

**Summary of the Result of the 2010 JETRO Survey on Business
Conditions of Japanese Companies in the U.S. and Canada**

**Business confidence of Japanese companies in the U.S. and Canada: substantial
improvement over the previous year, but the future remains uncertain**

November, 2010

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2010 JETRO Survey on Business Conditions of Japanese Companies in the U.S. and Canada: Summary and Figures

1. United States: “Business confidence of Japanese manufacturing companies operating in the U.S.: substantial improvement over the previous year, but the future remains uncertain”

[Main Findings]

- Management problems faced by Japanese manufacturers operating in the United States: suppression of sales accompanied by intensifying price competition and increasing production costs due to factors such as the increases in the price of raw materials and appreciation of the Japanese Yen. Responses: decisive action to reduce costs of labor, administration, and energy (heating and lighting).
- Anticipated growth of green environment sector such as solar batteries and eco-friendly cars.
- Even with few expectations of ratification of the Korea-U.S free trade agreement (FTA) in the near future, there is increasing anxiety regarding intensifying price competition in automobile and other sectors.

○ Business confidence in 2010 improved substantially over the historical low in 2009. About 70% percent of businesses reported being ‘profitable’. However, companies have taken a ‘wait-and-see’ stance regarding capital investment and hiring of new employees.

The diffusion index (DI), used to measure business confidence (the proportion of businesses reporting increased operating profits minus those reporting decreased operating profits), reached 55.7, the highest score since the index was first calculated* (Fig. 1). *Business confidence surveys have been conducted since 1991.

However, this is attributable, to a large extent, to a rebound from the performance in the previous year. While the majority of businesses reports being profitable (74.2% of respondents, Fig. 2), there has been relatively little allocation of resources to capital investment and hiring of new employees (Figs. 3 and 4). Due to uncertainties about the future, most companies have taken a ‘wait-and-see’ stance.

○ Earnings are expected to improve due to a recovery of the domestic market and efforts to reduce fixed costs.

The improvement in operating profits was overwhelmingly attributable (80.3%) to an “increase in domestic sales” (Fig. 5). It appears that demand is beginning to recover in all sectors of the economy.

On the other side, reduction in labor costs (44.8%) and reduction in administrative and energy costs (37.1%) have contributed significantly (40%). Transportation machines and parts manufacturers, in particular, have achieved improved profits by reducing fixed costs.

○ **A gradual recovery anticipated in 2011**

Of the responding companies, 53.0% expected business to “improve” in 2011, while 37.8% of companies expected “no change,” indicating that the majority of companies (over 90%) do not fear a second recessionary dip (Fig. 6). In addition, 52.8% of companies expected to keep the same number of local employees while 37.7% hoped to increase, indicating that the most of the companies would, at least, keep their present employment level (Fig. 4).

○ **Companies are faced with the problems of declining sales resulting from intensifying price competition and increasing production cost pressures due to factors such as the increase in the prices of raw materials and appreciation of the Japanese Yen. There is an impression that the health care reform will lead to increased fixed costs.**

Among the problems facing companies, it appears that companies have come up against a structural limitation to improving profitability with increasing cost pressures, on the one hand, due to factors such as increasing raw material prices (60.9% of respondents, Fig. 7) that, on the other hand, cannot be passed on to consumers due to intensified price competition (78.4% of respondents, Fig. 8). Other reasons cited for increasing production costs include “appreciation of the Japanese Yen” (50.6%) and worries about “increase in health care cost” (45.1%, Fig. 7). Appreciation of the Yen is considered particularly problematic for manufacturers of precision machines and apparatuses (77.3%), machines (72.1%), transportation machines and parts (60.0 and 62.6%, respectively) that seem to be relying heavily on components from Japan. Companies in a wide range of industries expressed the concern that the Health Care Reform passed under the sponsorship of the Obama administration in March of this year would lead to “increased employer contributions” to health insurance.

○ **Increasing anticipation in the green environment sector for solar batteries and eco-friendly automobiles**

Among the companies, the tendency appears to be to perceive the enthusiasm surrounding ‘green environment sector’ in a positive light (Fig. 10, 38.2% “positive”, 8.1% “negative”). The companies’ confidence about the positive outlook for green environment sector is hinted at in comments such as “The strengthening of environmental regulations will create new demands”, “the growing awareness of ‘eco-friendliness’ will add value to our products”. Solar batteries and high gas mileage/low emission vehicles, including electric vehicles, were identified by many respondents as opportunities for new business.

○ **For Japanese companies whose business is concluded entirely in the U.S., there is little impact of the trade conflict between the U.S. and China and also of the administration’s export promotion policy.**

Approximately 80% of the companies responded that the impact of “the trade conflict between the U.S. and China” and “administration’s National Export Initiative” was neither positive nor negative (Figs. 11 and 12). As a reason for their responses, the majority of manufacturing companies cited the fact that “other than the import of components from Japan,

our business is entirely concluded within the U.S.”

However, there was a strong tendency to view the current “export policy” as favorable with comments that the policy would “stimulate demand for domestic production” and “increase employment levels, which will lead to recovery of consumption” being particularly notable.

○ **Wariness concerning the Korea-U.S. FTA, particularly with regards to the automobile industry. Awareness of the Trans-Pacific Partnership Trade Agreement (TPP) will take time.**

The number of companies responding that the “lowering of tariffs on Korean products upon ratification of the Korea-U.S. FTA” would be “negative” rose to 31.6% (Fig. 13). The number of companies responding that this would be “positive” was limited to 1.8%. Wariness was particularly evident among transportation machines and parts manufacturing companies with the number of negative responses (65.0% and 57.5%, respectively, Fig. 14) being approximately double the average of all industrial sectors combined. Linking this with concerns regarding the exchange rate, some companies voiced the opinion that “the elimination of tariffs on top of an already weak Korean currency Won would be fatal to Japanese companies.” With regards to the Trans-Pacific Partnership Trade Agreement (TPP), nearly 90% responded that the impact would be “neither positive nor negative” (Fig. 15), suggesting that the level of interest among companies is not high, ostensibly because details of the agreement have not yet been made clear.

In the following section, the bulleted lists represent selected comments by companies (with the industry indicated in []) from interviews or surveys of 37 Japanese manufacturing companies or industry groups (food, agriculture, and fishery process; transportation machines and parts; electric machines and electronic parts; machines; chemicals and allied products, etc.) conducted in late August and early September by JETRO.

1. Business confidence in 2010 has improved substantially over the historical low in 2009. About 70% percent of businesses are 'profitable'. However, companies have taken a 'wait-and-see' stance regarding capital investment and hiring of new employees.

It appears that in 2010, Japanese companies operating in the U.S. recovered from the low point in 2009, which represents the lowest point since the commencement of these annual surveys. The diffusion index (DI), used to measure business confidence (the proportion of businesses reporting increased operating profits over the previous year minus those reporting decreased), indicates the highest gain of 55.7 since the index was first calculated*(Fig. 1).

*Business confidence surveys have been conducted since 1991.

However, this is attributable, to a large extent, to a rebound from the performance in the previous year. While the majority of companies report being profitable (74.2% of respondents, Fig. 2), there has been relatively little allocation of resources to capital investment and hiring of new employees (Figs. 3, 4). The number of companies reporting “increased”, “no change”, and “decreased” capital investment were 35.6%, 51.3%, and 13.1%, respectively, indicating a trend to maintain present levels of investment (Fig. 3). In addition, the target of investment was overwhelmingly (about 70%) “rationalization and optimization of the manufacturing facility.” While there appears to be little concern regarding a second recessionary dip, in anticipation of unforeseen future events, companies have taken a “wait-and-see” stance.

With respect to employment, 36.4% of companies reported that the number of local employees had “decreased” compared to the previous year, while 35.9% reported “no change”, for a combined total of over 70%, indicating the severity of the business confidence (Fig. 4).

<Improvements in business performance over the previous year>

- The majority of Japanese automobile parts manufacturers operating in the U.S. are expected to become profitable in the present fiscal year. [Transportation machines and parts]
- Actual conditions look even better in 2010, partly because of the comparison with the very bad situation in 2009. [Electric machines]

<While there is little concern about a second recessionary dip, there is anxiety regarding recovery of market conditions and consumption>

- The U.S. economy is gradually recovering and there is little concern regarding a second recessionary dip. [Electric machines]
- There is no anxiety of a second recessionary dip. It is unlikely that conditions such as those experienced in December of 2008, will continue. [Paper and pulp]

- Demand has improved since the summer of 2009. Although conditions have not returned to those before the Lehman shock, they are improving. Thus, it appears there will not be a second recessionary dip. [Textiles]
- There is a concern that market demand has not truly recovered. [Ceramics, earth and stone]
- There appears to be no momentum in U.S. consumption. [Steel]
- Unemployment has not improved and the impact on personal consumption is worrisome. [Transport equipment and components]
- With uncertainty regarding the consumer market, there is a tendency towards prudence. The high domestic unemployment rate is of particular concern. [Transportation machines and parts]
- The prospect of economic recovery is still uncertain, and with the lack of improvement in the unemployment rate, there is little expectation of increase in individual consumption. [Transportation machines and parts]

<Cautious capital investment>

- Companies cited wariness regarding the recovery of consumer confidence and lack of resources for investment as reasons for the lack of increase in capital investment compared to the previous year. [Transportation machines and parts]
- Due to lackluster business condition, capital investments are limited to improving existing facilities and are lower than the previous year. [Food, agriculture, and fishery process].
- Based on the expected economic stagnation, capital investment is also stagnant and targeted fundamentally at improving existing facilities. [Food, agriculture, and fishery process]
- Capital investment is targeted, not so much at creating new facilities, but, rather, at improving efficiency, increasing product quality, and becoming more environmentally friendly. [Textiles]

2. Earnings are expected to improve due to a recovery of the domestic market and efforts to reduce fixed costs.

The improvement in operating profits was overwhelmingly attributable (80.3%) to an “increase in domestic sales” (Fig. 5). It appears that demand is beginning to recover in all sectors of the economy. However, in the Transportation machines and parts sector, the contribution of increased domestic sales was around 50%, much lower than for all sectors combined. More than a third of the companies (34.9%) cited “increase in sales in foreign markets” as a reason for their increased profits too. It appears that the domestic and foreign demand which had fallen in the previous year is gradually recovering.

<A sense of recovering consumption>

- There are signs of recovery in demand from regular clients [Paper and pulp]
- While the demand fell dramatically as a result of the economic recession last year, there are signs of a gradual recovery in demand for certain products this year. [Transportation

machines and parts]

Along with an increase in profits due to the recovering economy, there was evidence of a continued trend by companies to cut fixed costs. Many companies appeared to be continuing efforts to cut cost by reducing “labor cost” (44.8%) as well as “administrative and energy” costs (37.1%) (Fig. 5). The trend of reducing fixed costs was particularly evident in the transportation machines and parts industries, in which a much larger proportion of companies reported taking such measures than the average for all industries combined. These industries were supported by a combination of gradually recovering consumption and their individual efforts to cut costs. (78.6% and 60.4% of transportation machines manufacturing and their parts manufacturing companies, respectively, reported taking measures to “reduce labor costs”; also 71.4% and 49.3% of them reported taking measures to “reduce administrative and energy costs.”)

<Recovery of business performance through reduction of fixed costs>

- The profit structure has improved through corporate restructuring in the previous year which involved large scale reduction of employment rolls and other cost-cutting measures, such that the company can be profitable even with a low volume of sales. [Transportation machines and parts]
- The fruits of cost cutting measures as part of corporate restructuring are starting to appear. [Transportation machines and parts]

On the other hand, companies that experienced a decline in profits in 2010 than in the previous year (12.2% of the total companies) cited “decrease in domestic sales” (47.9%), “drop in prices” (43.8%), “fluctuations in exchange rate” (29.2%), and “increase in domestic procurement costs” (21.9%) as reasons for their lower earnings. A portion of the companies are still experiencing harsh economic realities.

3. A gradual recovery anticipated in 2011

53.0% of companies forecasted that business will “improve” in 2011, while 37.8% of companies expected “no change”, indicating that the majority of companies (over 90%) do not fear a second recessionary dip (Fig. 6). In addition, 52.8% of companies expected to keep the same number of local employees while 37.7% hoped to increase the number of employees (Fig. 4). The focus of attention of these companies is whether this trend toward recovery, albeit gradual, can be maintained.

