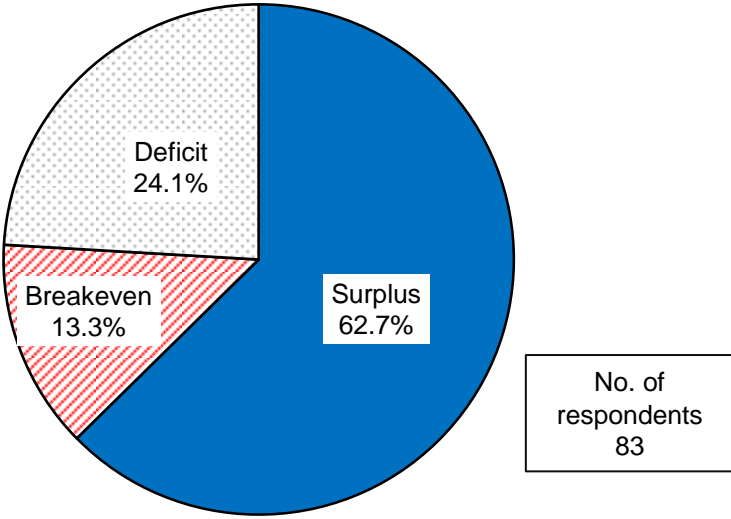
□ Factors behind improved or declining operating profit forecasts

- The largest factor behind improved operating profit forecasts in 2017 continued to be “increased sales in local markets,” which was chosen by 90% of respondents. Manufacturing firms also pointed out “increased sales due to expansion of exports” and “improvement in production efficiency” as factors behind the improvement. Factors behind declining operating profit forecasts included “decreased sales in local markets” and “exchange rate fluctuations.”

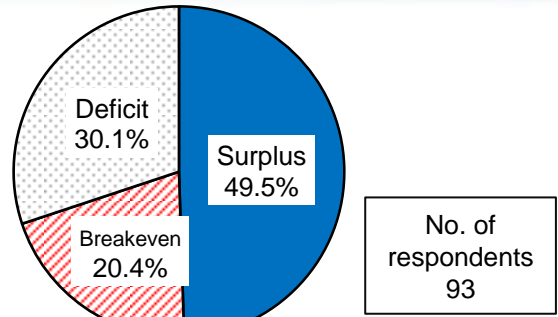


1. Operating profit forecasts (2)

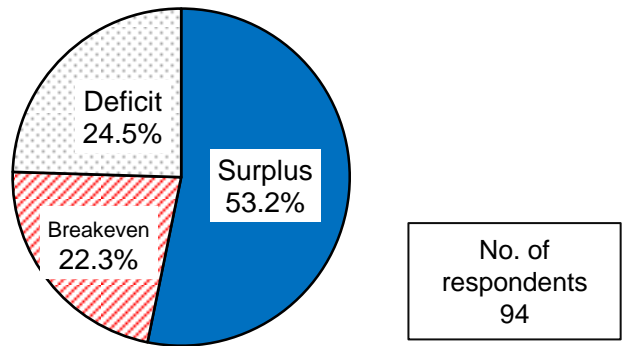
2016 operating profit forecasts



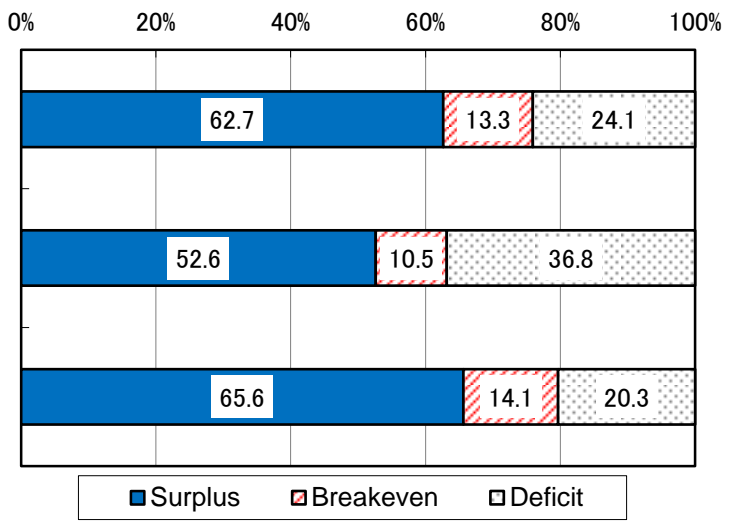
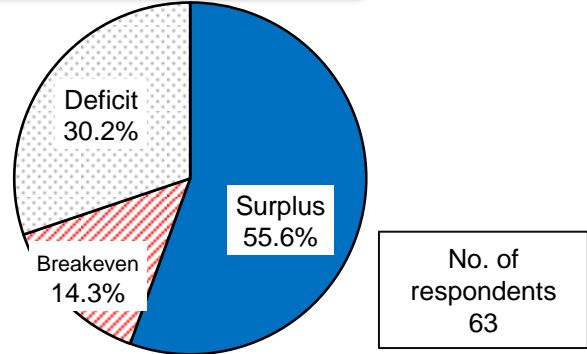
2015 operating profit forecasts



2014 operating profit forecasts

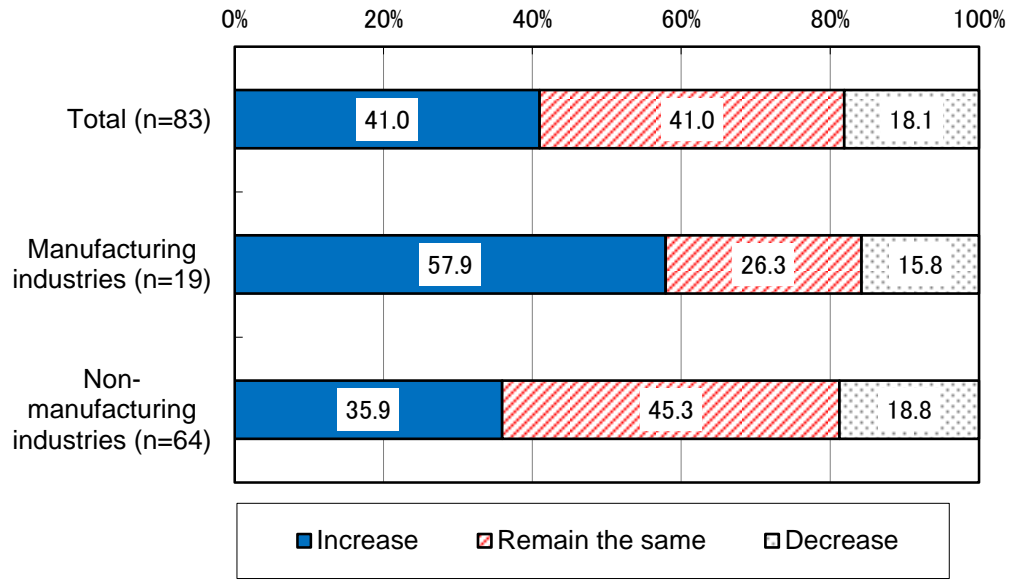
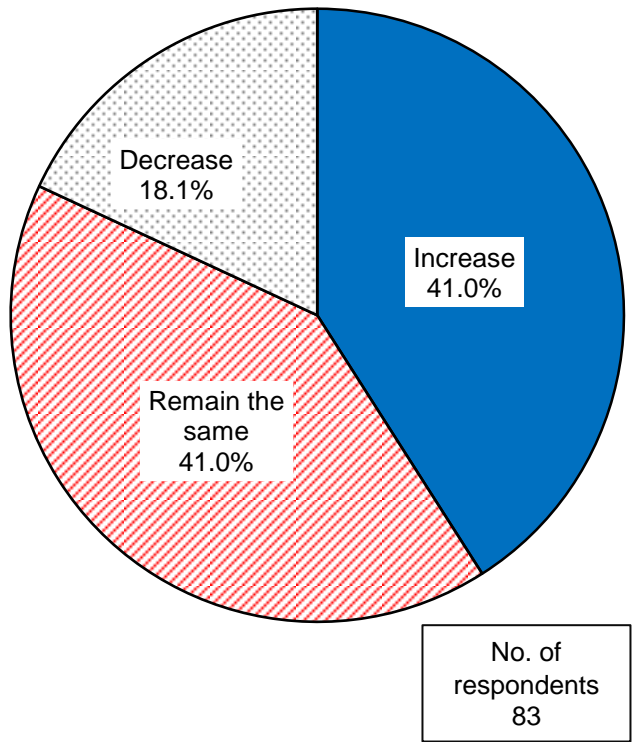


2013 operating profit forecasts



1. Operating profit forecasts (3)

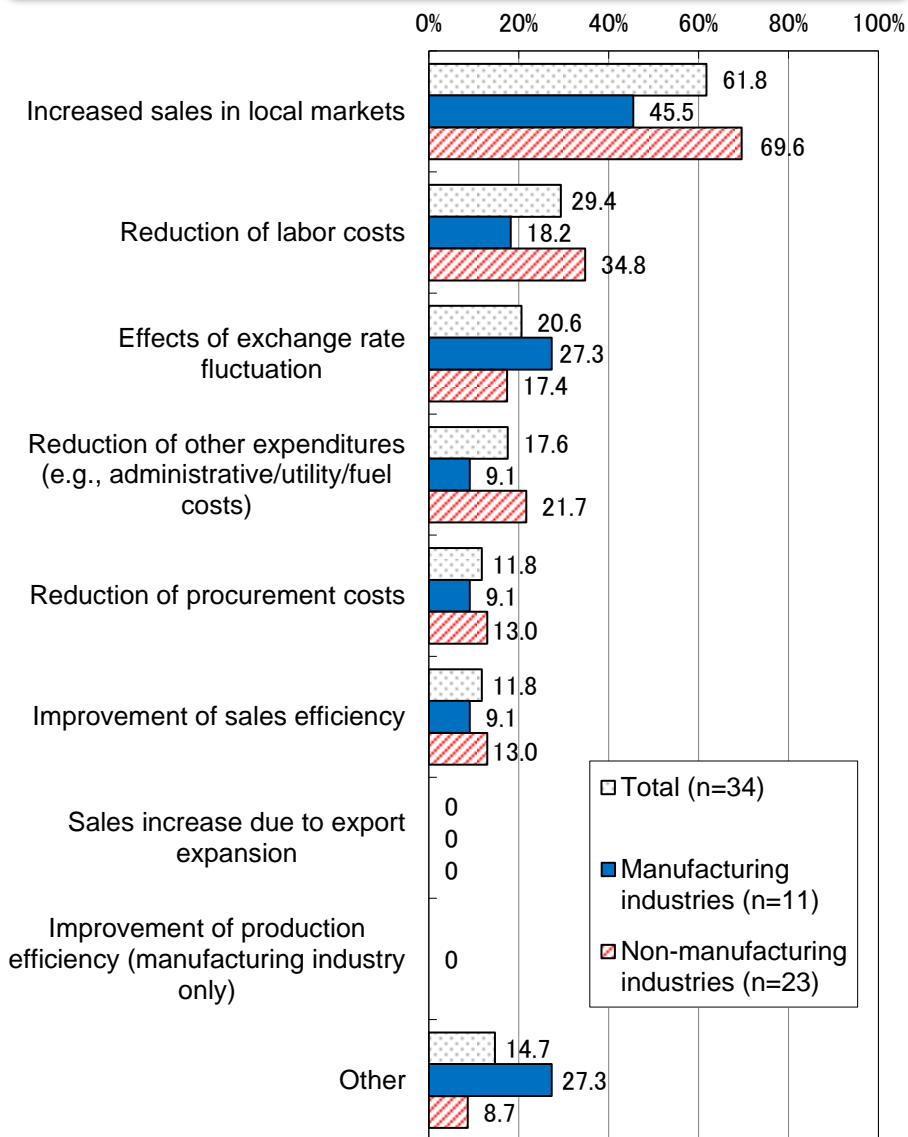
Changes in 2016 operating profit forecasts compared to 2015 results



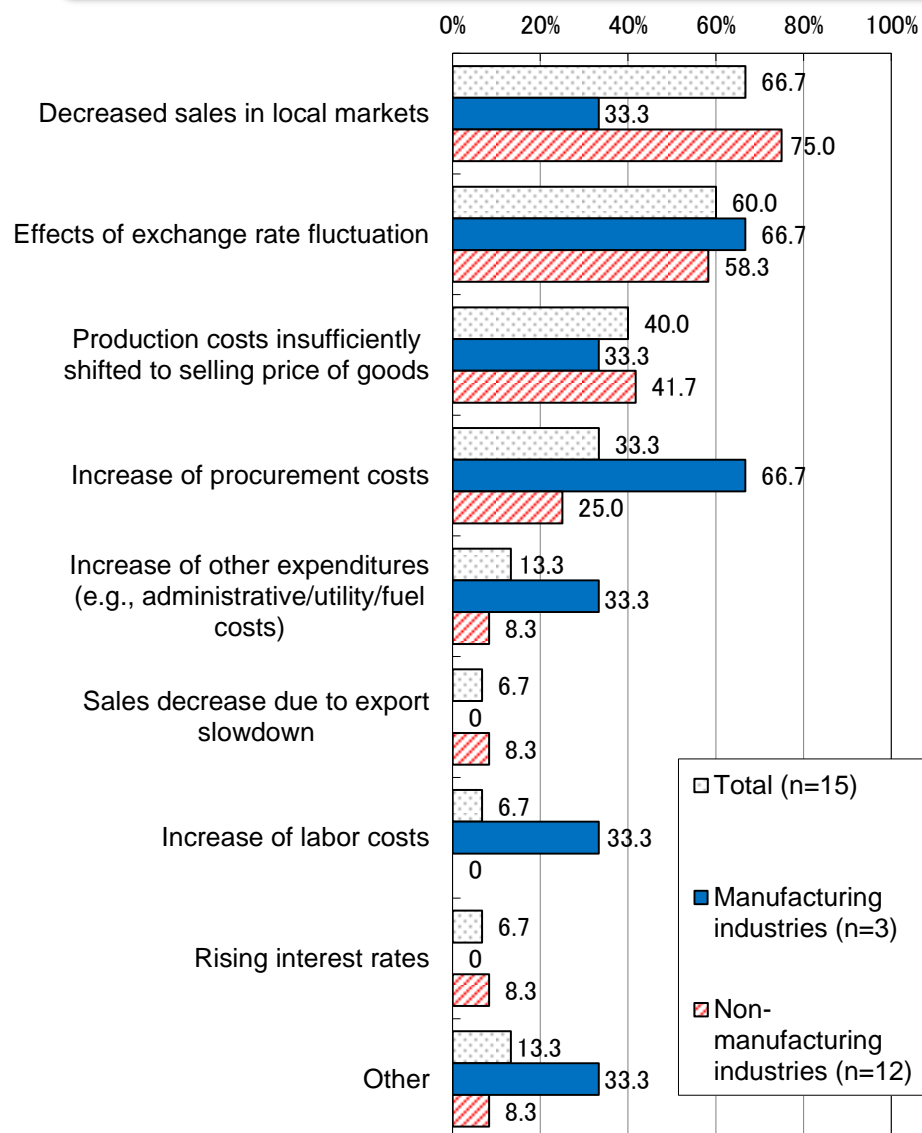


1. Operating profit forecasts (4)

Reasons for forecasting an increase in 2016 operating profits
(Manufacturing/non-manufacturing) <Multiple answers>