- It appears that the economy will be in a slightly better state in 2011, so some improvement in business is expected. [Food, agriculture, and fishery process]
- With the planned release of new automobile models in 2011 and 2012, it is estimated that there will be an increase in hiring of new employees and capital investment since the beginning of next year. [Transportation machines and parts]

4. Companies are faced with the problems of declining sales resulting from intensifying price competition and increasing production cost pressures due to factors such as the rise in the prices of raw materials and appreciation of the Japanese Yen. There is an impression that the health care reform will lead to increased fixed costs.

Among the problems facing companies, it appears that companies have come up against a structural limitation to improving profitability with increasing cost pressures, on the one hand, due to factors such as the sudden rise in raw material prices (60.9% of respondents, Fig. 7) that, on the other hand, cannot be passed on to consumers due to intensifying price competition (78.4% of respondents, Fig. 8). Other reasons cited for increasing production costs include “appreciation of the Japanese Yen” (50.6%) and worries about “increasing in health care cost” (45.1%). Appreciation of the Yen is considered particularly problematic for manufacturers of precision instruments (77.3%), machines (72.1%), transportation machines and parts (60.0 and 62.6%, respectively) that seem to be relying heavily on components from Japan.

<Concern regarding rising prices of raw materials>

- What is particularly worrisome is the rising price of raw materials. [Chemical and petroleum products]
- There is strong demand from steel, rubber, and plastic suppliers to raise prices. [Transportation machines and parts]
- The price of raw paper has suddenly increased. Because of the sudden recovery of demand, there is a shortage of supply. [Paper and pulp]

<Varied impacts of appreciation of the Japanese Yen>

(Positive)

- Being able to keep down labor costs of our expatriate staff is a positive result of appreciation of the Yen. [Transportation machines and parts]
- Since our business is primarily to export to Japan and since business transactions are conducted in Japanese Yen, the appreciation of the Yen is welcome. [Food, agriculture, and fishery process]

(Negative)

- Because of problems with profitability, there is an accelerated effort to procure materials locally. The mood is that we must, in any case, find local suppliers for not only components, but also manufacturing equipment and even metal molds. [Transportation machines and parts]
- The price of materials for components has increased. It is difficult to change suppliers and if the appreciation of the Yen continues, we will have to reevaluate our product pricing. [Electric machines]
- We are considering replacing Japanese suppliers of raw materials with others in third countries such as Mexico or countries in Southeast Asia. [Transportation machines and parts]

When asked about the main competitors in the “intensifying price competition”, which was the most cited factor holding down sales (78.4%, Fig. 8), there was a wide range of responses, including “Chinese and Korean companies”, “U.S. companies”, “Central and South American companies”, “Indian companies”, and “transnational corporations.” Japanese companies are facing stiff competition from companies around the world in both developed and developing countries.

<Competition with companies of all nationalities>

- Primarily, industrial motor, LED lighting, and monitor/display manufacturers are in the midst of intense competition with the emergence of competing products and intensifying price competition. Competitors are mostly U.S. companies and very few, if any, Chinese companies. [Electric machines].
- The situation is severe, with share-leading U.S. companies following the footsteps of the aggressive low pricing by Korean and Indian companies. [Transportation machines and parts]
- Competition between foreign companies, such as Chinese and Korean companies, and local companies is intensifying. [Paper and pulp]

From comments such as “the overall picture is not clear” and “at this point, it isn’t possible to evaluate what the magnitude of impact is”, it appears that direct impacts of the Health Care Reform passed under the sponsorship of the Obama administration in March of this year have yet to be felt. Still, the majority of companies are preparing themselves for the expected “future increase in employer contributions.” Anxiety is spread across a wide range of industries.

<Anxieties of companies in the health care industry>

- Since insurance premiums are increasing from year to year, it isn’t possible to pinpoint when the increase in employer contributions will start. We are negotiating with contracted insurance companies and continually reviewing our contract. [Electric machines]
- The increase in insurance premiums has already started. [Transportation machines and parts]
- Combined with increasing salaries, the increase in employer contributions to health insurance will result in a steep rise in labor costs. [Food, agriculture, and fishery process]
- There is a fear that price control of government-subsidized prescription drugs will lead to a fall in overall prices. [Other]
- While investment in medical equipment is expected to rise, a tax increase on medical equipment manufacturers is scheduled to occur in 2013. [Medical devices]

5. Increasing anticipation in the green environment sector for solar batteries and eco-friendly automobiles

Among companies, the tendency appears to be to perceive the enthusiasm surrounding ‘green environment sector’ in a positive light (Fig. 10, 38.2% “positive”, 8.1% “negative”). The

companies' confidence about the positive outlook for green environment sector is hinted at in comments such as "the strengthening of environmental regulations will create new demands", "the growing awareness of 'eco-friendliness', will add value to our products". Solar batteries and high gas mileage/low emission vehicles, including electric vehicles, were identified by many respondents as opportunities for new business. With the favorable winds of the Obama administration's "Green New Deal" at their backs, green environment sector has started definitively to move forward. On the other hand, there was the opinion that "because our main products up to now have not been 'eco-friendly', it would be a negative if the industry as a whole suddenly shifted in the eco-friendly direction."

<Business opportunity in eco-friendly products>

- The number of employees involved in the manufacture of eco-friendly products such as in-vehicle motors and solar batteries is growing. [Electric machines]
- Thanks in part to large-scale favorable policies by federal and state governments, investments related to batteries and motors are growing in states such as Michigan and Texas. [Transportation machines and parts]
- Legislation starting this year which promotes usage of energy-efficient motors will serve as impetus to move things forward. [Electric machines]
- We hope that consumers will welcome our fuel-efficient product offerings and that demand will grow for new hybrid and electric products. [Transportation machines and parts]
- It appears that eco-awareness is finally spreading among U.S. consumers. With the rising rate of recycling and growing awareness of eco-friendly materials, there is increasing recognition, albeit slight, of the value added in our products. [Paper and pulp]
- The growth in the number of or capability of waste-water treatment facilities is increasing demand for our products. [Machines]
- We can expect the sales rise of newly-developed products for energy-efficient vehicles. [Transportation machines and parts]
- The selection (sales) of recycled products, such as plastic, will increase. [Food, agriculture, and fishery process]

6. For Japanese companies whose business is concluded entirely within the U.S., there is little impact of the trade conflict between the U.S. and China and of the administration's export promotion policy.

Approximately 80% of the companies responded that the impact of "the trade conflict between the U.S. and China" and "administration's National Export Initiative" was neither positive nor negative (Figs. 11 and 12). As a reason for their response, the majority of manufacturing companies cited the fact that "other than the import of components from Japan, our business is entirely concluded within the U.S."

However, there was a strong tendency to view the current "export policy" as favorable (18.5% "positive" vs. 4.2% "negative", Fig. 12), with comments that the policy would "stimulate domestic orders" and "increase employment levels, which will lead to recovery of

consumption” being particularly notable.

<Hopes for increasing orders and recovery of consumption>

- It is hoped that the Obama administration’s export policy will lead to increase domestic consumption. We expect that our sales will increase if the income of U.S. consumers increases. [Transportation machines and parts]
- There is a possibility that the export policy will have the positive impact of increasing foreign exports. [Electric machines]
- Higher sales of made-in-the-U.S. products will also lead to an increase in overall domestic demand. [Electric machines]
- Increased domestic production will translate into increased domestic demand for our products. [Non-ferrous metals]
- Increased investment in U.S. manufacturing companies will lead to greater sales of our products to those companies. [Electric machines]

7. Wariness of the Korea-U.S. FTA, particularly with regards to the automobile industry. Awareness of the Trans-Pacific Partnership Trade Agreement (TPP) will take time.

The number of companies responding that the “lowering of tariffs on Korean products upon ratification of the Korea-U.S. FTA” was “negative” rose to 31.6% (Fig. 13). The number of companies responding that this would be “positive” was limited to 1.8%. Wariness was particularly evident among transportation machines and parts manufacturers with the number of negative responses (65.0% and 57.5%, respectively, Fig. 14) being approximately double of that of the average of all industries combined. This is a natural response, given that a major provision of the Korea-U.S. FTA is the elimination of tariffs on automobiles. Linking this with concerns regarding the exchange rate, some companies voiced the opinion that the “the elimination of tariffs on top of an already weak Won would be fatal against Japanese companies.”

<Wariness spreads among companies related to the automobile industry>

- The fear is that the market share held by Japanese auto makers operating in the U.S. will fall, and with that, sales of our products to tier 1 and tier 2 Japanese companies. [Electric machines]
- It is expected that the price competitiveness of Korean automobiles will increase, leading to an intensification of the price competition. [Transportation machines and parts]
- The sales of U.S. auto makers will decline, which will have a ripple effect on tire makers, who are our main customers. [Machines]

With regards to the Trans-Pacific Partnership Trade Agreement (TPP), nearly 90% responded that the impact would be “neither positive nor negative” (Fig. 15). However, particular interest was expressed in Vietnam as a potential location for a production base or as a source of imports.

<Increased attractiveness of Vietnam, Central and South America>

- There is a possibility that we will create a manufacturing hub in Vietnam in the future.
[Electric machines]
- We may look into importing from Vietnam. [Food, agriculture, and fishery process]
- It is hoped that market barriers in Central and South America will be lowered. [Other]

Survey methods, comments, etc.

1. Criteria for inclusion in survey

A “Japanese company” is defined as a company whose “10% or more of the total shares are held directly or indirectly by the Japanese parent company.” For example, if a Japanese company has a 20% stake in subsidiary ‘A’ which operates in the U.S. and subsidiary ‘A’ has a 50% stake in subsidiary ‘a’, subsidiary ‘a’ is considered a “Japanese company”, because the Japanese ‘grandparent’ company has a 10% stake ($0.2 \times 0.5 \times 100$). The same is true for subsequent generations of subsidiaries.

2. Survey methods

Potential respondents were contacted by one of JETRO’s six branch offices in the U.S. (New York, San Francisco, Los Angeles, Chicago, Houston, and Atlanta) via an e-mail directing the respondents to a web address (URL) where they entered responses directly into an online survey form.

3. Survey period

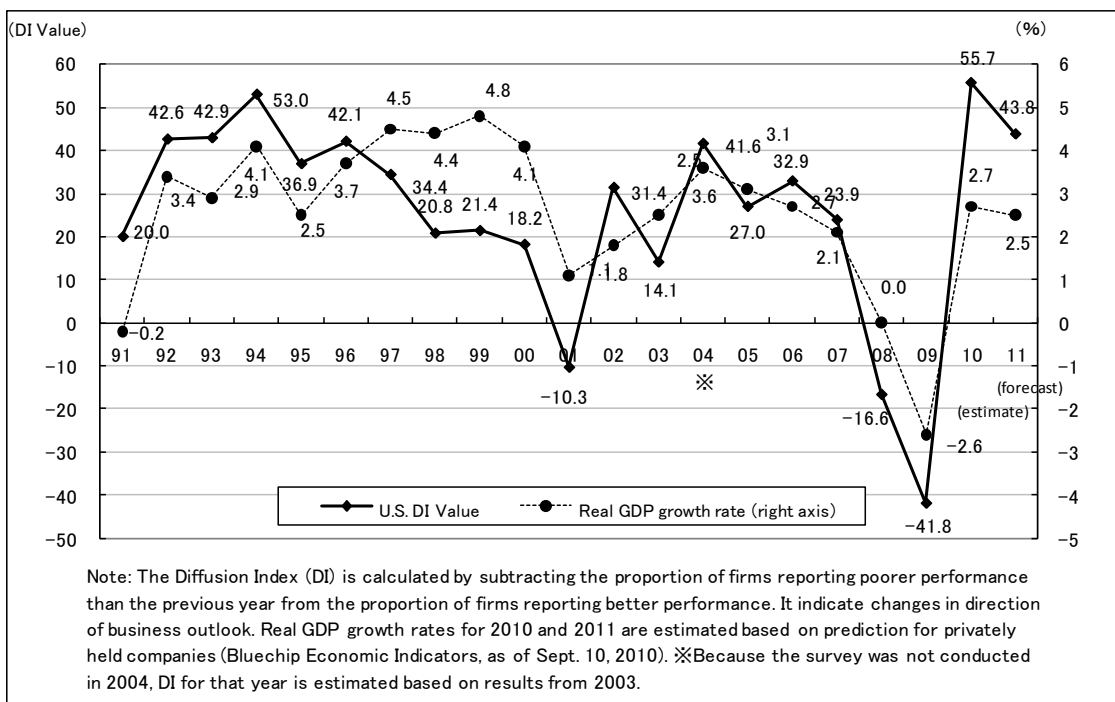
July and August, 2010

4. Collection of responses

1,183 companies representative of Japanese manufacturing companies (or umbrella organizations) operating in the U.S. were invited via e-mail or fax to participate in the study, resulting in 806 responses. Response rate was 68.1%. This was the 29th annual survey since 1981.

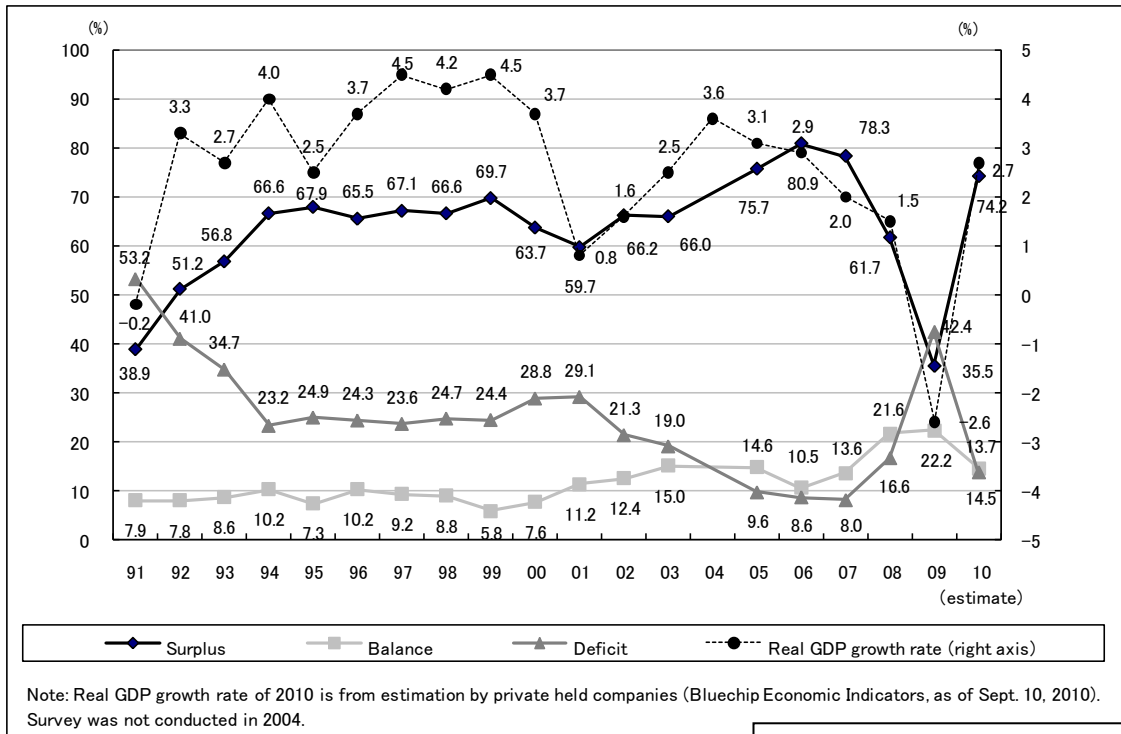
(Note) Each JETRO office used information sources that were believed to be reliable and data were tallied with the cooperation of individual companies. However, there is no guarantee that the data is accurate or comprehensive.

Figure 1. Trend in operating profits as measured by the Diffusion Index (DI) and U.S. real GDP growth rate



Number of respondents in 2010: 798

Figure 2. Proportions of companies reporting "surplus", "balance", or "deficit" in operating profit and U.S. real GDP growth rate



Number of respondents in 2010: 796

Figure 3. Proportion of companies reporting "increase", "no change", and "decrease" in capital investment compared to 2009

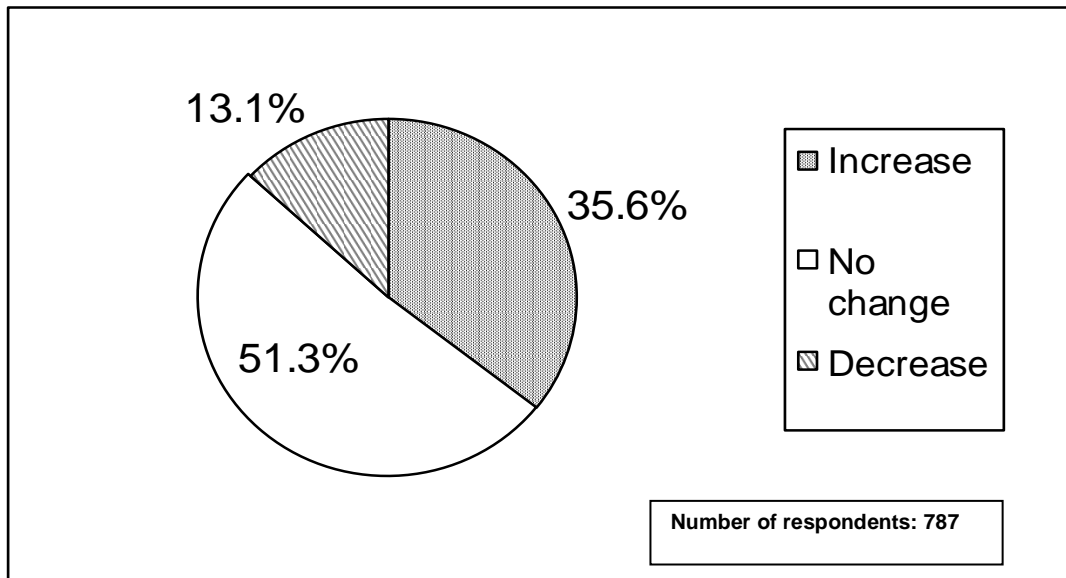


Figure 4. Proportions of companies reporting "increase", "no change", and "decrease" in number of locally-hired employees in the previous year (actual) and in the future (expected)

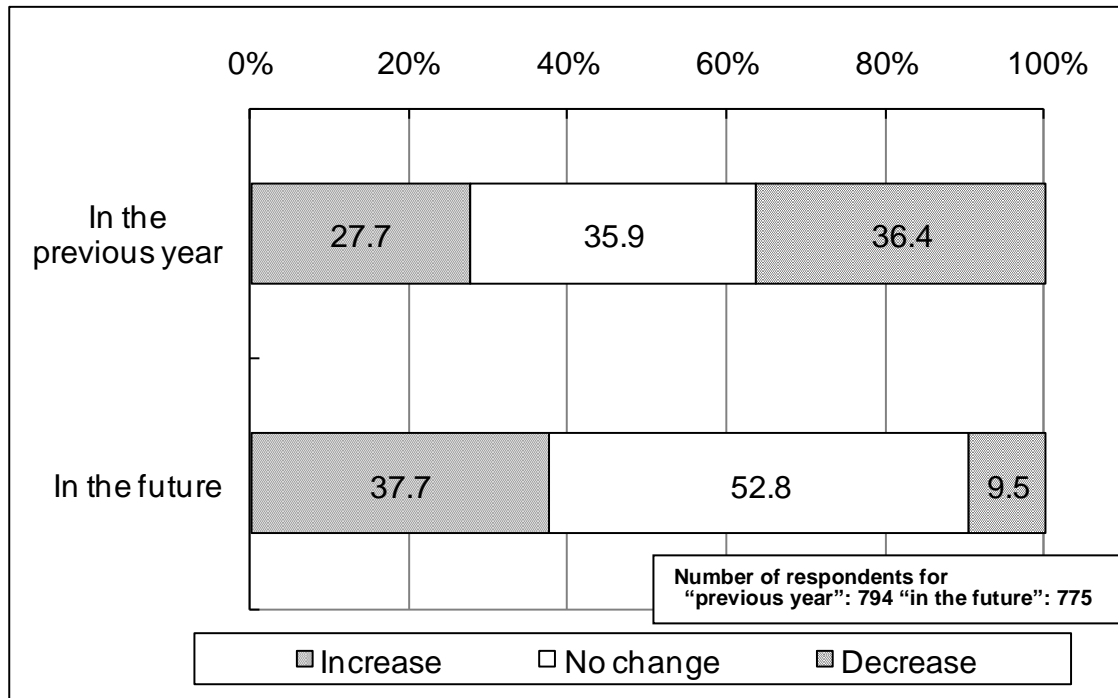


Figure 5. Reasons given for improved operating profits over the previous year (multiple responses were possible)

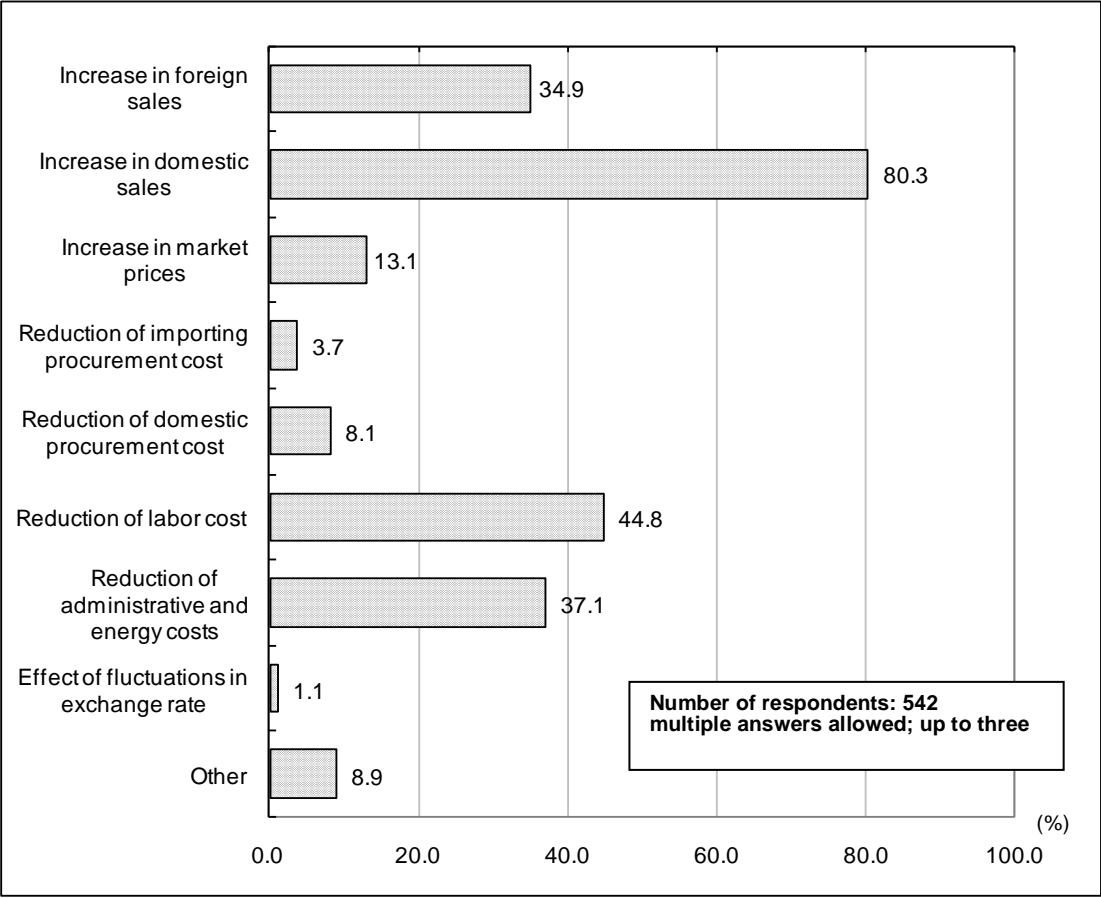


Figure 6. Change in proportion of companies reporting "improvement", "no change", and "worsening" of operating profits compared to the previous year