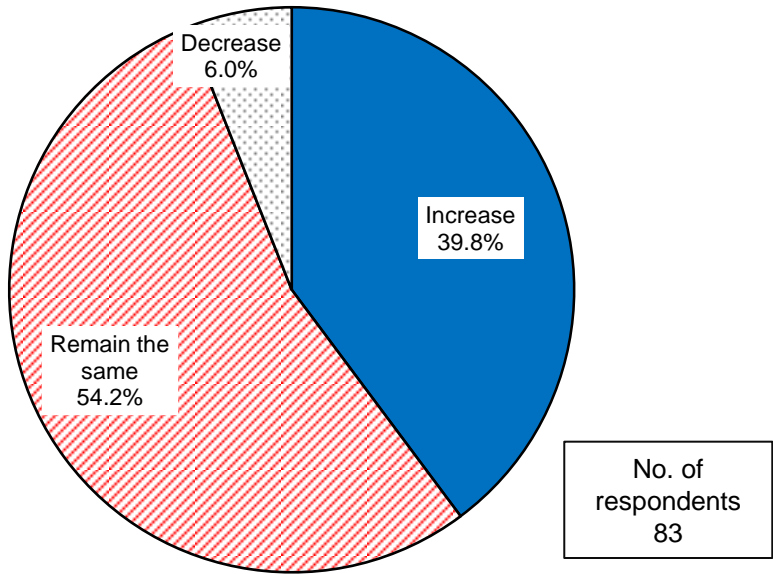


Reasons for forecasting a decrease in 2016 operating profits
(Manufacturing/non-manufacturing) <Multiple answers>

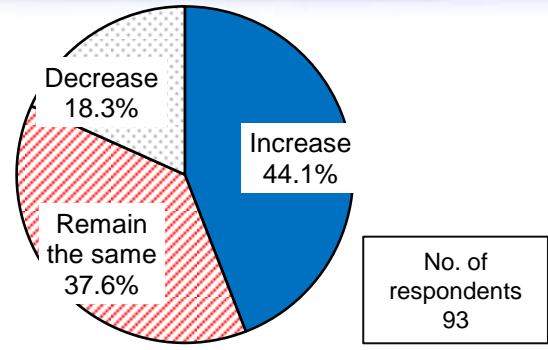


1. Operating profit forecasts (5)

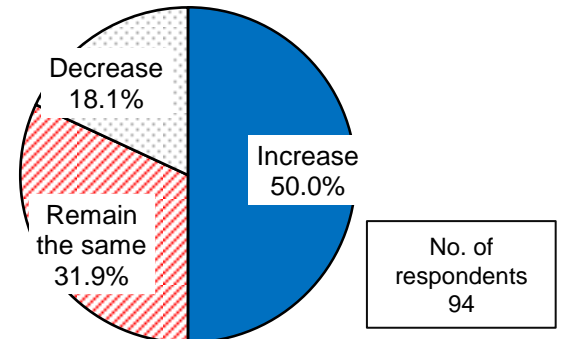
2017 operating profit forecasts



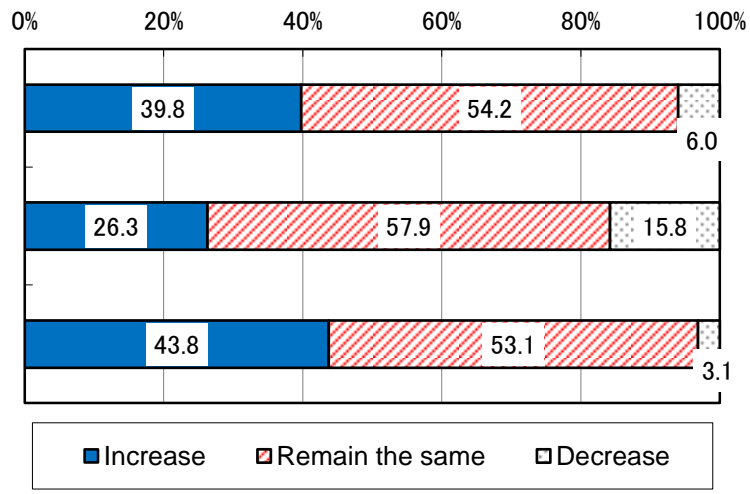
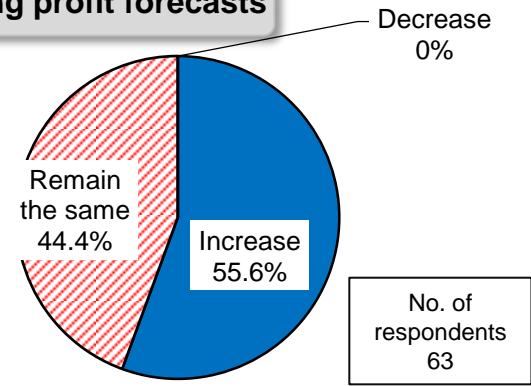
2016 operating profit forecasts



2015 operating profit forecasts



2014 operating profit forecasts

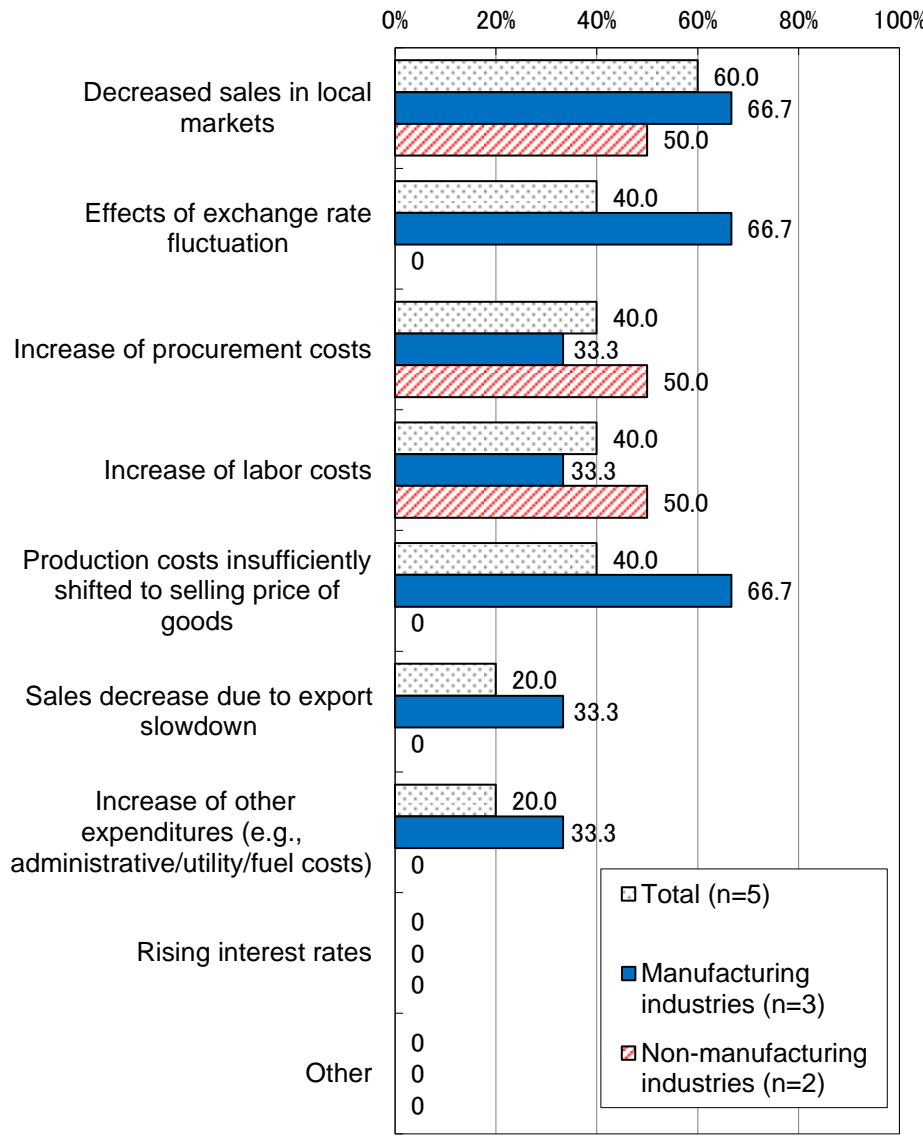
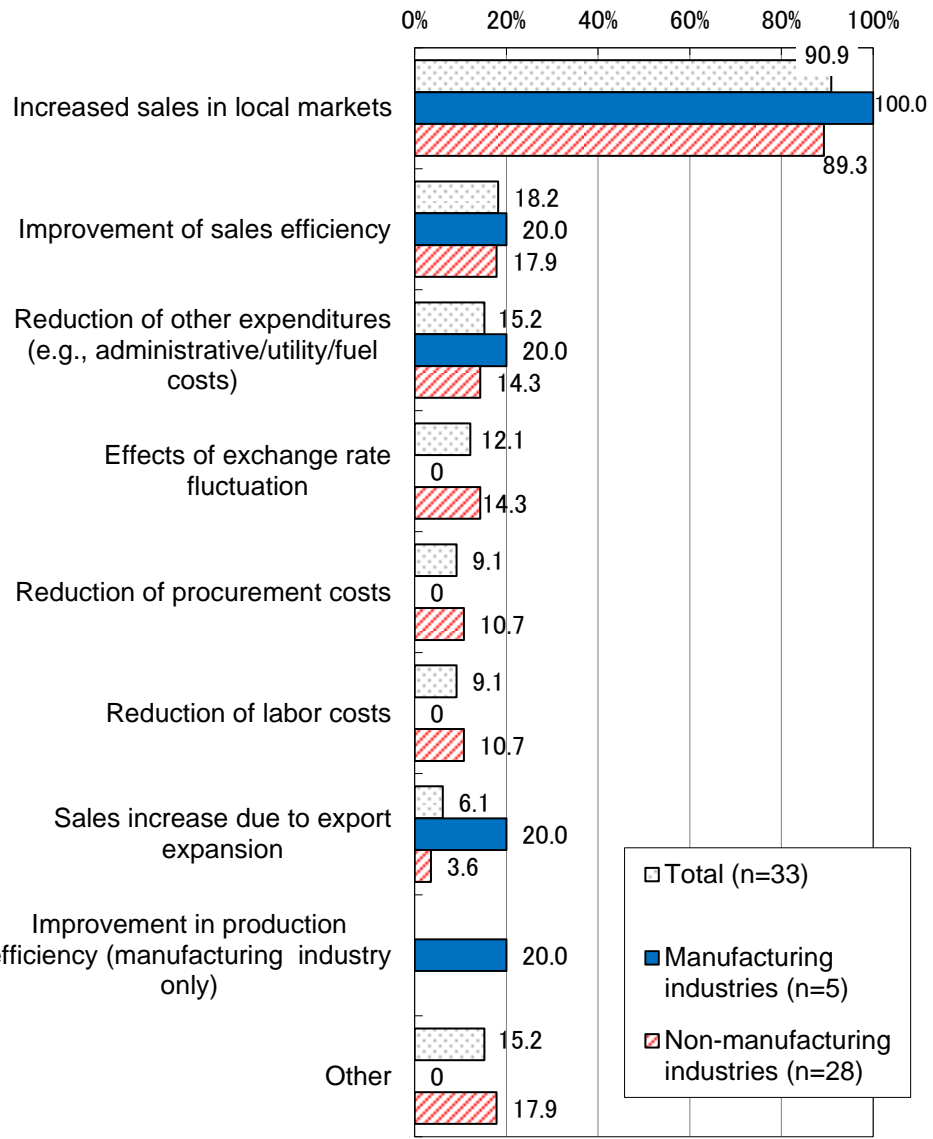




1. Operating profit forecasts (6)

Reasons for forecasting an increase in 2017 operating profits
(Manufacturing/non-manufacturing) <Multiple answers>

Reasons for forecasting a decrease in 2017 operating profits
(Manufacturing/non-manufacturing) <Multiple answers>



2. Future business outlook (1)

Summary points

□ Direction of business development in the next one to two years

- The percentage of firms that chose “expansion” for their direction of business development over the next one to two years was 51.8%, up by 7.2 points from the previous survey (44.6%). The percentage of firms that chose “remain the same” was 47.0%, down by three points from the previous survey. Only one firm chose “reduction” (four firms did so in the previous survey). Although the business outlook did not greatly improve, these results show signs of a bright future. On the whole, many firms have a positive outlook on business development in Russia.

□ Reasons for forecasting an expansion, and functions that will expand, in the business outlook

- Of the companies that chose “expansion,” 81.4% chose “increased sales” as the reason. The percentage of firms that chose “high growth potential” was 53.5%, down by 14.8 points from the previous year. Although expectations for markets are improving, the results show that many firms are still careful about their prospects.
- Regarding the functions that will be expanded, many companies chose “sales functions” (79.1%) and “logistics functions” (20.9%). The percentage of firms that chose “functions of service administration (shared services, call centers, etc.)” increased by nearly 10 points from the previous survey to 14.0%.