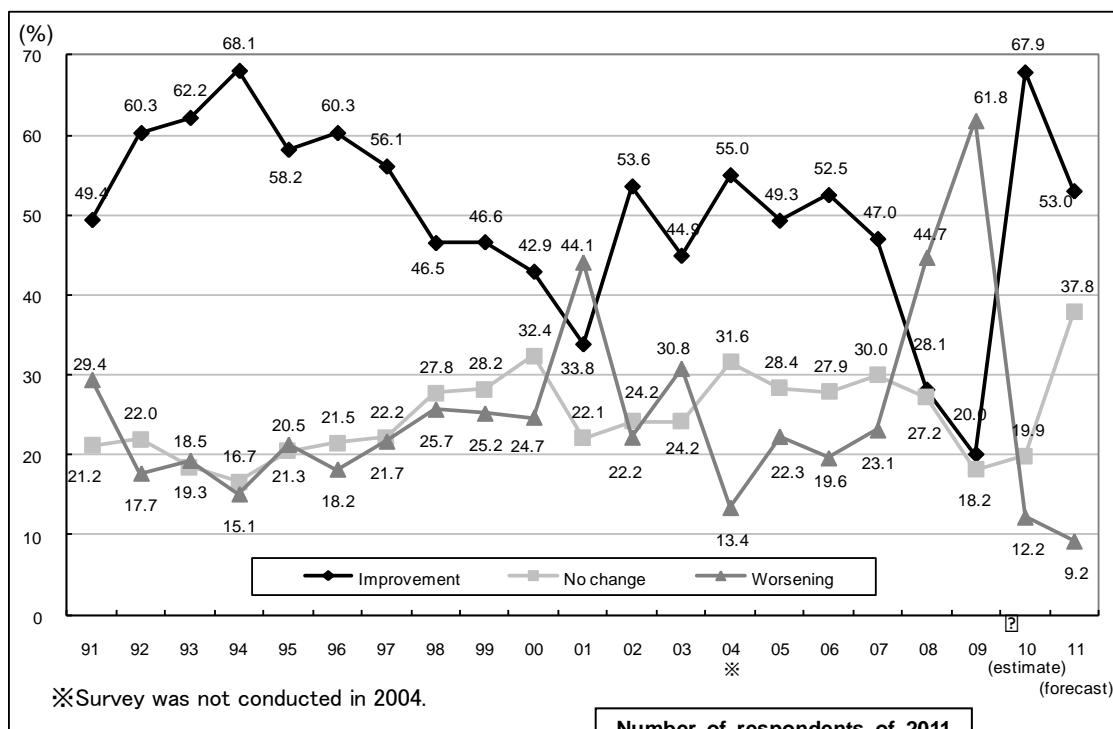


Figure 7. Management problems: Factors for cost increase

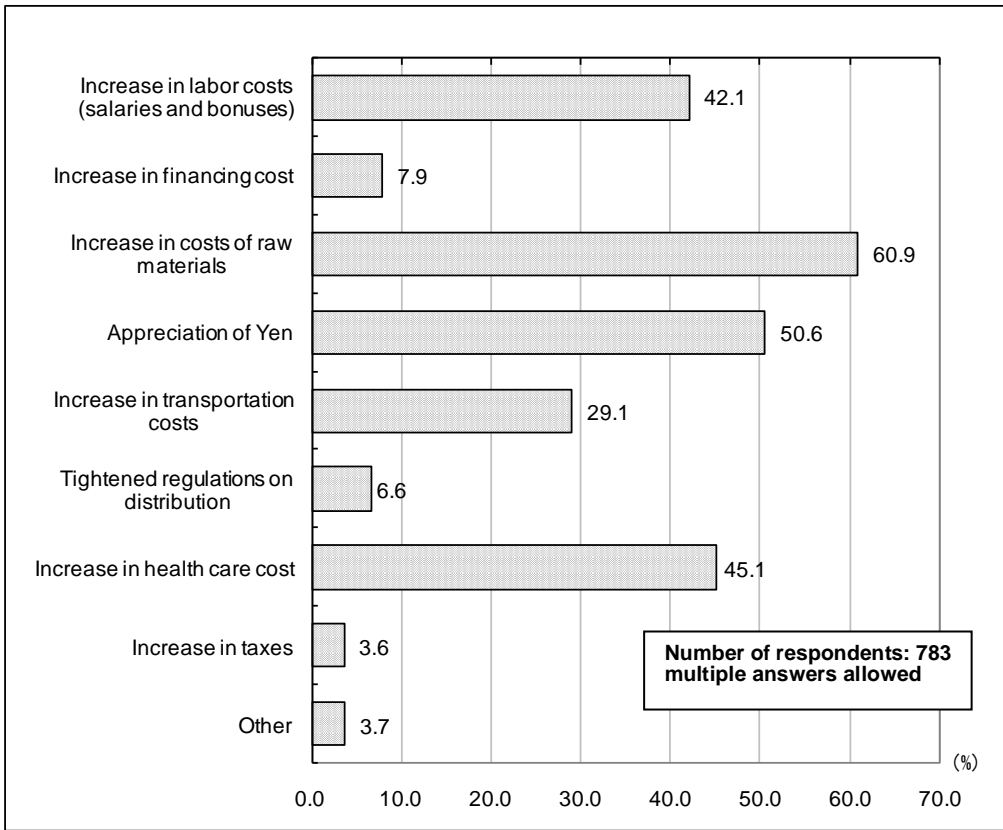


Figure 8: Management problems: Factors for weak sales

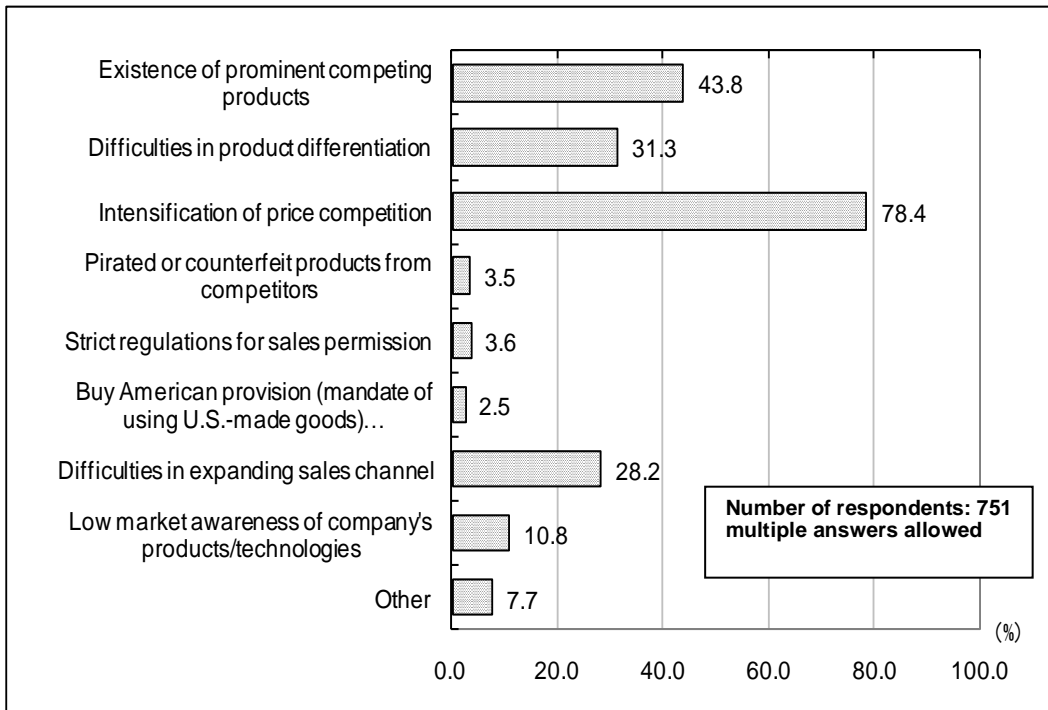


Figure 9. Proportion of companies viewing health care reforms as "positive", "negative", or "neither", by industry

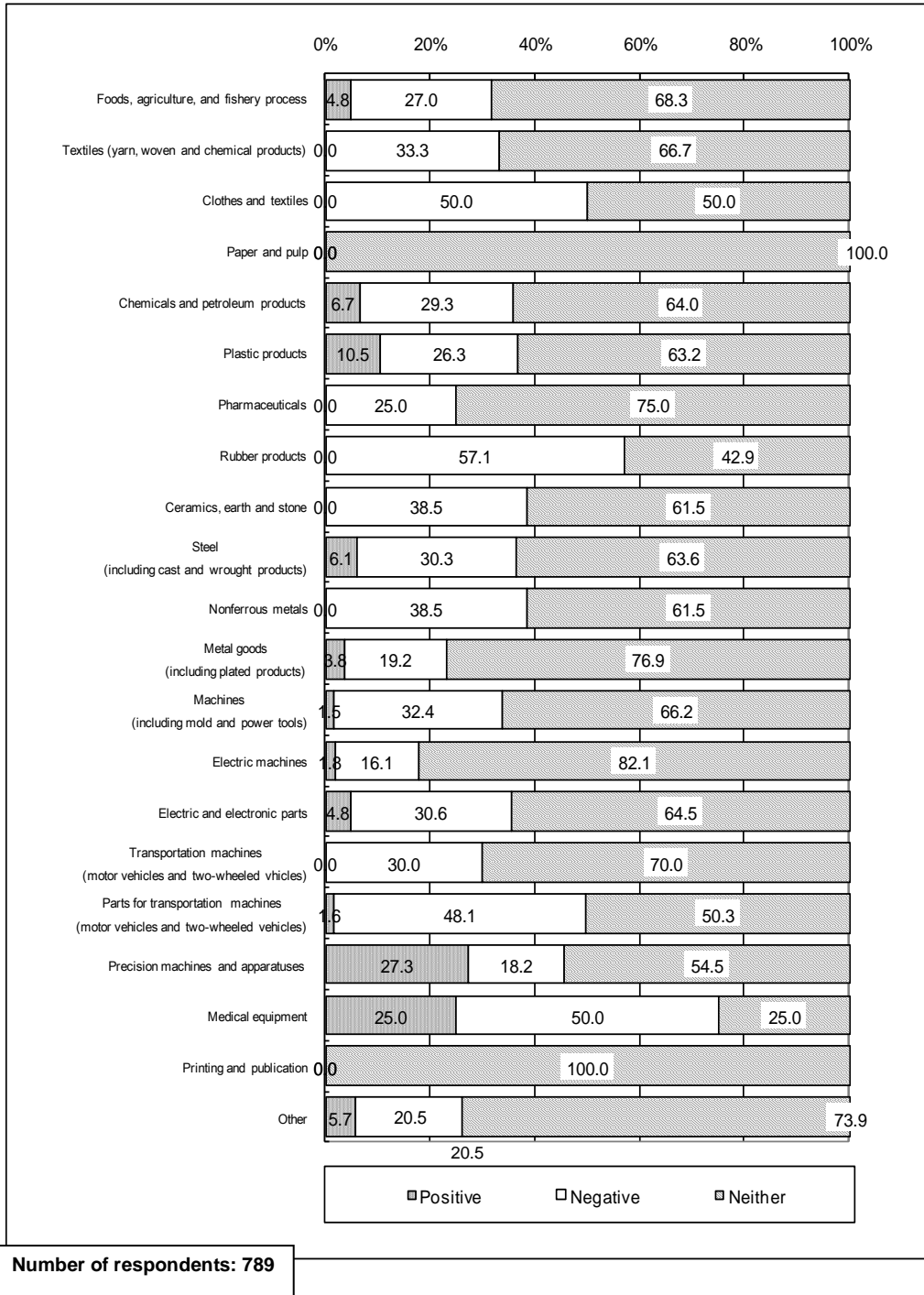


Figure 10. Proportion of companies viewing the current interest in green environment sector as "positive", "negative", or "neither".