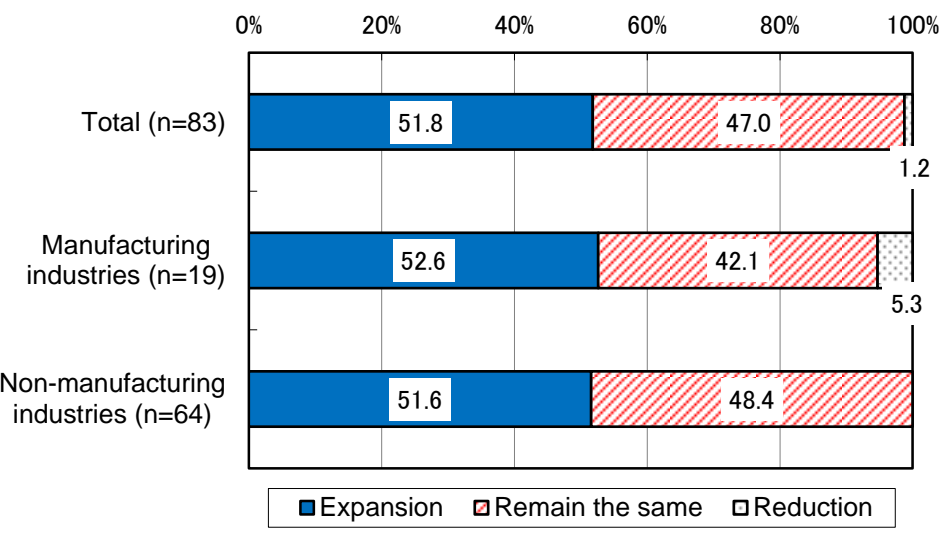
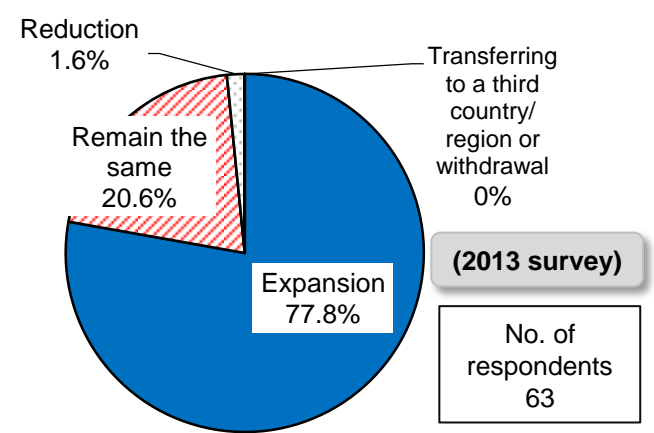
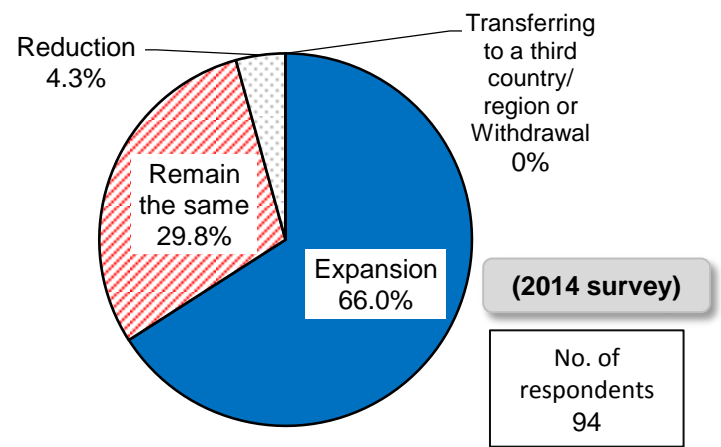
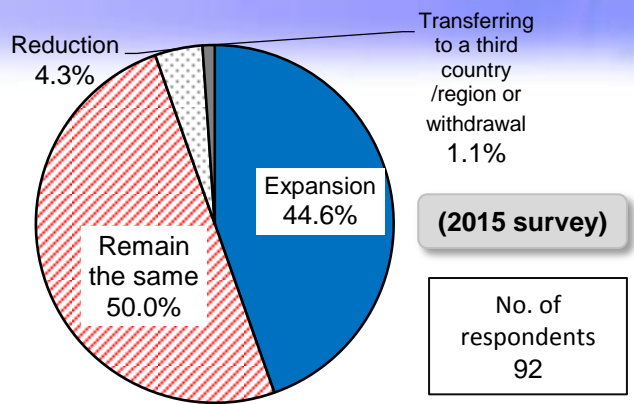
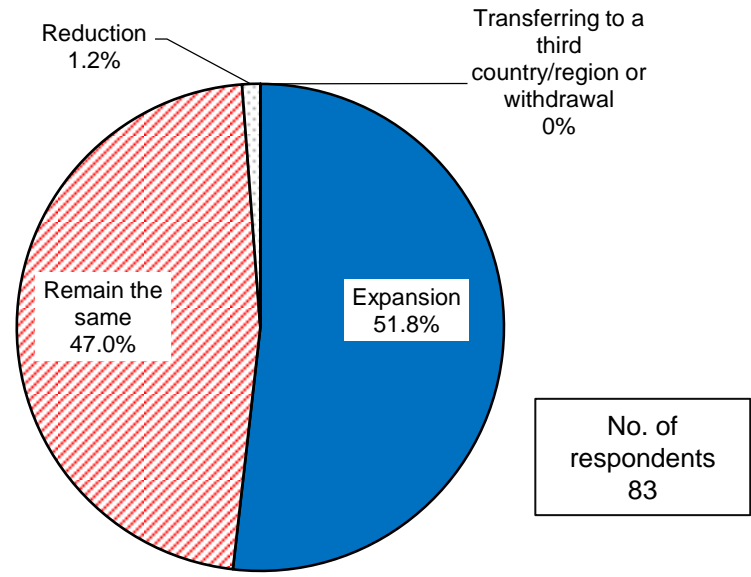
□ Increase/decrease in the number of employees

- In terms of changes in the number of employees during the past year, more than half of the respondents chose “remain the same” for the number of local employees and the number of Japanese expatriates. Only about 20% of respondents answered “decrease” for both numbers. Although the manufacturers that chose “decrease” for both numbers accounted for more than 40% in the previous survey, this time the percentage fell by almost half.
- Regarding future personnel plans, about 40% of respondents are planning to increase the number of local employees, while more than half chose “remain the same.” On the other hand, nearly 90% chose “remain the same” in terms of the number of Japanese expatriates, and only 2.4% chose “increase.” This shows a relative tendency to increase the number of local employees.



2. Future business outlook (2)

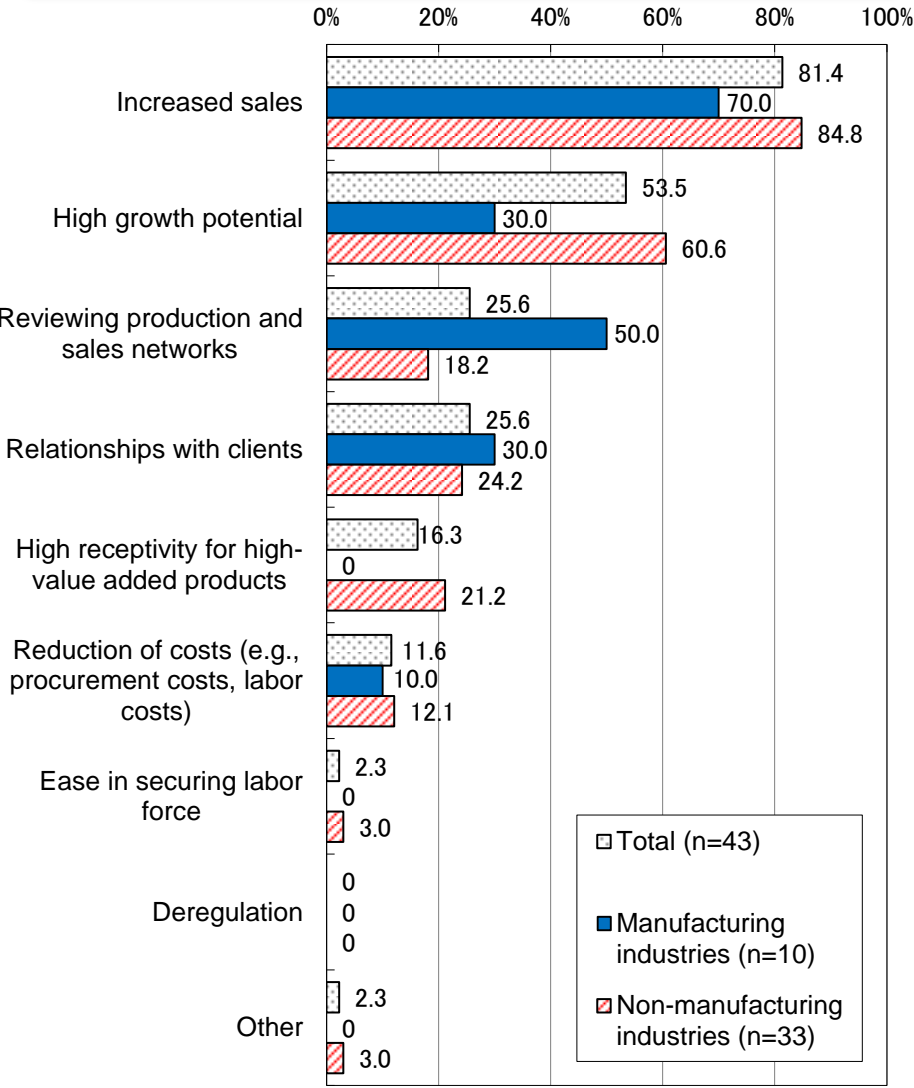
Direction of business development over the next one to two years (2016 survey)



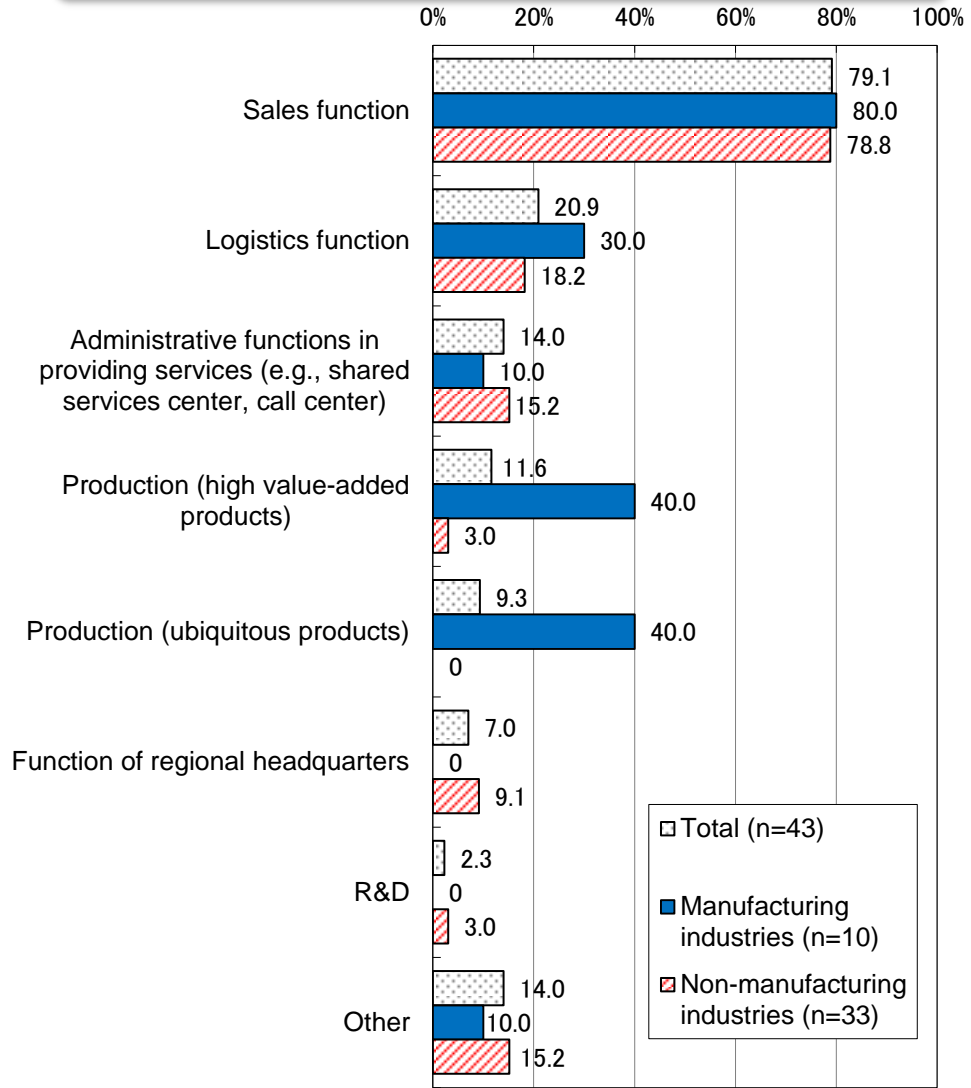


2. Future business outlook (3)

Reasons for expanding business over the next one to two years
(Manufacturing/non-manufacturing) <Multiple answers>



Functions that will be expanded over the next one to two years
(Manufacturing/non-manufacturing) <Multiple answers>



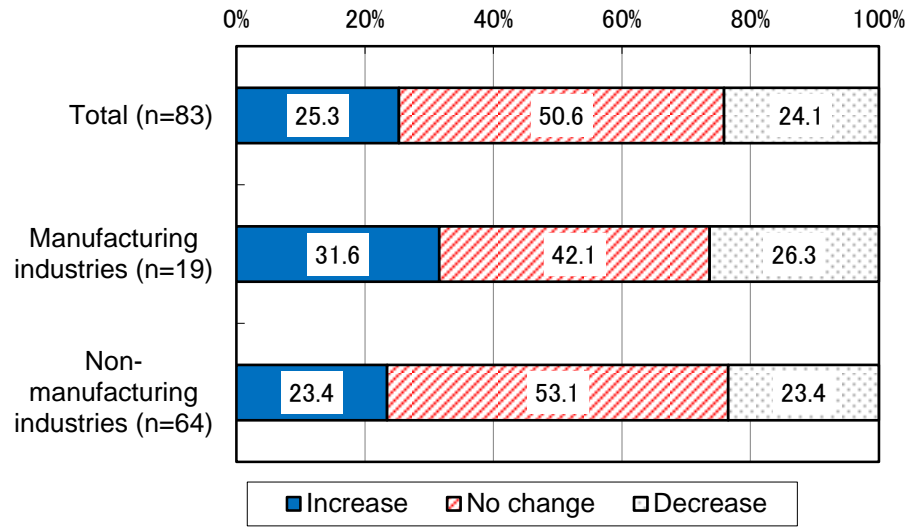
* Firms that answered "reduction" regarding their expected direction of business development over the next one or two years chose "decreased sales" and "rising costs (e.g., procurement and labor costs)" as reasons for the expected reduction.



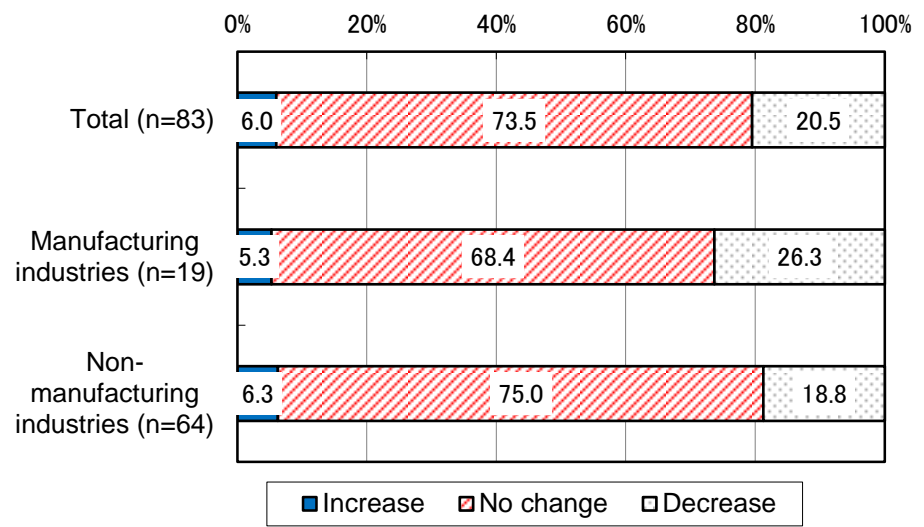
2. Future business outlook (4)

Increase or decrease in the number of employees

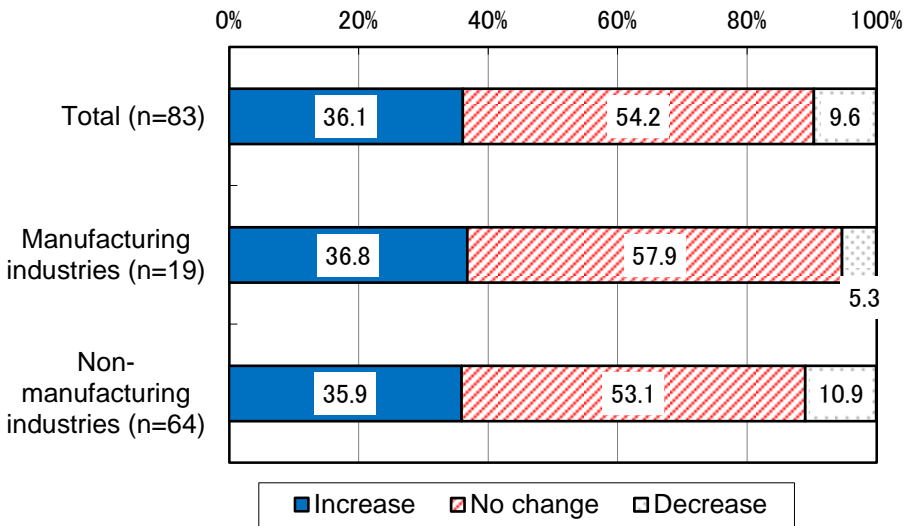
Changes in the number of local employees over the past year



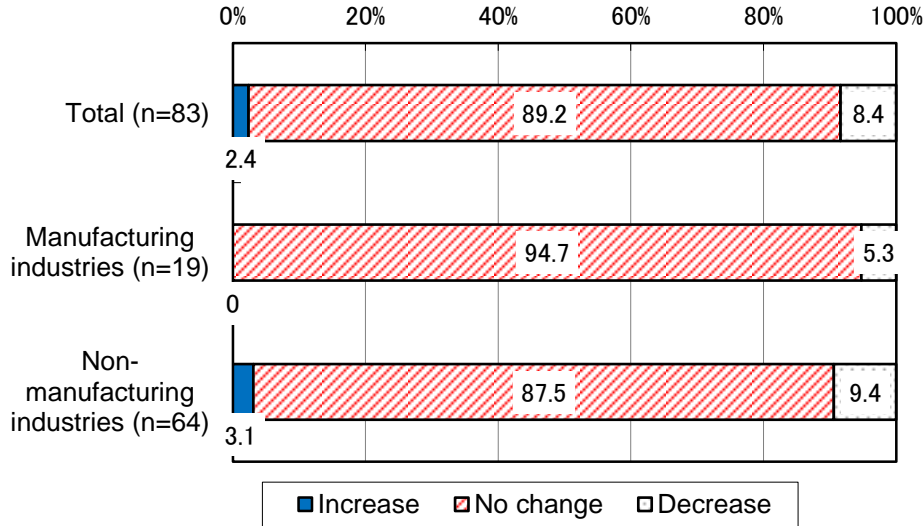
Changes in the number of Japanese expatriates over the past year



Future plans for the number of local employees



Future plans for the number of Japanese expatriates



3. Challenges in management (1)

Summary points

□ Sales and marketing

• “Sluggish sales in major markets” was chosen by 64.6% of respondents. Among types of companies, the percentage of manufacturers choosing this answer increased by 28.2 points. The results reflect the following: although many firms answered “surplus” in terms of operating profits, the size of their surplus was unsatisfactory; and their expectations of market potential are high. The percentage of manufacturers choosing “rise of competitors (competition in terms of cost)” came to nearly double the number in the previous survey.

□ Financial and monetary affairs and foreign exchange

• Although many firms chose “fluctuations in the exchange rate of the local currency against the dollar/euro” (69.5%) and “fluctuations in the exchange rate of the local currency against the yen” (28.0%), the percentage of firms choosing these answers each decreased by 10 points from the previous survey. This result reflects the gradual stabilization of exchange rates. The percentage of firms choosing “no challenges in particular” doubled to 8.5% over the previous year.

□ Foreign trade legislation

• While many firms continued to choose “complex procedures,” the percentage of firms choosing “customs clearance takes time” decreased to 24.4%, down by 15.8 points from the previous survey. Among others, the percentage of manufacturers choosing this answer greatly decreased to 16.7% from 52.0% in the previous survey. This indicates that customs clearance is carried out more rapidly. Responding to the question about the authorities’ efforts to improve the customs clearance system, although many firms chose “no change,” a few companies answered that there was improvement in “computerization of clearance procedures” and “reduction in the number of documents necessary for clearance.” This seems to point to a reduction of the time taken for customs clearance.

□ Hiring and labor

• Although there is no great change from the previous survey on the whole, more than a half of the respondent manufacturers and non-manufacturers each regarded “quality of employees” as the most serious challenge in this category. On the other hand, the number of companies that identified “retention rate of employees” decreased slightly.

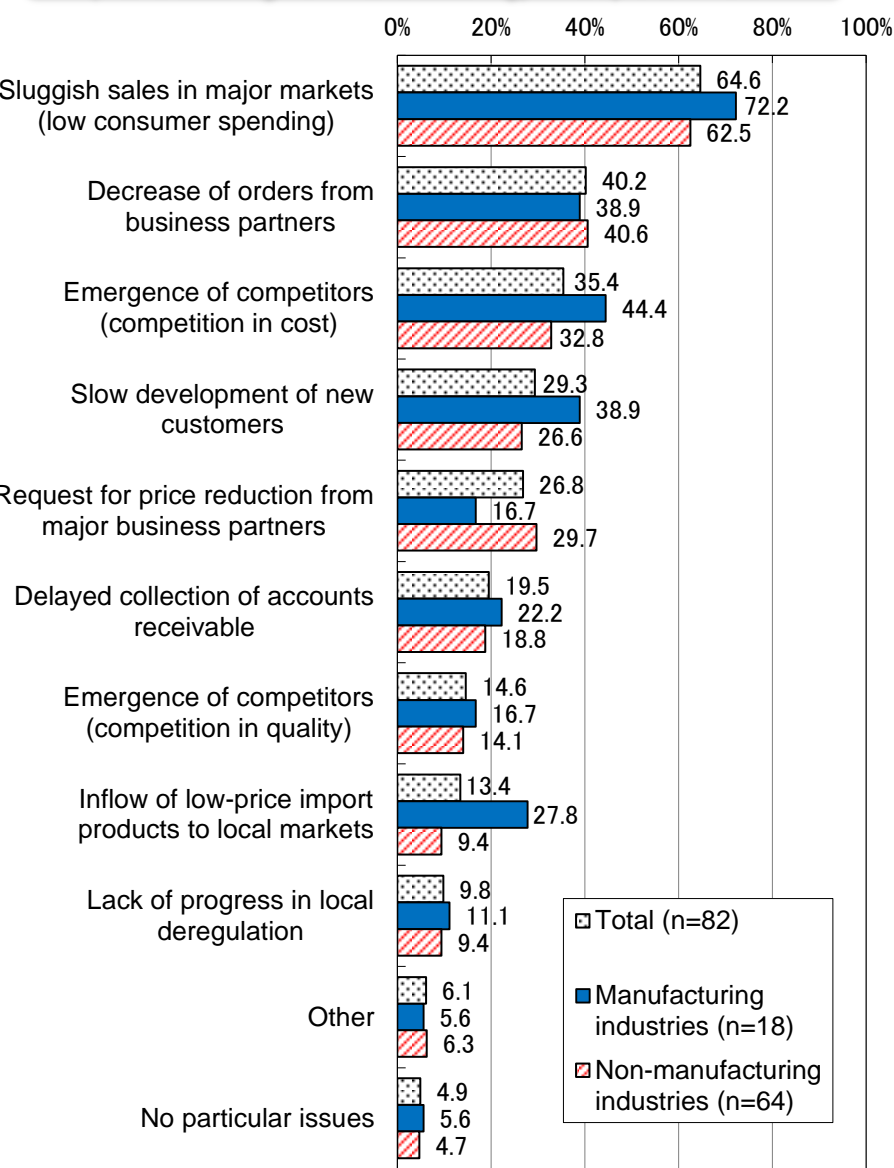
□ Production (manufacturing industries only)

• As in the previous survey, the largest number of firms chose “difficulties with local procurement of raw materials and parts.” However, the number of firms choosing “underdeveloped logistical infrastructure” or “shortages of power supply and blackouts” decreased, indicating an improvement in infrastructure.

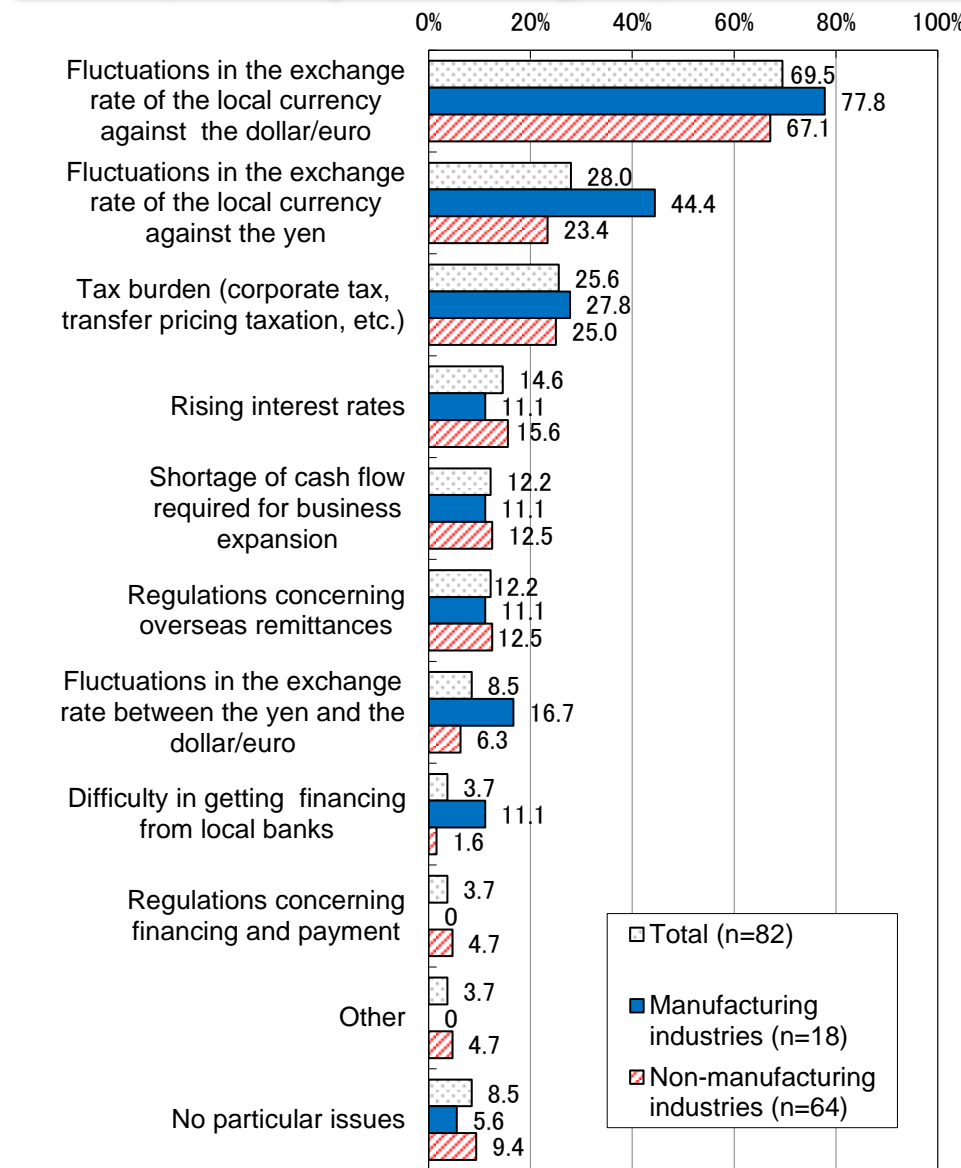


3. Challenges in management (2)

Challenges for sales and marketing
(Manufacturing/non-manufacturing) <Multiple answers>