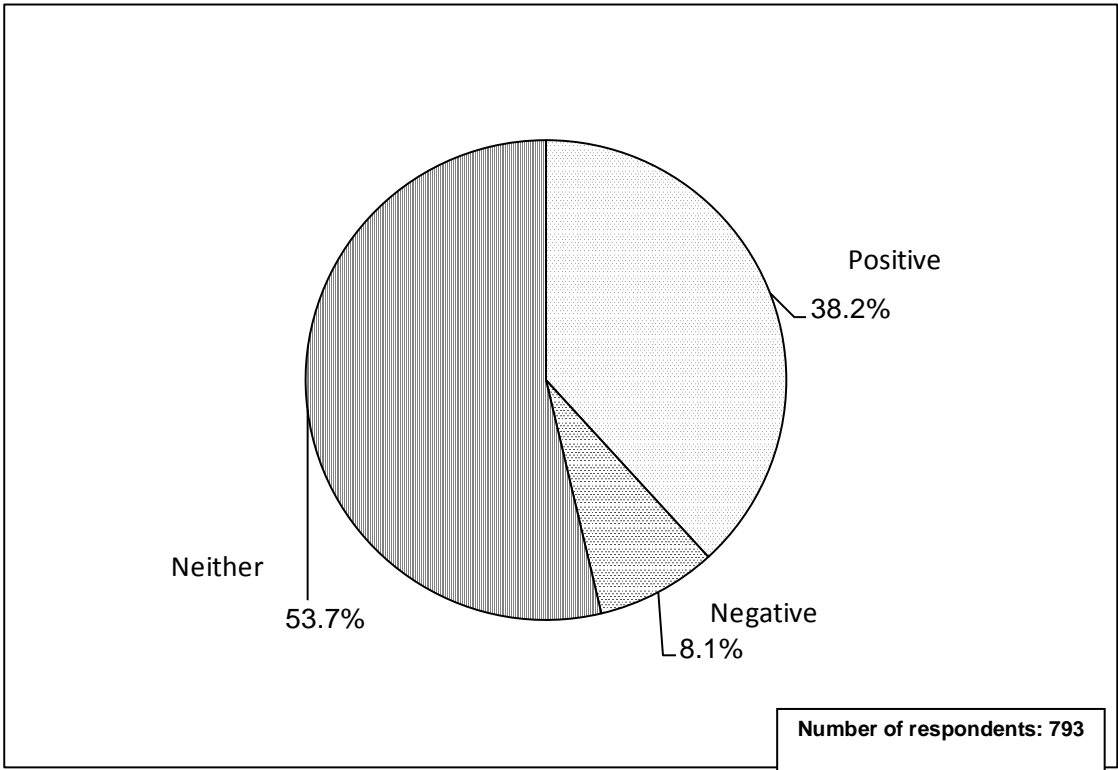


Figure 11. Proportion of companies viewing the trade conflict between the U.S. and China as "positive", "negative", or "neither"

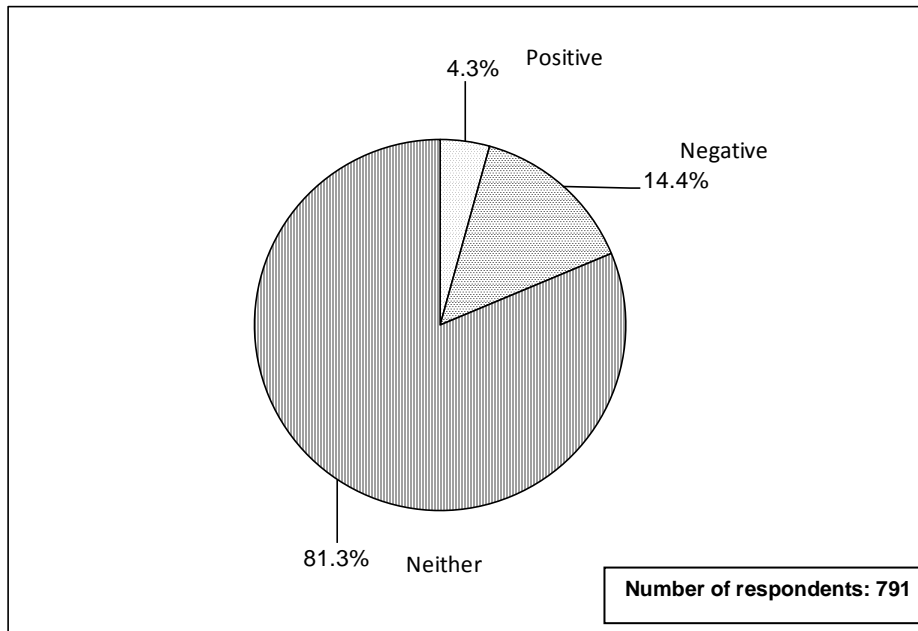


Figure 12. Proportion of companies viewing the "export strategy" of the administration as "positive", "negative", or "neither".

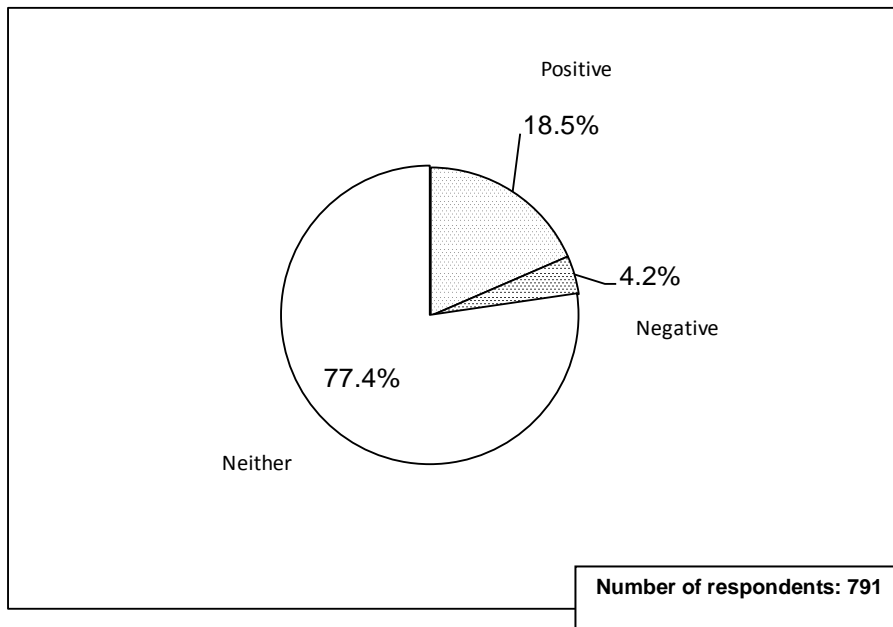


Figure 13: Proportion of companies viewing the lowering of tariffs on Korean products resulting from the Korean-US FTA as "positive", "negative", or "neither".

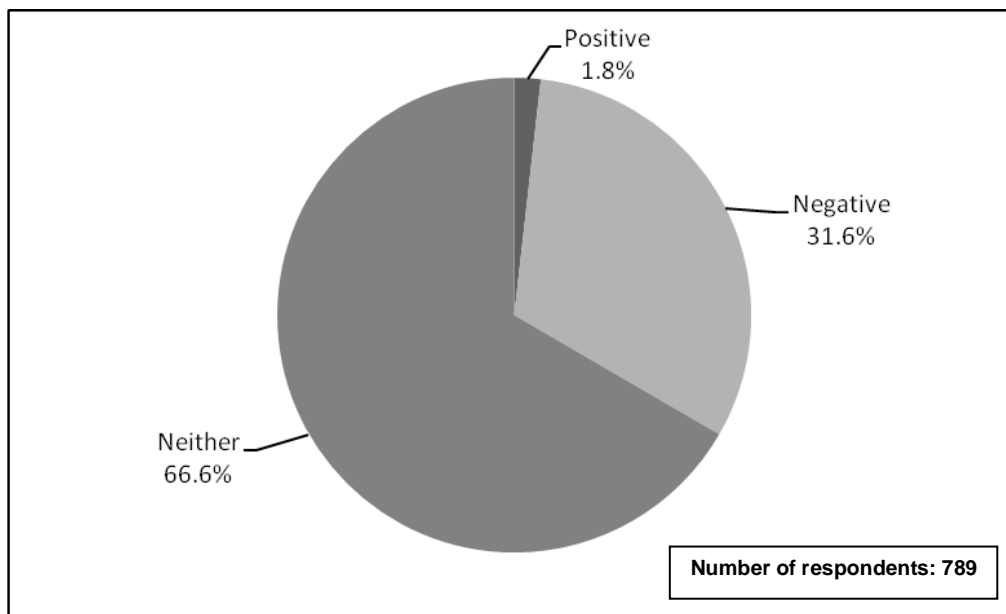


Figure 14: Proportion of companies, by industry, viewing the impact of lowering tariffs on Korean products resulting from the Korean-US FTA as "positive", "negative", or "neither".

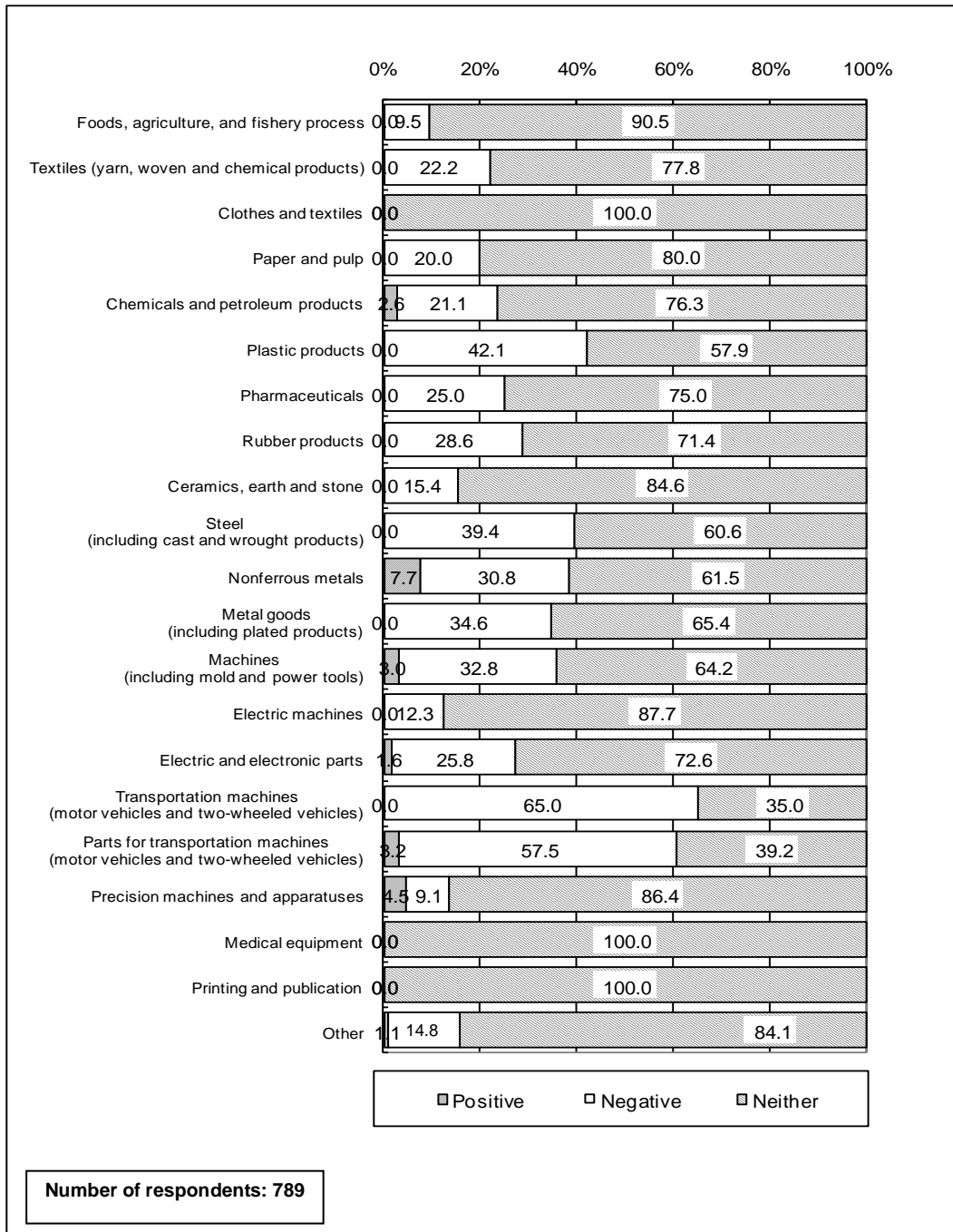
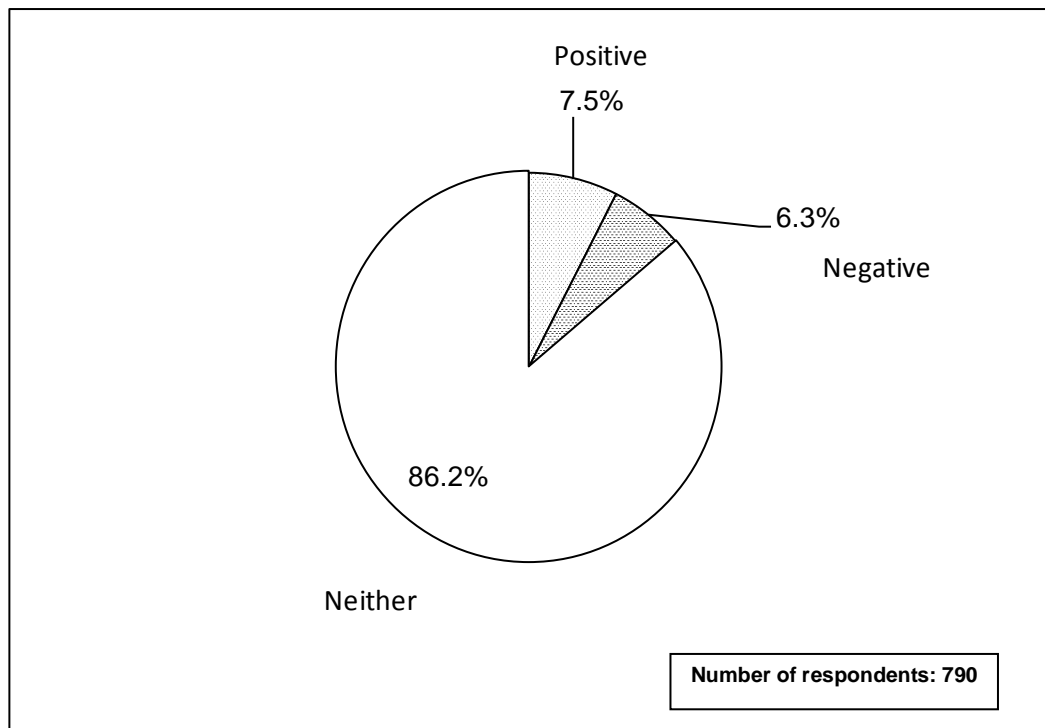