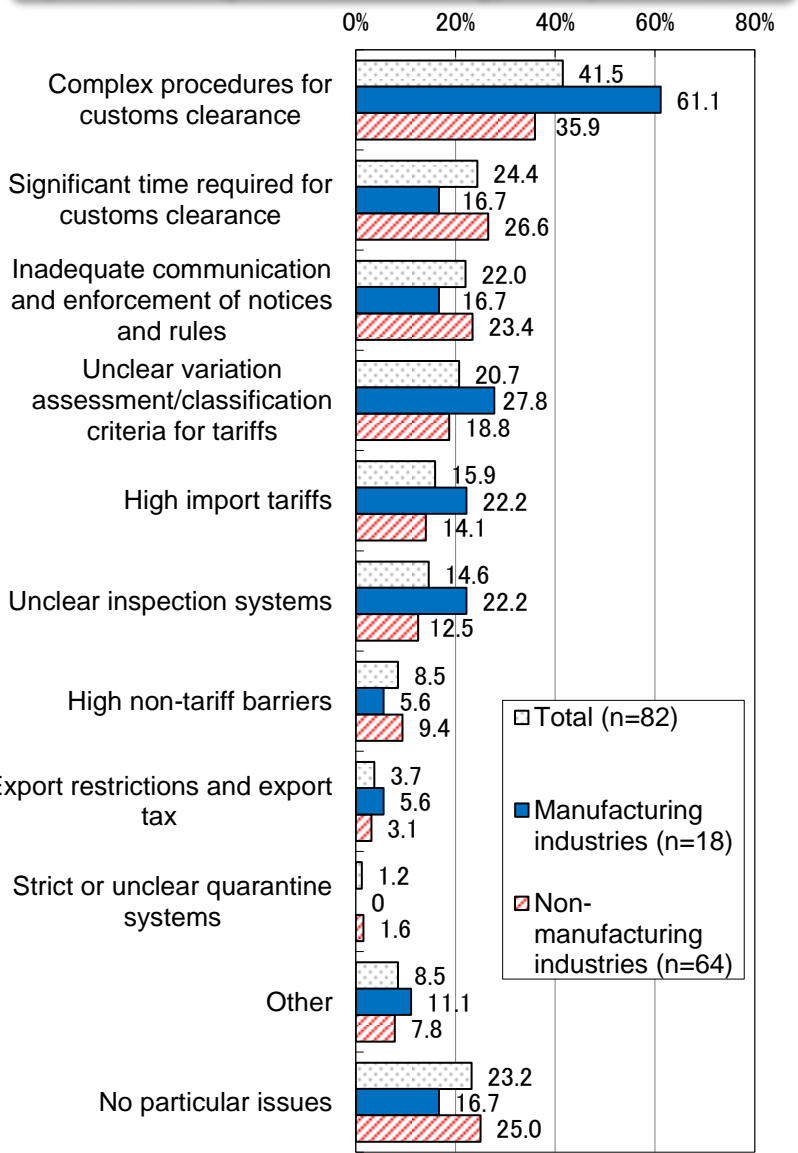


Challenges in terms of financial and monetary affairs and exchange rates
(Manufacturing/non-manufacturing) <Multiple answers>

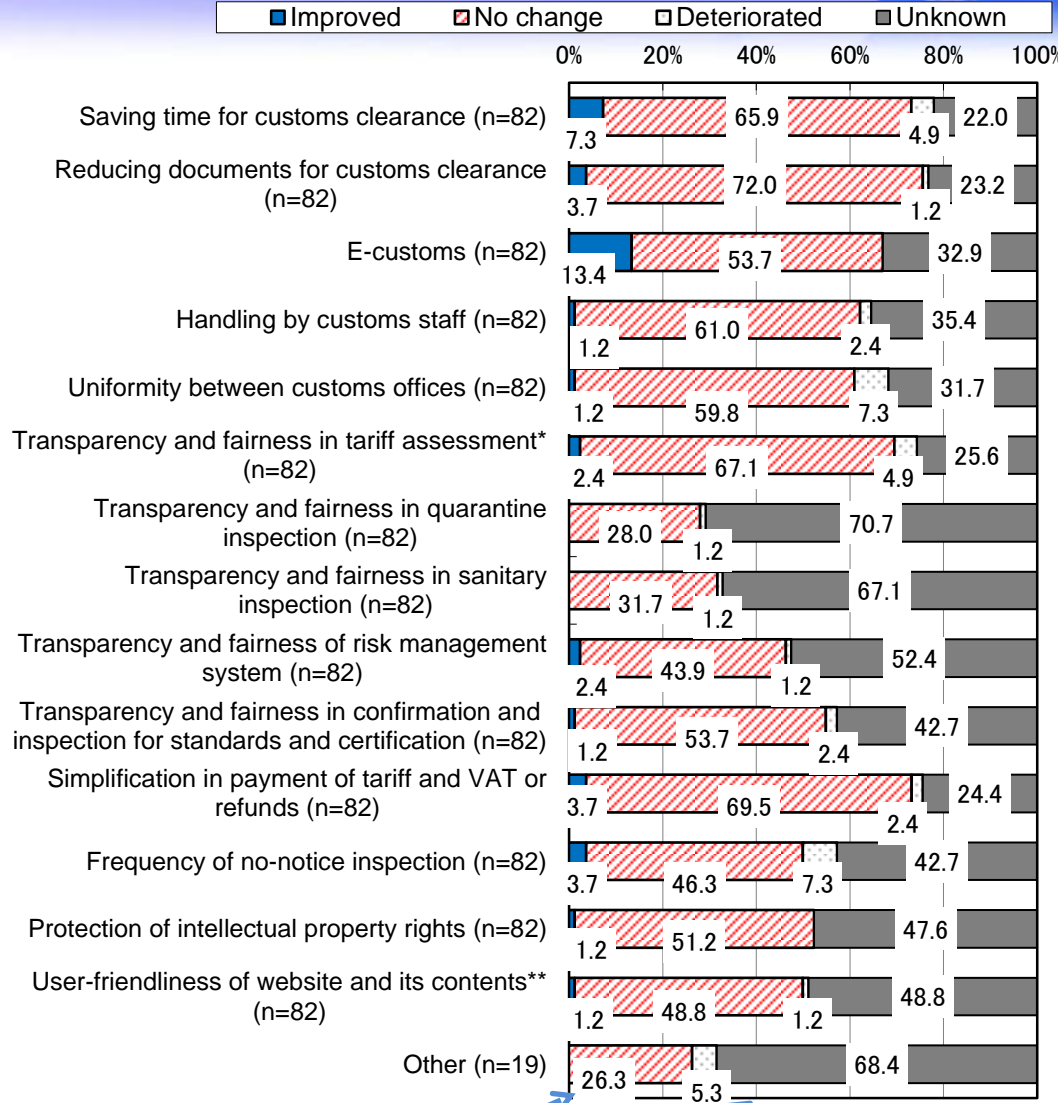


3. Challenges in management (3)

Challenges in terms of trade legislation
(Manufacturing/non-manufacturing) <Multiple answers>



Russian authorities' efforts to improve the customs system over the past year



*including deciding classification of HS codes
**including provision of information in English

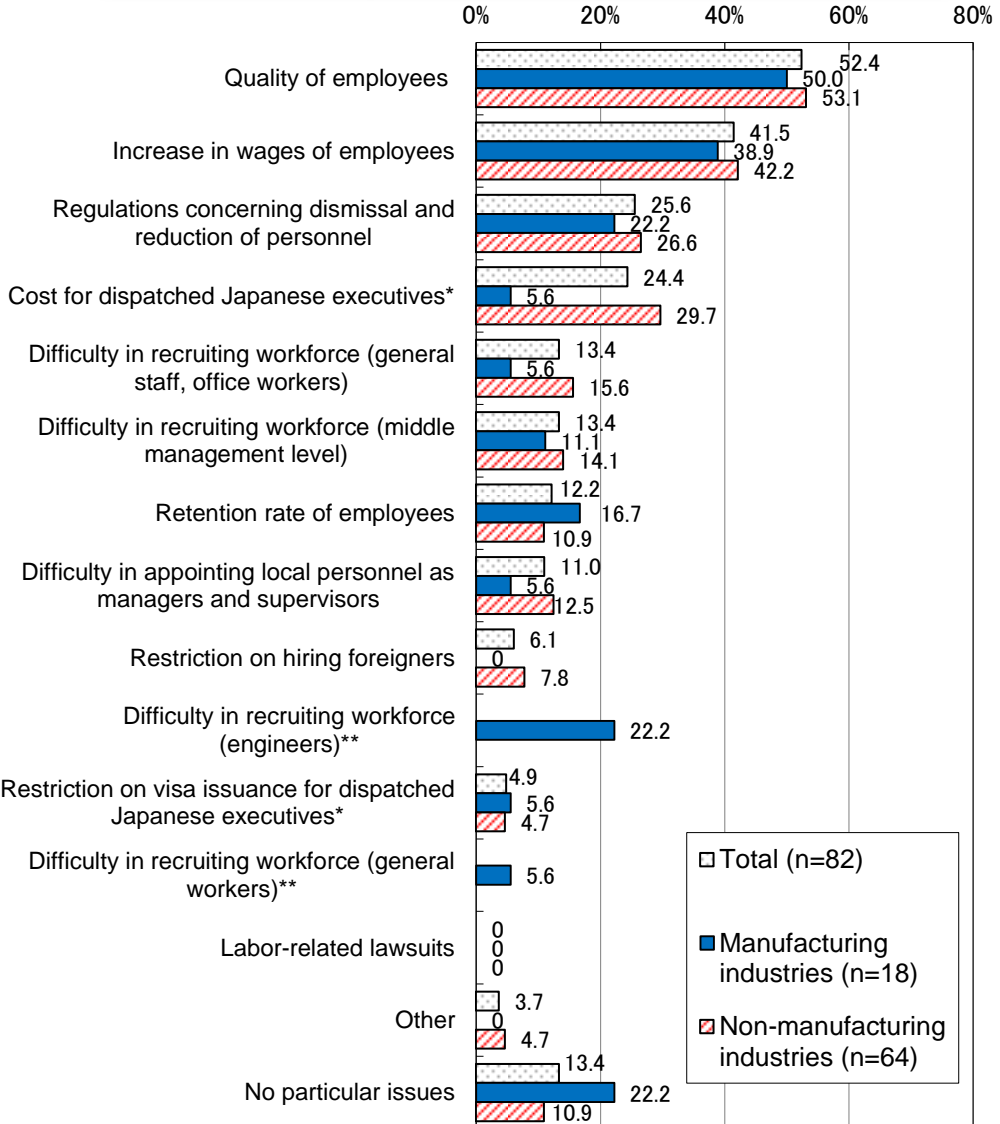
<No change>
Fairness of customs inspections (non-manufacturing: transport/warehousing)
Simplification of inspection of standard materials recognized in markets (manufacturing: Electrical and electronic parts)

<Declined>
Increase in the number of instructions to correct commodity prices (non-manufacturing: transport and warehousing)

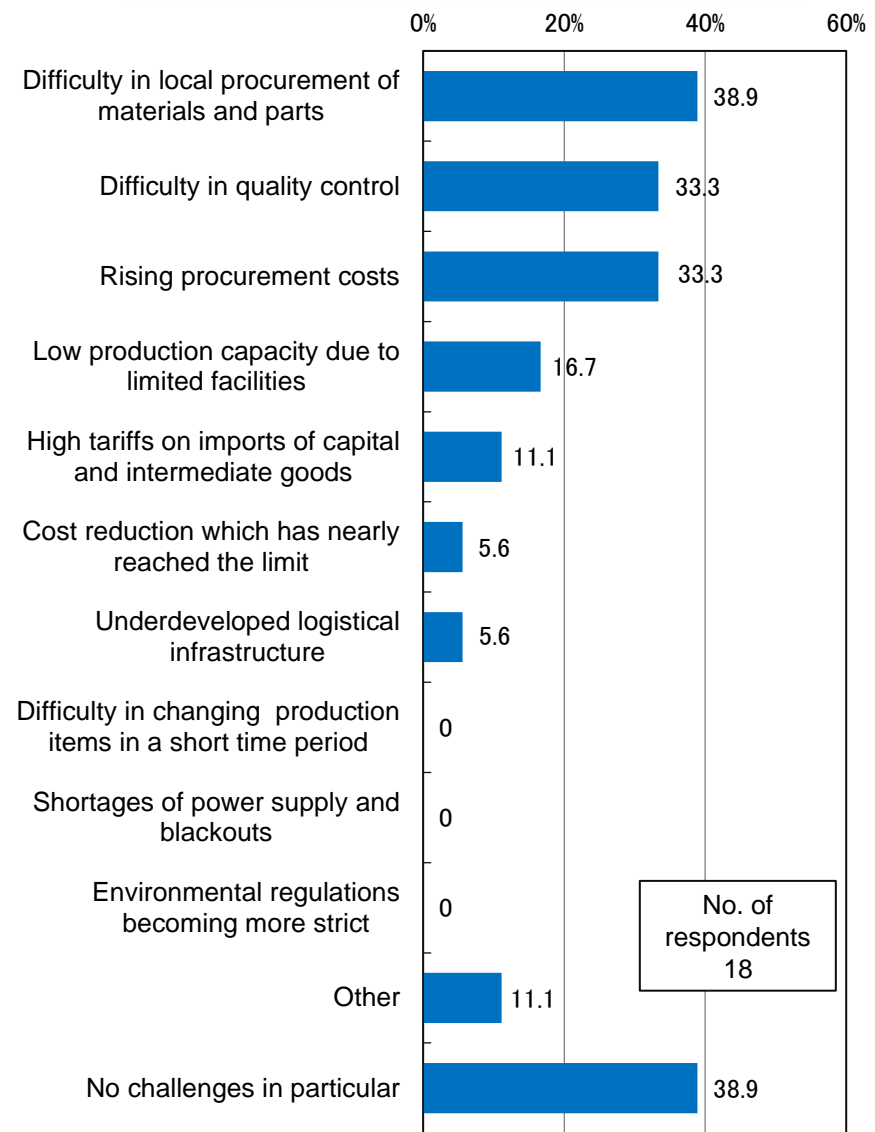


3. Challenges in management (4)

Challenges in terms of hiring and labor
(Manufacturing/non-manufacturing) <Multiple answers>



Challenges in terms of production
(Manufacturing) <Multiple answers>



*stationed representatives
**manufacturing companies only

4. Advantages and risks in terms of the investment environment (1)

Summary points

□ Advantages (merits) and risks in the overall investment environment

- Overwhelmingly, many firms chose “market size/growth potential” as an advantage in terms of the investment environment. Although the percentage of such firms decreased slightly, it can be said that growth potential remains an appeal of the Russian market. The percentage of firms choosing “stable political and social conditions” increased to 20.7%, up by 15.3 points from the previous survey.
- Although the largest percentage of firms chose “volatility of exchange rates” as an investment environment risk, it decreased by eight points from the previous survey. In addition, this decrease was also shown in the percentage of firms choosing “unstable political and social climates” and “unclear policy implementation by the government” which decreased by 18.4 points and 8.1 points respectively, clearly that political and social risks involved in investment are on the decline.

□ Safety risks

- The largest portion, 78%, of respondents chose “public security and terrorism.” As in the previous survey, several firms choosing “other” identified “traffic accidents” and an “underdeveloped medical environment.”

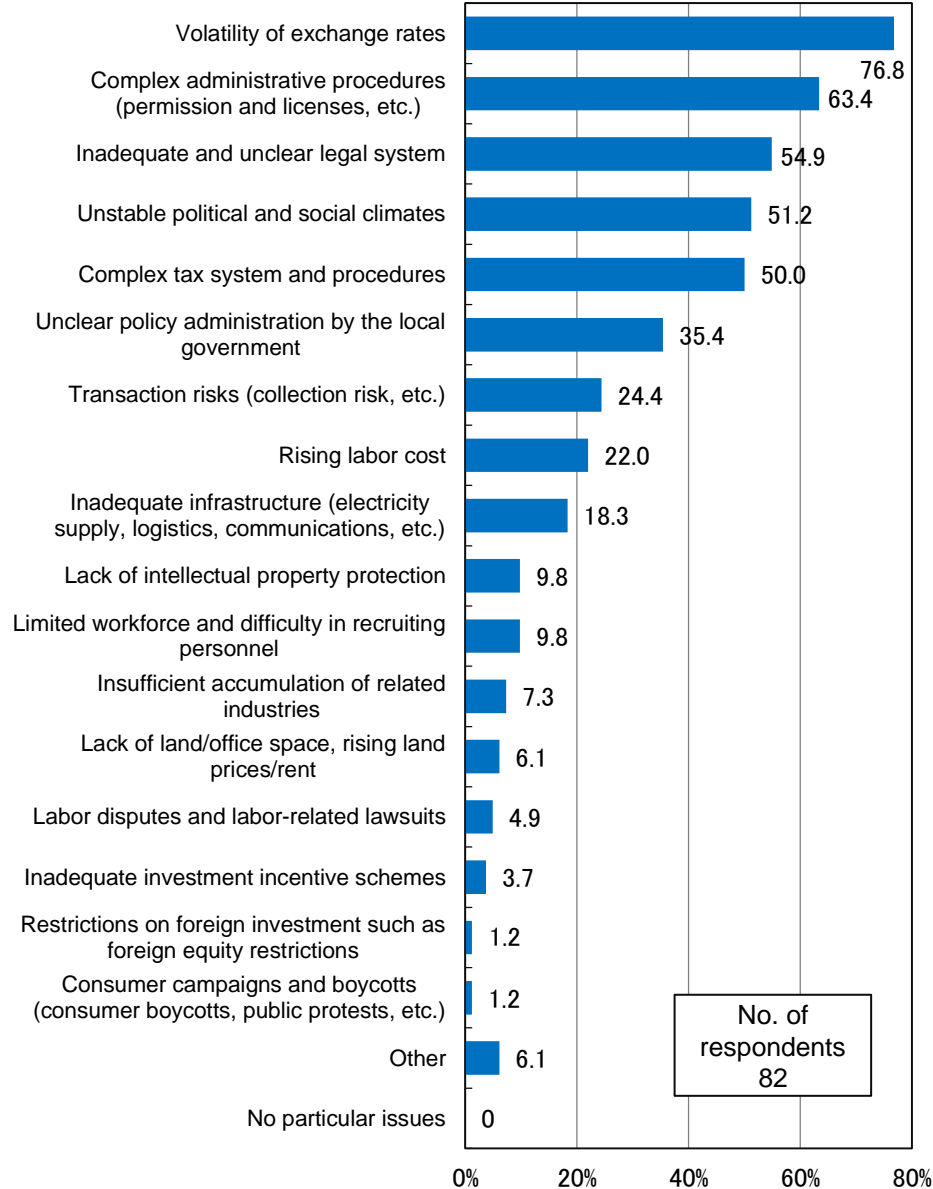
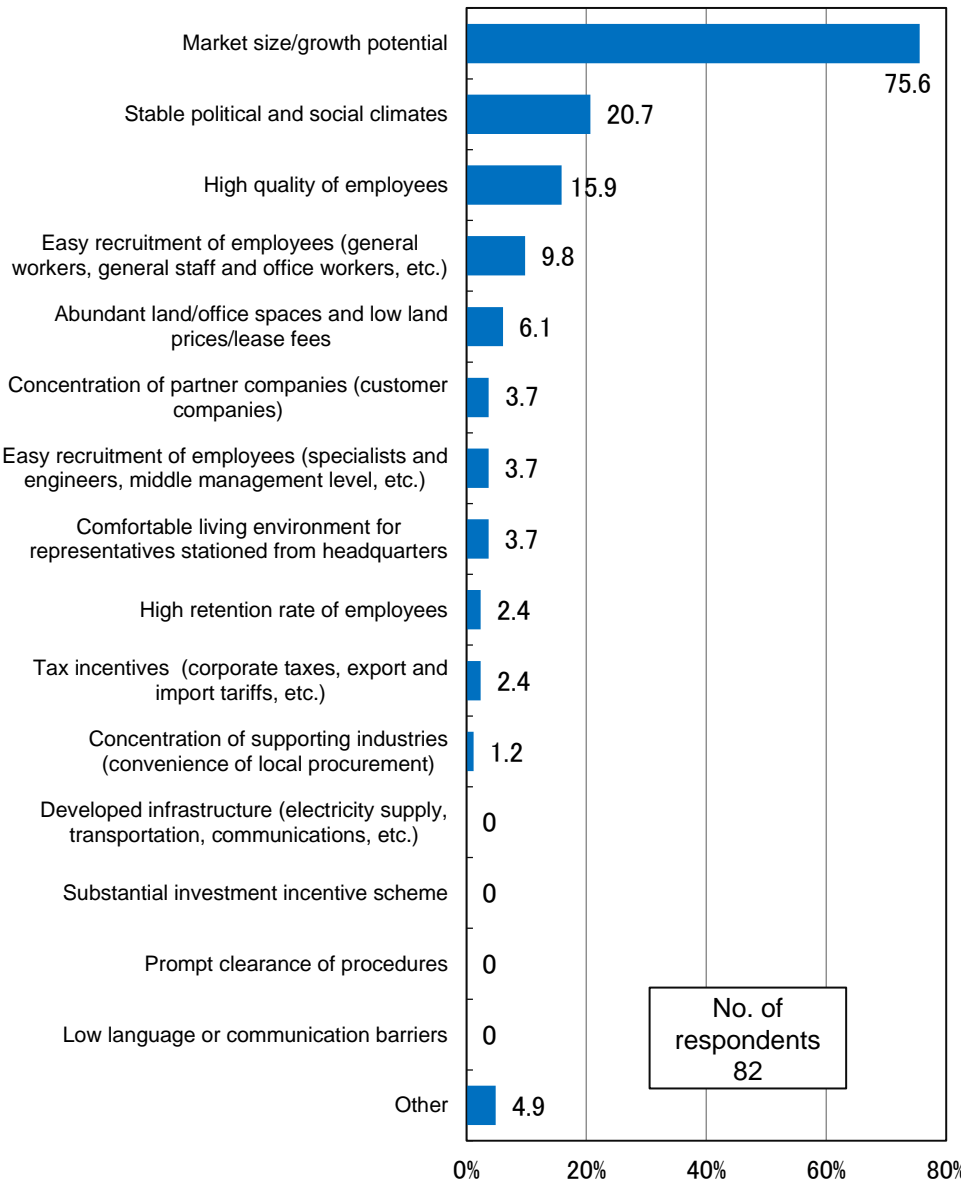
□ Competition

- Regarding companies facing the most competition, the largest group of respondents, at 36.6%, identified that competition as Japanese companies. The percentage of firms choosing “local companies,” which had greatly increased in the previous survey, continued to increase by another 7.7 points to 20.7%. Under the government’s import substitution policy, local companies further strengthened their presence as competitors. By contrast, the percentage of firms choosing European companies as competitors decreased by 12 points from the previous survey.
- Regarding changes in competition, the percentage of firms stating that competition increased came to 45%, down by 8.8 points from the previous survey. On the other hand, the percentage of firms choosing “unchanged” increased by about 10 points to 55%. There was not much difference in the response rate between manufacturers and non-manufacturers.

4. Advantages and risks in terms of the investment environment (2)

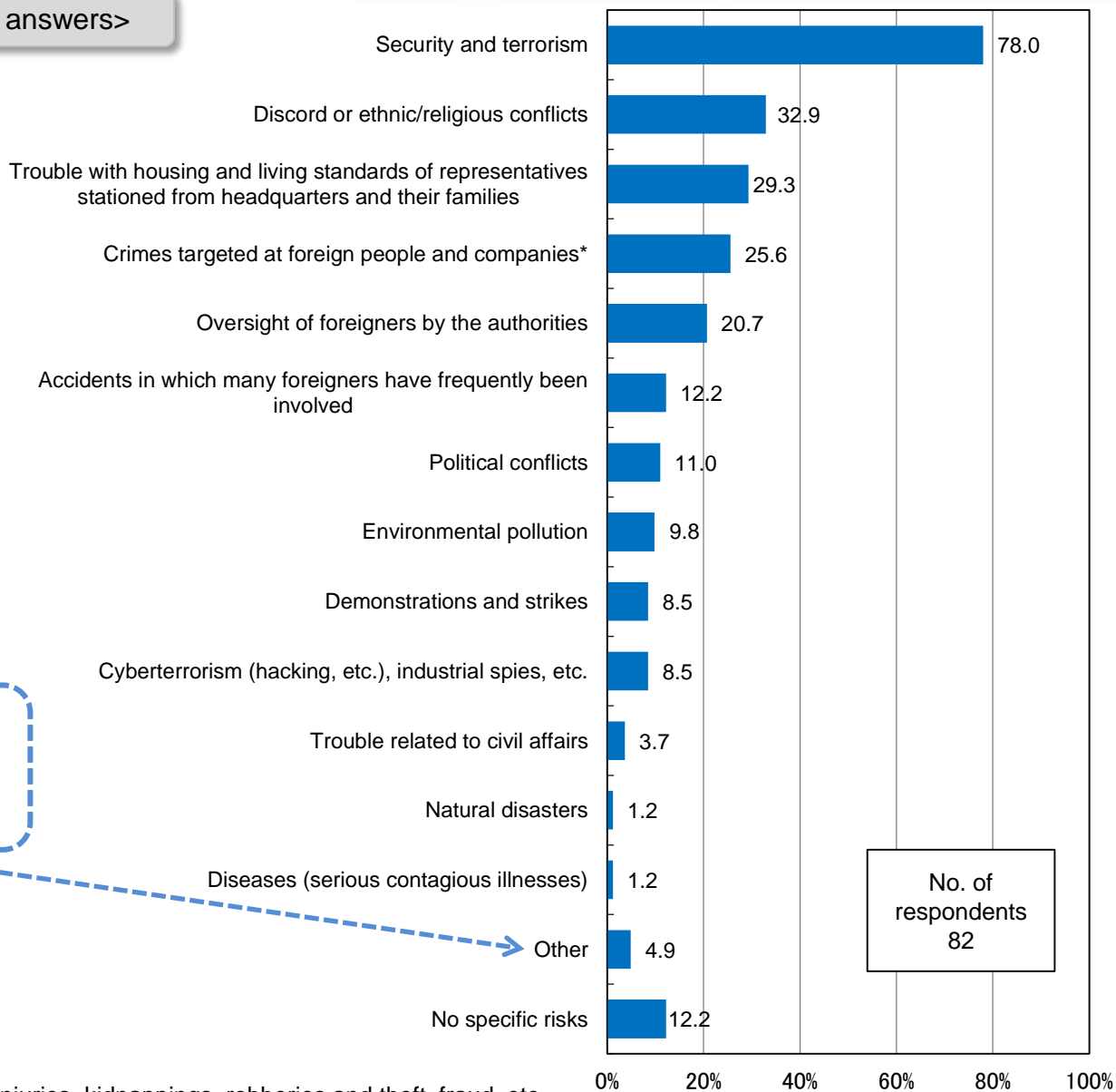
Advantages in the investment environment <Multiple answers>

Risks in the investment environment <Multiple answers>



4. Advantages and risks in terms of the investment environment (3)

Safety risks <Multiple answers>

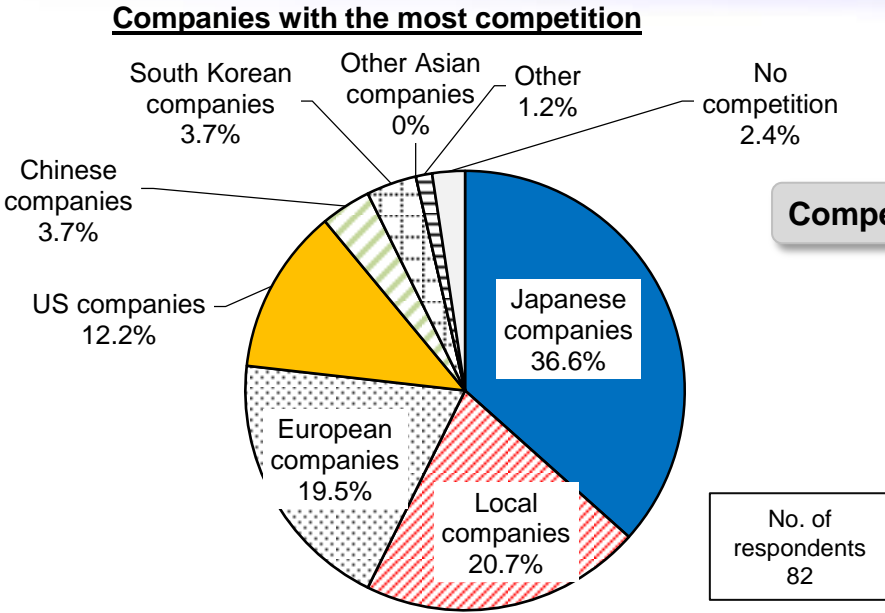


- Traffic accidents
- Underdeveloped medical environment

*killings and injuries, kidnappings, robberies and theft, fraud, etc.