Figure 15. Proportion of companies viewing the Trans-Pacific Partnership Trade Agreement (TPP) as "positive", "negative", or "neither"



2. Canada: “Business confidence of Japanese companies operating in Canada: substantial improvement over the previous year, but the future remains uncertain”

[Main Findings]

○ **Business confidence in 2010 improved substantially over the historical low in 2009. Over 70% of businesses are ‘profitable’. However, companies have taken a ‘wait-and-see’ stance regarding capital investment and hiring of new employees.**

The diffusion index (DI), used to measure business confidence (the proportion of businesses reporting increased operating profits over the previous year minus those reporting decreased operating profits), reached 30.5, marking a substantial improvement over the previous year (Fig. 1).

However, this is attributable, to a large extent, to a rebound from the performance in the previous year. The majority (50.6%) of companies reported improved performance compared to 2009, though lower than 65.0% of companies operating in the U.S. that indicated improved performance (Fig. 2). The proportion of companies reporting that they were “in the black”, i.e. profitable, was 65.2% (Fig. 3). However, there has been relatively little allocation of resources to capital investment and hiring of new employees (Figs. 4 and 5). Given the uncertainty about the future, most companies have taken a ‘wait-and-see’ stance.

○ **Companies are faced with the problems of weak sales resulting from intensifying price competition and increasing production cost pressures due to factors such as the increase in labor cost, the prices of raw materials and as the appreciation of the Japanese Yen.**

Among the problems facing companies, it appears that companies have come up against a structural limitation to improving profitability with increasing cost pressures, on the one hand, due to factors such as rising labor costs (50.0% of respondents) and rising raw material prices (44.7%) that, on the other hand, cannot be passed on to consumers due to intensified price competition (78.4%, Figs. 6 and 7). There was also strong concern that “appreciation of the Japanese Yen” (36.7%) would lead to lower profitability. Concern regarding appreciation of the Yen was notably greater among companies expected to rely heavily on parts and components from Japan – manufacturers of machines (57.1%), electric machines (54.5%), and electric and electronic parts (57.1%) – than all industries combined.

○ **A gradual recovery anticipated in 2011**

46.9% of companies forecasted business to “improve” in 2011, while 46.9% of companies expected “no change”, for a combined total of over 90%, indicating that there is little fear of a second recessionary dip (Fig. 2). In addition, 65.2% of companies expected to maintain the same number of local employees while 24.8% hoped to increase (Fig. 4).

○ **High expectations in the green environment sector for wind power and solar batteries**

Among companies, there was a trend to view the enthusiasm surrounding ‘green environment sector’ in a positive light (Fig. 8, 34.9% “positive”, 5.4% “negative”). The companies’ confidence

regarding the future of green environment sector is hinted at in comments regarding the “potential for increasing sales of ‘eco-friendly’ products”. Wind power and solar batteries were identified as opportunities for new business.

- **The reduction/elimination of corporate and fixed asset taxes in Ontario expected to bolster associated businesses**

49.7% of responding companies viewed these changes in taxes as “positive” (Fig. 9). The plan entails a lowering of the provincial corporate tax from 14% to 10% by 2013, and a complete elimination of the tax on fixed assets by the end of 2010. Lowering of these fixed costs is expected to lead to increased profitability.

In the following section, the bulleted lists represent selected comments by companies (with the industry indicated in []) from interviews or surveys conducted by JETRO in late August and early September of Japanese companies (Transportation machines and parts, Machines, Paper and pulp, etc.) operating in Canada.

1. Business confidence in 2010 improved substantially over the historical low in 2009. 70% of businesses are ‘profitable’. However, companies have taken a ‘wait-and-see’ stance regarding capital investment and hiring of new employees.

The diffusion index (DI), used to measure business confidence (The proportion of businesses reporting increased operating profits over the previous year minus those reporting decreased operating profits), reached 30.5, marking a substantial improvement over the previous year (Fig. 1).

However, this is attributable, to a large extent, to a rebound from the performance in the previous year. The majority (50.6%) of companies reported improved performance compared to 2009, though lower than 65.0% of companies operating in the U.S. that indicated improved performance (Fig. 2). The proportion of companies reporting that they were “in the black”, i.e. profitable, was 65.2% (Fig. 3). However, there has been relatively little allocation of resources to capital investment and hiring of new employees (Figs. 4 and 5). Given the uncertainty about the future, most companies have taken a ‘wait-and-see’ stance.

Companies appeared to be cautious regarding capital investment, with 60.0% of companies reporting that there would be “no change” in capital investment over 2009 (Fig. 4). The purposes of investment were primarily “rationalization and optimization of manufacturing facilities” (54.1%) and “optimization through investment in information technology” (25.7%).

With respect to employment, more than 70% of companies reported “no change” or “decrease” in the number of locally-hired employees compared to the previous year (“increased” 24.8%, “no change” 44.7%, “decrease” 30.4% in Fig. 5), from which the companies’ “wait-and-see” stance can be inferred.

- The decline in the Canadian economy over the last two years was less severe than in the U.S. Accordingly, the magnitude of recovery has also been smaller. [Transportation machines and parts]
- The recovery is almost the same as in the U.S. [Machines]
- Because business performance has been poor over the past two years, capital investment has been all but frozen. In order to return to normal levels, we need to develop an overall budget for capital investment. [Transportation machines and parts]
- The number of expatriate staff has been reduced to the bare minimum. We are not planning to reduce this number further. [Machines]

2. Companies are faced with the problems of suppression of sales resulting from intensifying price competition and increasing production cost pressures due to factors such as the increase in the labor cost, the prices of raw materials and as the appreciation of the

Japanese Yen.

Among the problems facing companies, it appears that companies have come up against a structural limitation to improving profitability with increasing cost pressures, on the one hand, due to factors such as rising labor costs (50.0% of respondents) and rising raw material prices (44.7%) that, on the other hand, cannot be passed on to consumers due to intensified price competition (78.4%, Figs. 6 and 7). There was also strong concern that “appreciation of the Japanese Yen” (36.7%) would lead to lower profitability. Concern regarding appreciation of the Yen was notably greater among companies expected to rely heavily on parts and components from Japan – manufacturers of Machines (57.1%), electric machines (54.5%), and electric and electronic parts (57.1%) – than among companies from all industries combined.

Companies identified a wide variety of competitors depending on the industry, including “global suppliers”, “Korean companies”, “domestic Canadian companies”, “U.S. companies”, and “Mexican companies”. Japanese companies are facing stiff competition from companies around the world in both developed and developing countries.

- The prices of iron, resins, and polyesters have risen sharply. [Transportation machines and parts]
- With regard to the sharp rise in labor costs, Canada’s minimum wage is not only relatively higher than in other countries, the annual increase is also steep. [Transportation machines and parts]
- It is necessary to offer higher salaries in order to attract high-level technicians and employees.[Transportation machines and parts]
- The influx of low-price U.S. products due to the strong Canadian dollar is leading to a drop in prices. [Rubber products]

3.A gradual recovery anticipated in 2011

46.9% of companies forecasted that business will “improve”, while 46.9% of companies expected “no change” in 2011, for a combined total of over 90%, indicating that there is little fear of a second recessionary dip (Fig. 2). In addition, 65.2% of companies expected to maintain the same number of local employees while 24.8% hoped to increase (Fig. 5).

4. High expectations in the green environment sector for wind power and solar batteries

Among companies, there was a trend to view the enthusiasm surrounding ‘green environment sector’ in a positive light (Fig. 8, 34.9% “positive”, 5.4% “negative”). The companies’ confidence regarding the future of green environment sector was hinted at in comments regarding the “potential for increasing sales of ‘eco-friendly’ products”. Wind power generation and solar batteries were identified as opportunities for new business. On the other hand, concerns of increasing burdens were evident in comments by a small number of companies, including, “the need to navigate complex environmental laws will lead to increased administrative burden” and “costs of developing products that comply with environmental regulations will increase.”

- Increased wind power generation will lead to increased demand for our products. [Machines]
- There is increasing production and sales of “eco-tires”, legislated in the State of California. [Transportation machines and parts]
- This is a chance for product differentiation. We are planning to focus our attention on development of material-saving, high value-added products that take the environment into consideration from the design stage. Specifically, we plan to use recycled materials and to position our company as a ‘green’ company. [Machines]
- We are making use of funding through the Green Transformation Program sponsored by the Canadian government to invest in our facilities. [Paper and pulp]
- We take the ‘green environment sector’ as “positive” since we can take advantage of funding by the Canadian government and invest in our facility to make it more environmentally friendly. [Electric machines].
- Both federal and provincial policies to reduce carbon emissions have been very beneficial. [Machines]

5. The reduction/elimination of corporate and fixed asset taxes in Ontario is expected to bolster associated businesses

49.7% of responding companies viewed these changes in taxes as a “positive” (Fig. 9). The plan entails a lowering of the provincial corporate tax from 14% to 10% by 2013, and a complete elimination of the tax on fixed assets by the end of 2010. Lowering of these fixed costs is expected to lead to increased profitability.

Survey methods, comments, etc.

1. Criteria for inclusion in survey

A “Japanese company” was defined as a company whose “10% or more of the total shares are held directly or indirectly by a Japanese parent company.” For example, if a Japanese company has a 20% stake in subsidiary ‘A’ which operates in the U.S. and subsidiary ‘A’ has a 50% stake in subsidiary ‘a’, subsidiary ‘a’ is considered a “Japanese company”, because the Japanese ‘grandparent’ company has a 10% stake ($0.2 \times 0.5 \times 100$). The same is true for subsequent generations of subsidiaries.

2. Survey methods

Potential respondents were contacted by one of JETRO’s two branch offices in Canada (Toronto and Vancouver) via an e-mail directing the respondents to a web address (URL) where they entered responses directly into an online survey form.