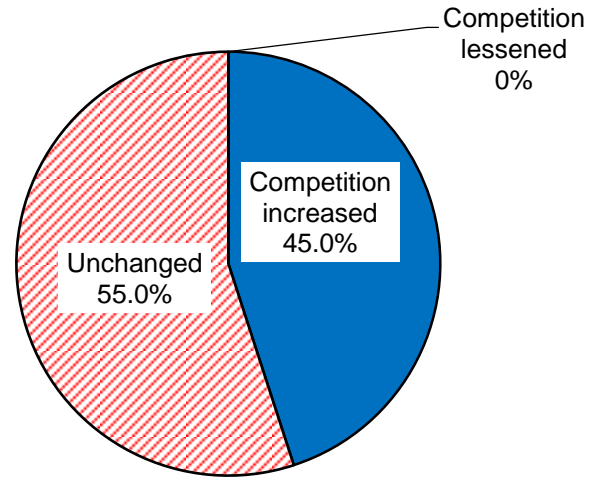
No. of respondents
82

4. Advantages and risks in terms of the investment environment (4)

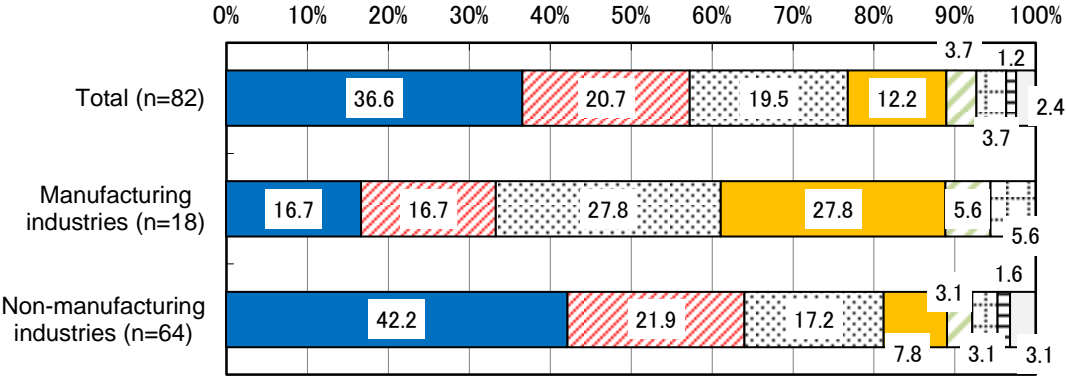


Competitive relationships

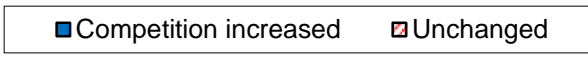
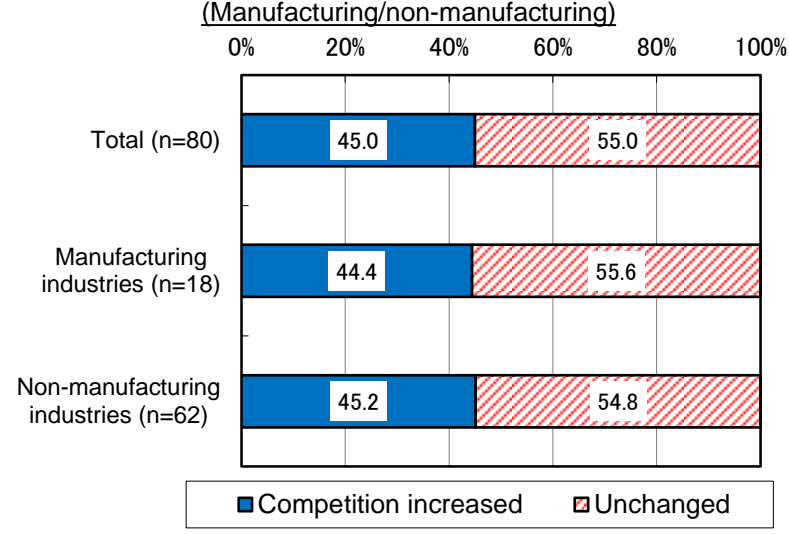
Changes in competition for companies facing the most Competition over the past year



Companies with the most competition (Manufacturing/non-manufacturing)



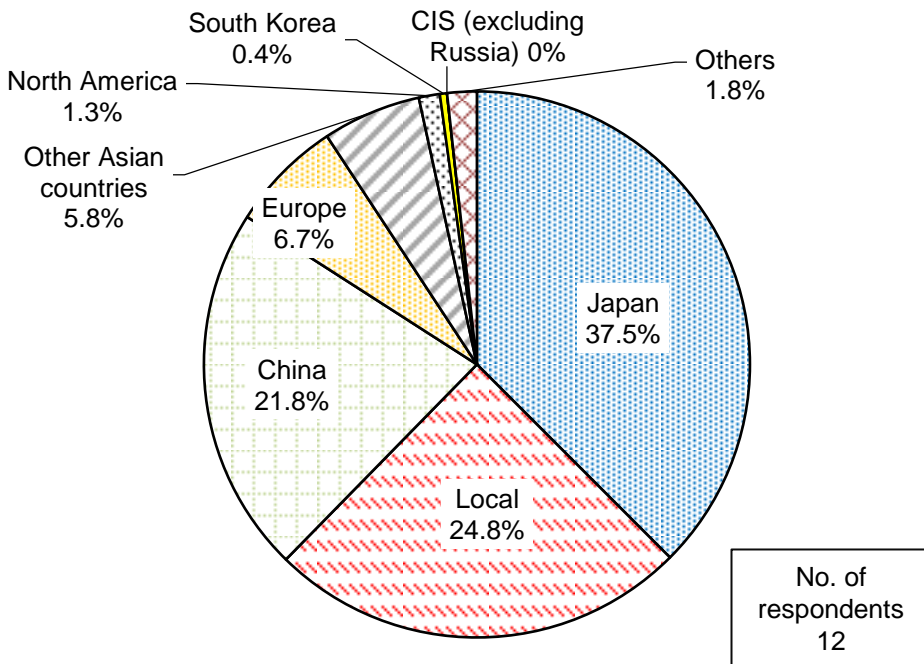
Changes in competition for companies facing the most Competition over the past year (Manufacturing/non-manufacturing)



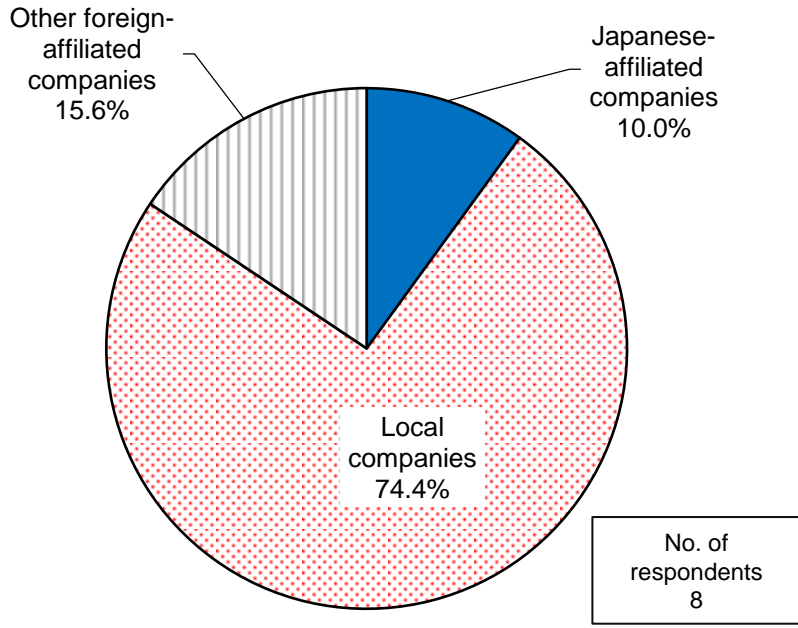
5. Procurement of parts and raw materials <Manufacturing industries only>

- Regarding the procurement of parts and raw materials, compared with the previous survey, the percentage of firms procuring from “Japan” increased by 14.9 points to 37.5%, the largest ratio of respondents. In addition, the percentage of firms procuring from “China” increased by a significant 16.9 points.
- In terms of local suppliers of parts and raw materials, although the percentage of firms procuring from local companies was the largest, it still decreased by 18.5 points. The percentage of firms procuring from Japanese companies entering the local market and from other foreign companies entering the local market increased by 5.7 points and by 12.9 points respectively.

Breakdown of suppliers for raw materials and parts
(Percentages of answers add up to 100%)



Breakdown of local suppliers for raw materials and parts

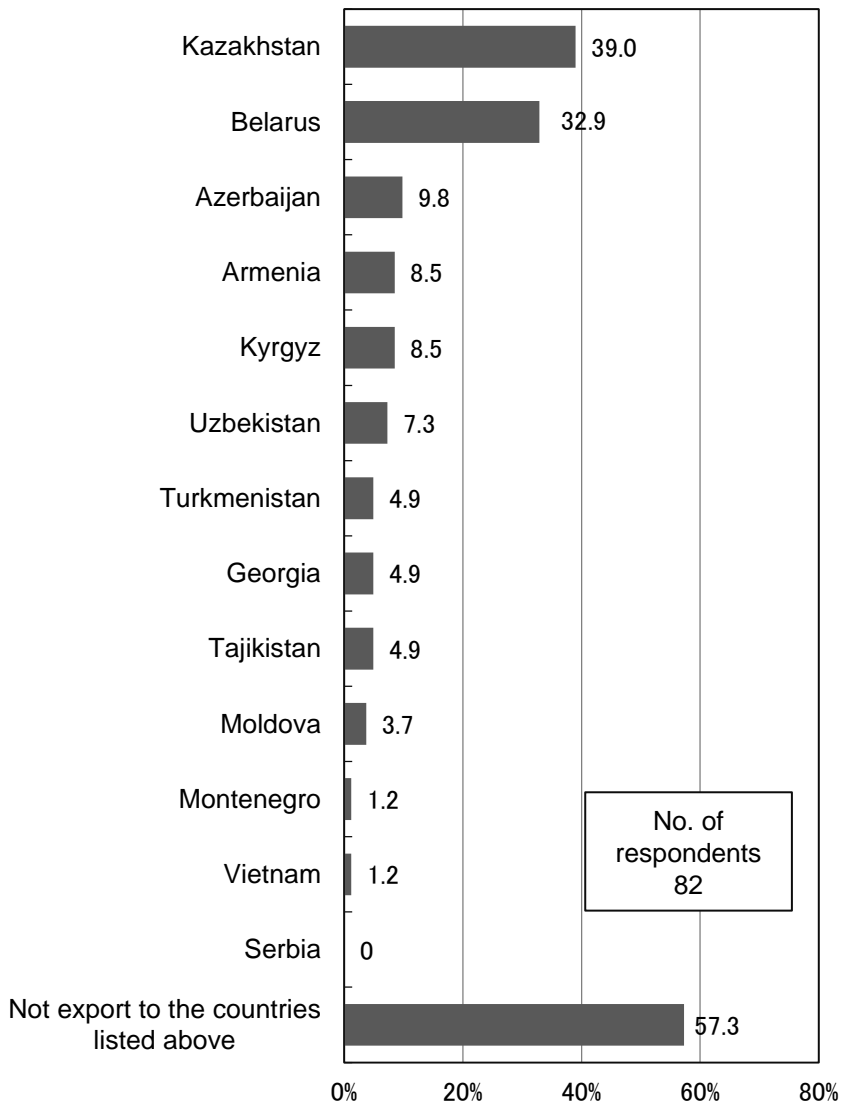




6. Use of FTAs (1)

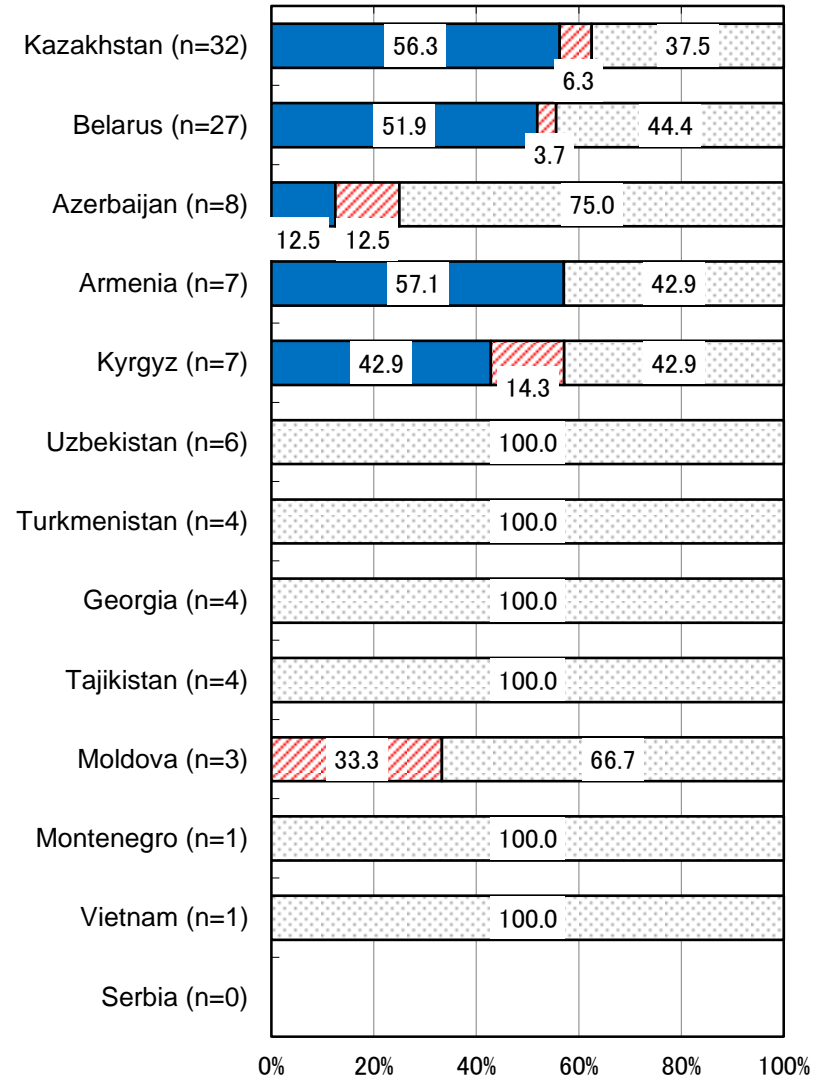
Exports

Exports to countries that have concluded FTAs and similar agreements with Russia <multiple answers>