3. Survey period

July and August, 2010

4. Collection of responses

239 Japanese companies operating in Canada (umbrella organizations of manufacturing companies or non-manufacturing companies) were invited via e-mail or fax to participate in the survey, resulting in 166 responses. Response rate was 69.5%. This was the 21st annual survey since 1989.

(Note) Each JETRO office used information sources that were believed to be reliable and data were tallied with the cooperation of individual companies. However, there is no guarantee that the data is accurate or comprehensive.

Figure 1. Trend in operating profits as measured by the Diffusion Index (DI) and real GDP growth rate

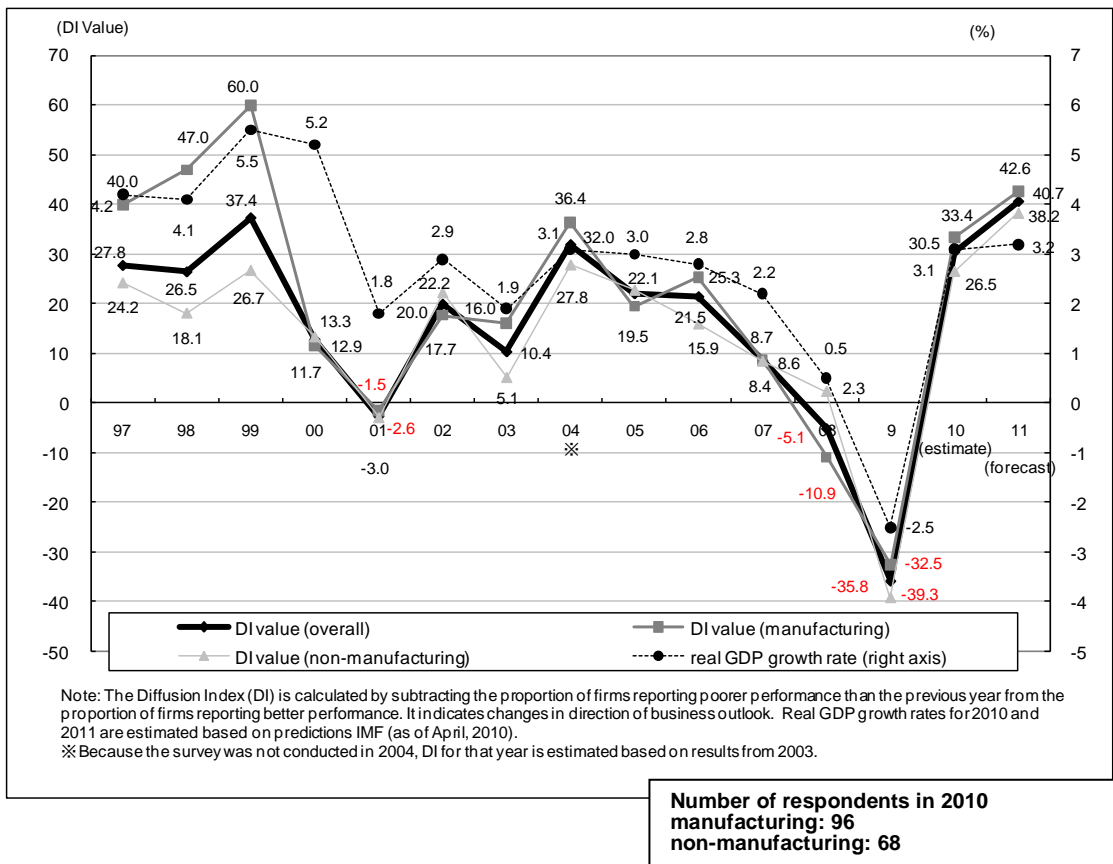
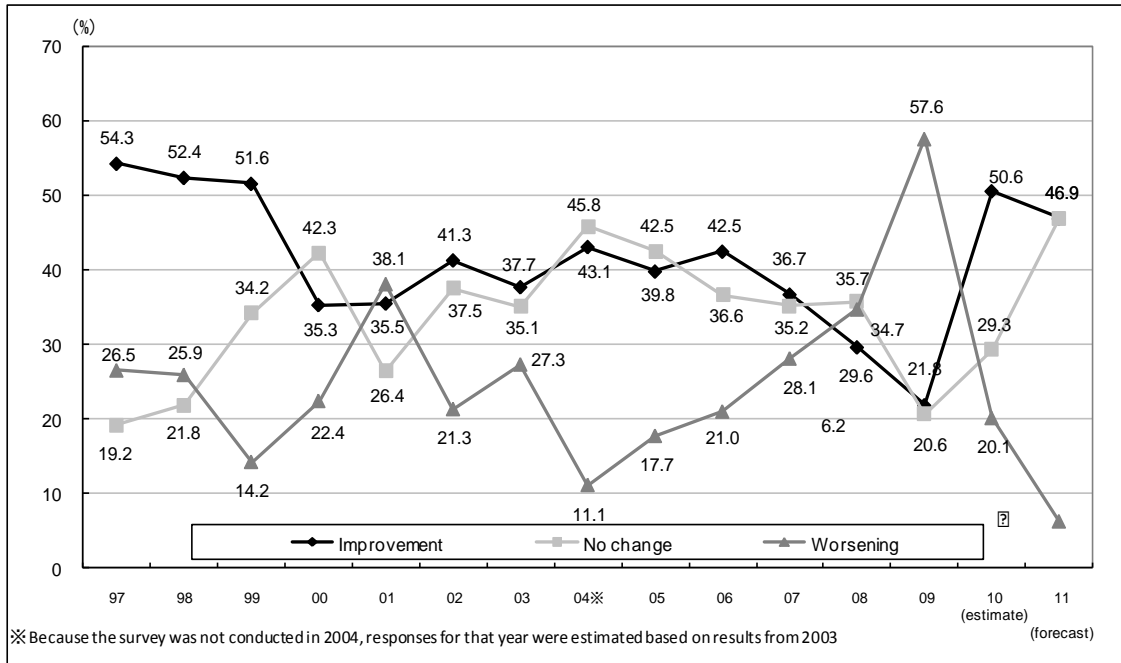
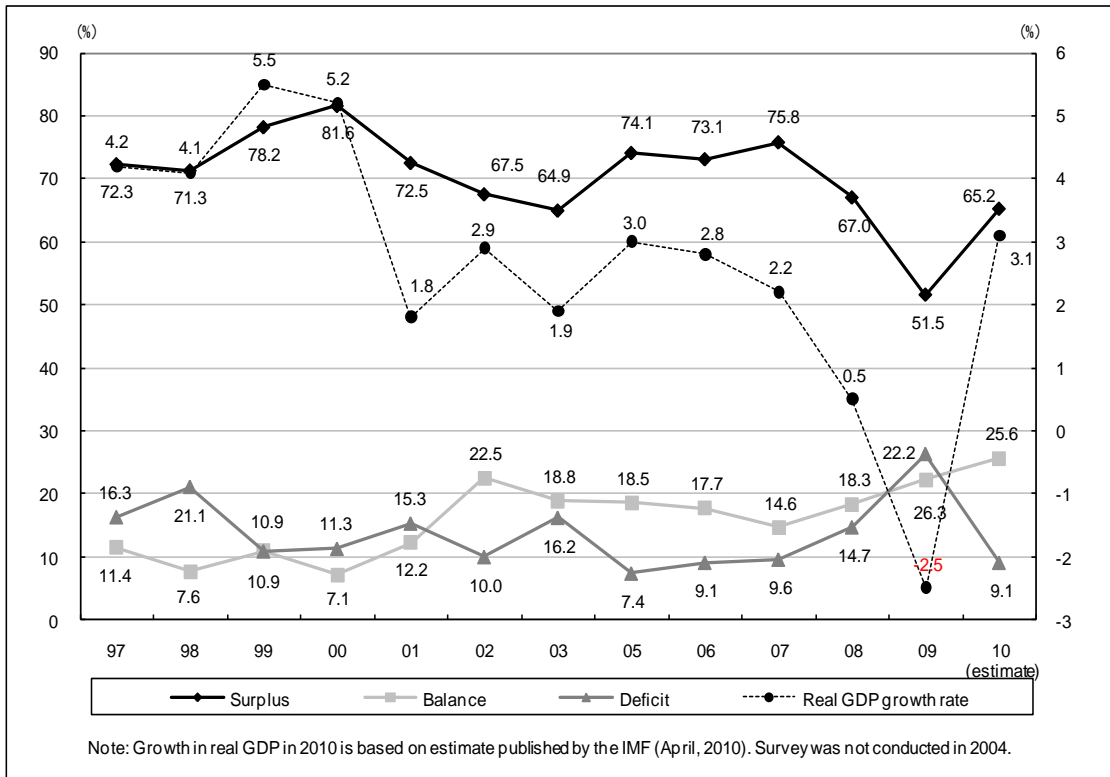


Figure 2. Change in proportion of companies reporting "improvement", "no change", and "worsening" of operating profits compared to the previous year



Number of respondents in 2010
manufacturing: 96
non-manufacturing: 68

Figure 3. Proportions of companies reporting "surplus", "balance", or "deficit" in operating profit and real GDP growth rate in Canada



Number of respondents in 2010
manufacturing: 96
non-manufacturing: 68

Figure 4. Proportion of manufacturing companies reporting "increase", "no change", and "decrease" in capital investment compared to 2009

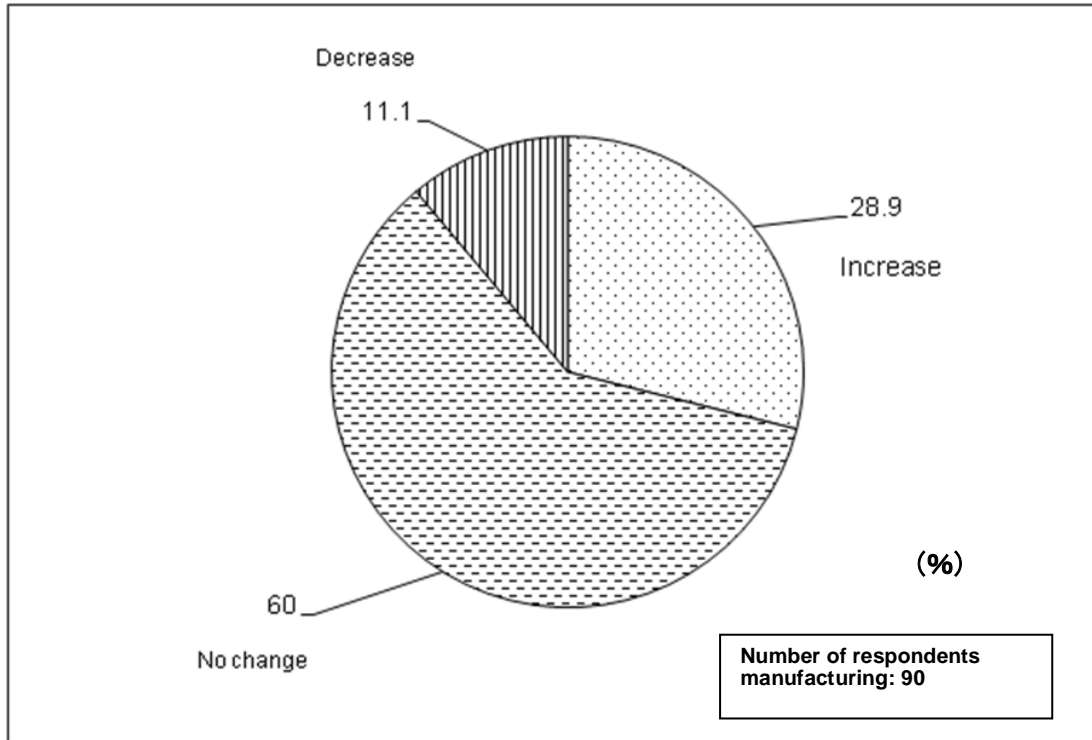
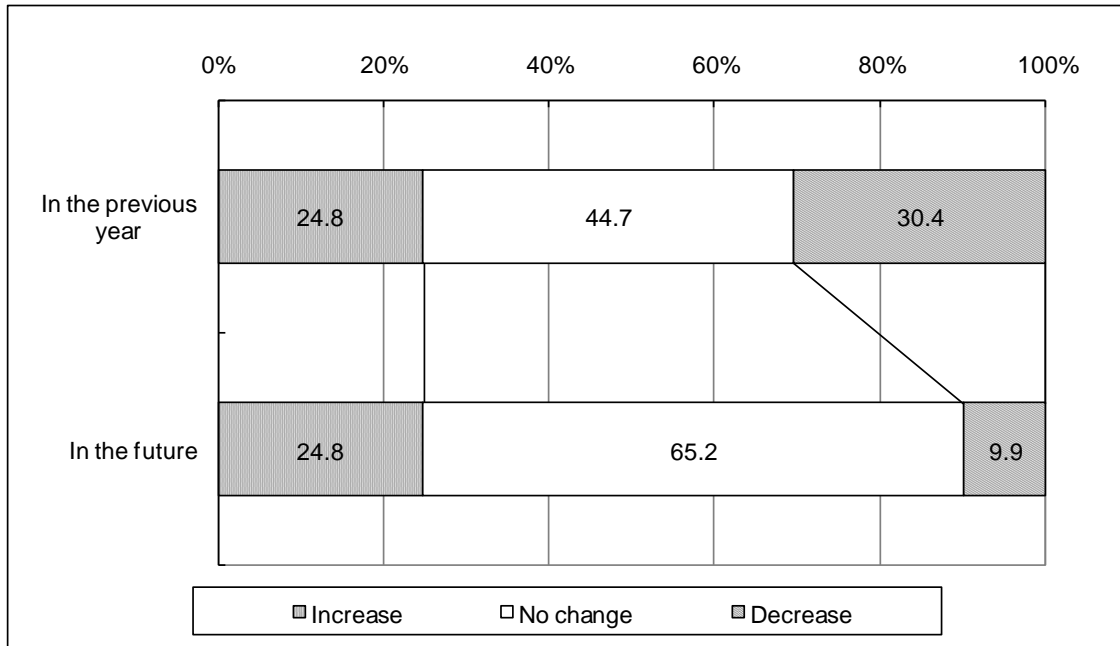