Use of preferential tax rates from FTAs or similar agreements when exporting

■ Utilizing ▨ Considering utilization □ Not utilizing (No plan to utilize)

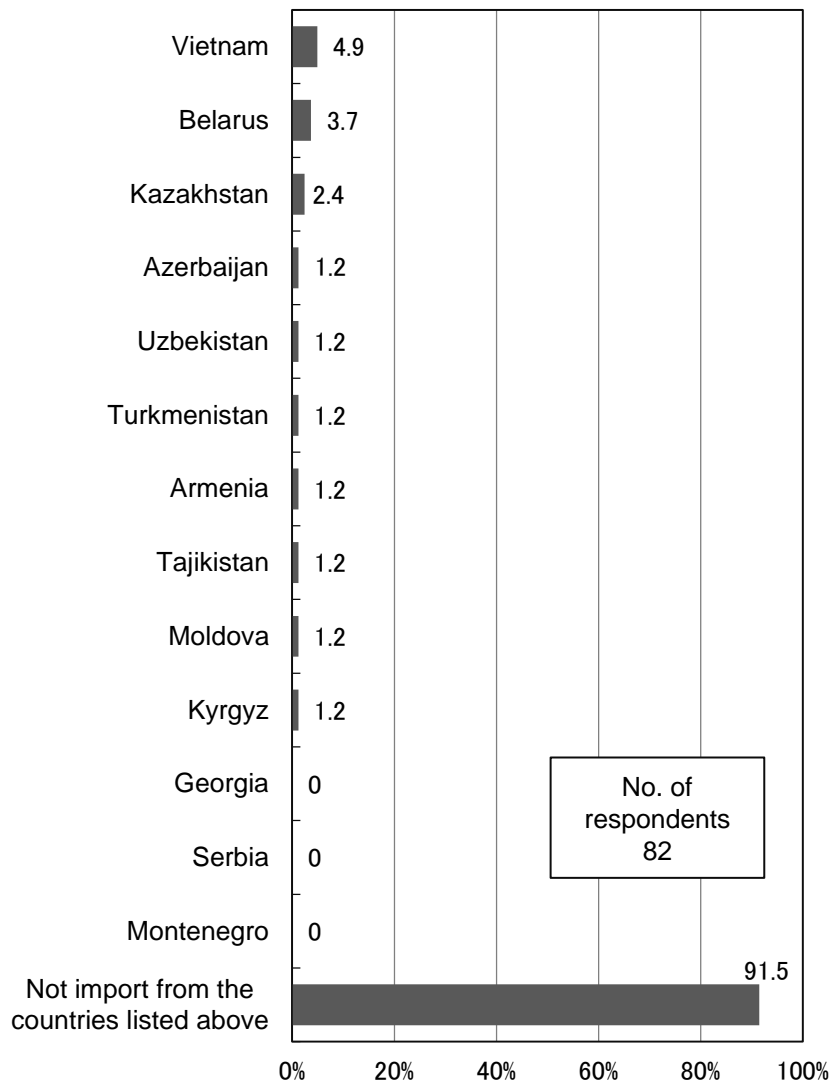




6. Use of FTAs (2)

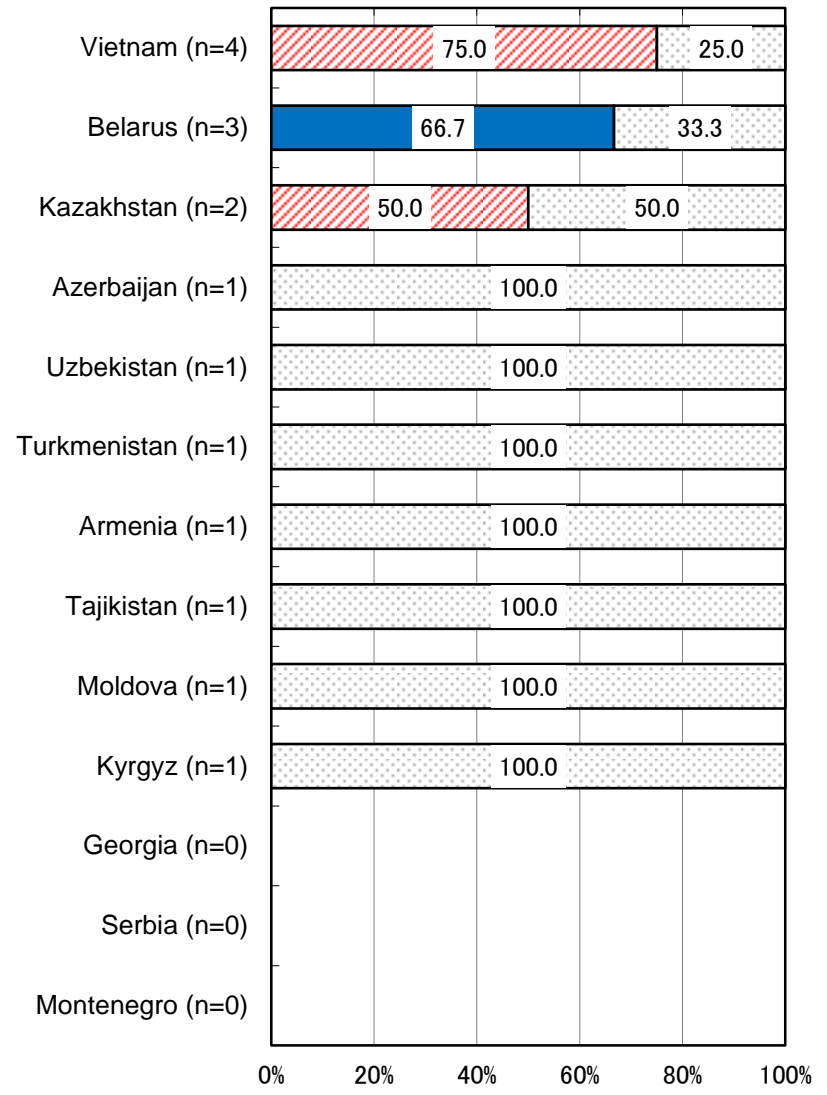
Imports

Imports from countries that have concluded FTAs and similar agreements with Russia <multiple answers>



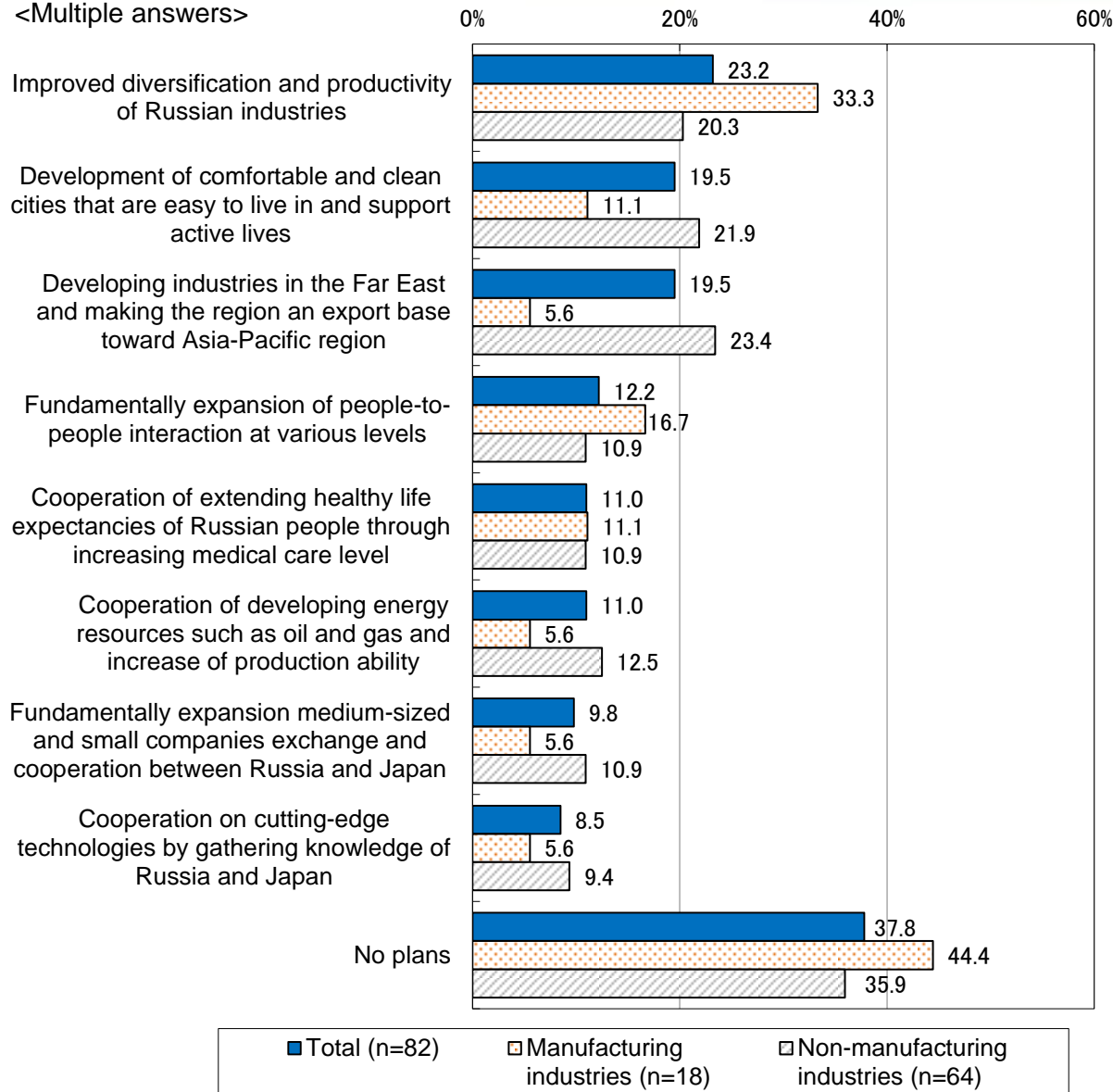
Use of preferential tax rates from FTAs and similar agreements when importing

■ Utilizing ■ Considering utilization ■ Not utilizing (No plan to utilize)



7. Interest in the Eight-Point Cooperation Plan

<Multiple answers>



- When we asked about the possibility of them making efforts in the fields specified in the Eight-Point Cooperation Plan that Prime Minister Abe proposed to President Putin in May 2016, more than 60% of the responding firms chose at least one of the eight points.
- The largest number of manufacturers chose “improved diversification and productivity of Russian industries,” followed by “rapid expansion of multilevel human exchange.” Many firms expect the range of industries and human resources to expand.
- The largest number of non-manufacturers chose “developing industries in the Far East and making the region an export base toward Asia-Pacific region,” followed by “development of comfortable and clean cities that are easy to live in and support active lives.” The Far East is attracting some interest mainly from firms that have already begun to make efforts under the plan, such as those engaged in logistics and services.



7. Challenges for developing business in Russia

- When we asked the target firms to write freely about their challenges for developing business in Russia, they identified unclear government orders, laws and regulations and the influence of Western countries' economic sanctions as challenges that were common to the manufacturing and non-manufacturing industries.
- Some manufacturers pointed out how customs offices and the government treated them.
- Several non-manufacturers gave opinions about the government's import substitution policy.

Manufacturing industries

Industry	Comments
Machines (including molds and power tools)	Influence of the protection policy against imitations on our firm's products
Electrical machinery and electronic equipment	Differences in judgment between customs offices and lack of any channel for complaints about decisions. Unclear standards and the consumer agency's stricter market research.
Medical equipment	Over these past few years, the only problem is instability due to economic sanctions.
Electric machinery and electronic equipment	Implementation of the middle-term plant and equipment investment plan as part of the government plan, and publication and transparency of the results

Non-manufacturing industries

Industry	Comments
Sales company (cosmetics)	Damage to our brand image due to irregular sales
Sales company (machine tools)	Economic sanctions and export controls by the Japanese, European and US governments. Rapid fluctuations of the ruble against the dollar/euro.
Sales company (machinery)	Although it is necessary to ask the administrative agencies about any unclear points in government orders, laws and regulations, it takes a lot of time and trouble to identify the agency in charge and we sometimes receive no response. Because a waste disposal tax has recently been suddenly introduced despite a lack of clarity in its definition, related companies have become confused. In addition, because there was a difference in opinion between the central and local authorities, our company had to suspend business activities due to a delay in carrying out procedures. Moreover, our group's manufacturer had to change its business plan because the construction of infrastructure did not progress according to the plan which was decided upon.
Sales company (audio tools)	Although we expanded our business beyond the Moscow area, it has been difficult to carry out business activities efficiently in the various markets that dot this vast territory.
Other service company	It has taken much time to erase the negative image and misunderstandings of Russia in the minds of Japanese people. Although the Russian economy is huge and its investment environment is highly advantageous to Japan, Japanese companies hardly ever expand into the country or make investments here due to their poor understanding.
Sales company (lubricating oil)	Although we are not considering making medium-term investments, we will expand our business.
Telecommunications/software	Laws, rules and measures related to telecommunications (such as the data protection law and the antiterrorism law) have had a great impact on costs and business opportunities for us.
Sales company (medical equipment)	Trend of measures to protect domestic products
Sales company (transportation equipment)	Negative image of Russia vaguely held by head office in Japan
Sales company (general electric/electronic equipment)	Because it is difficult for the Russian government and Russian companies to raise funds due to Western countries' economic sanctions, our customers' projects have been delayed. In addition, the government's import substitution policy has resulted in the reduction of opportunities for business negotiations with government-operated companies.



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