Figure 5. Proportions of companies reporting "increase", "no change", and "decrease" in number of locally-hired employees in the previous year (actual) and in the future (expected).



Number of respondents for "previous year": 161 "in the future": 161

Figure 6. Management problems: Factors for cost increase

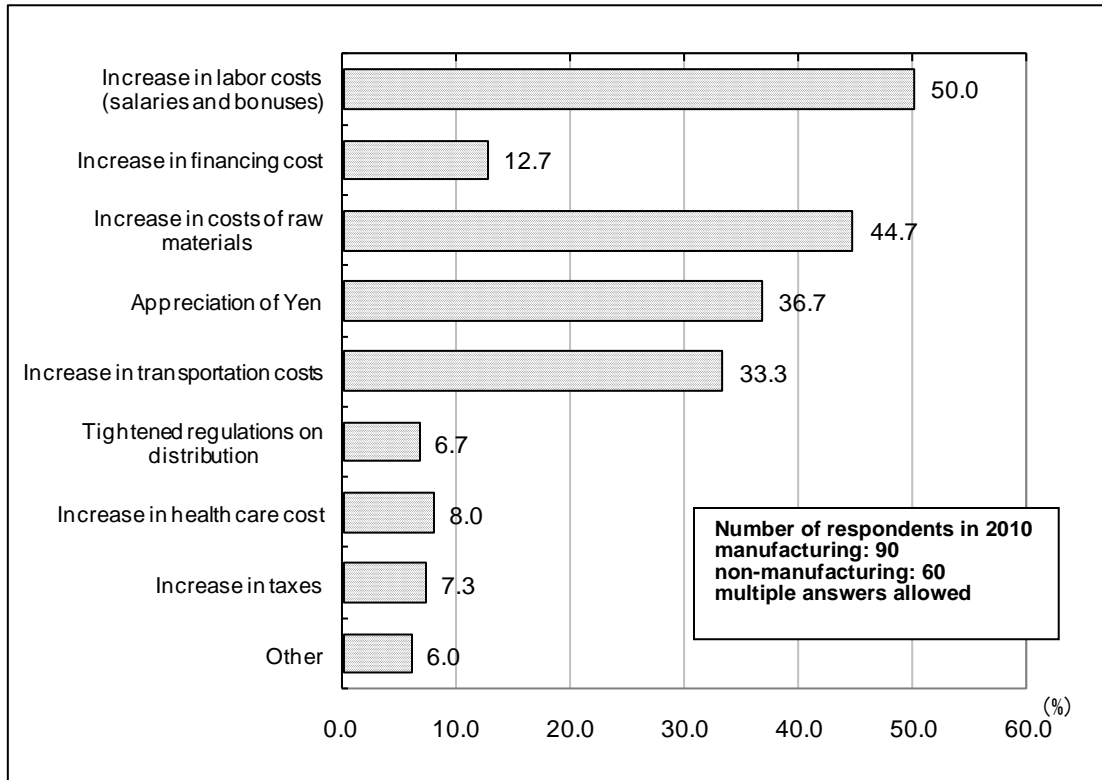


Figure 7: Management problems: Factors for weak sales

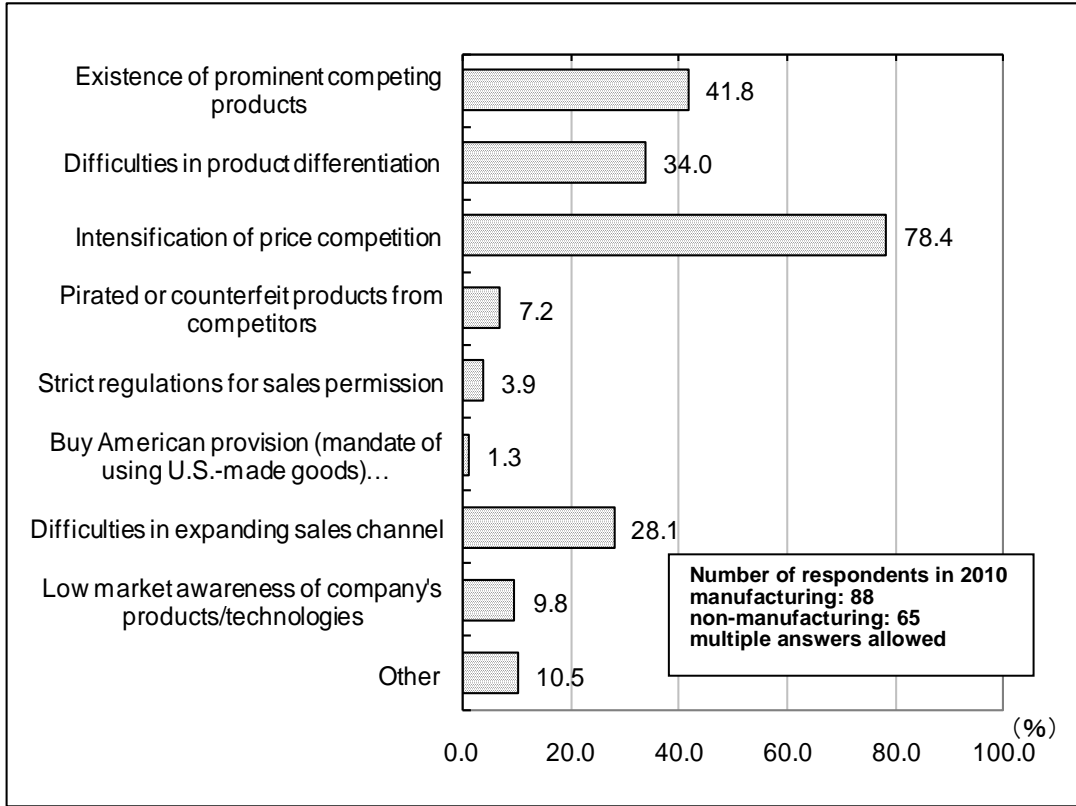


Figure 8. Proportion of companies viewing the current interest in green environment sector as "positive", "negative", or "neither"

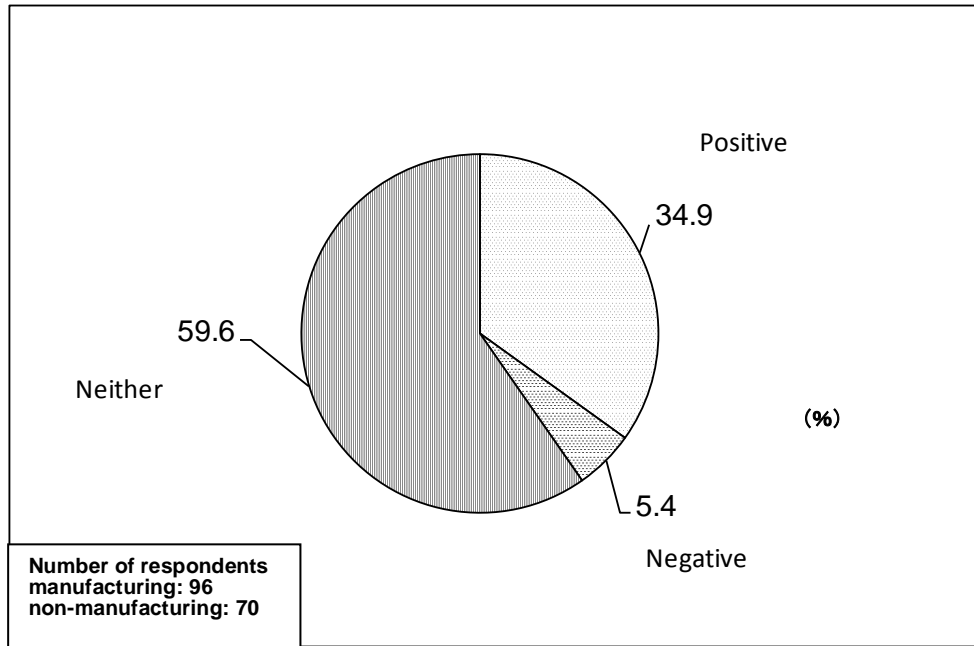
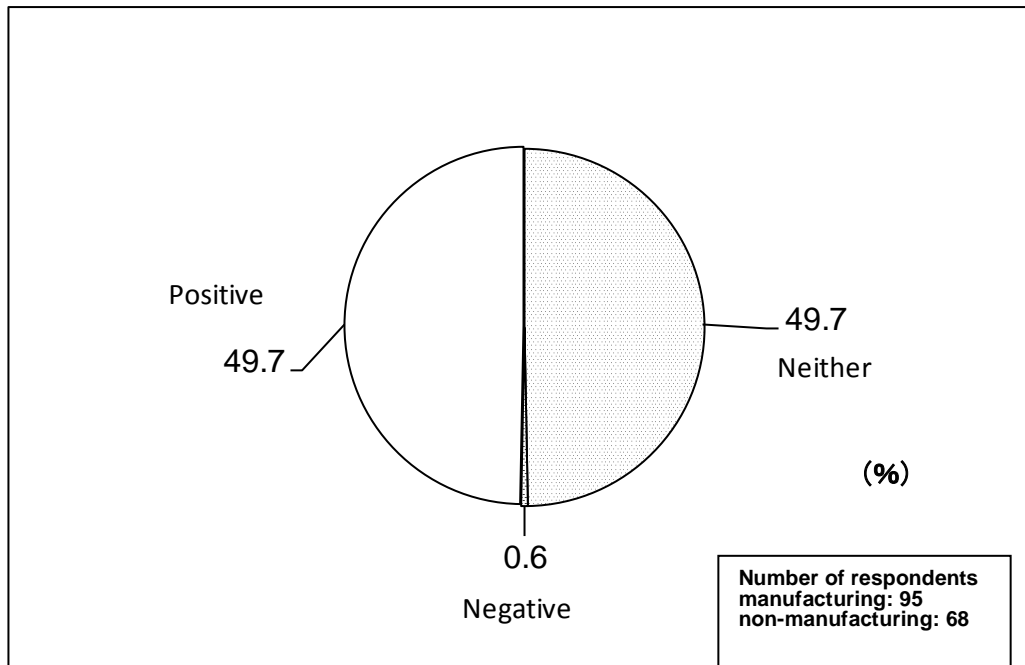


Figure 9. Proportion of companies viewing the reduction/elimination of corporate and fixed asset taxes in Ontario as "positive", "negative", or "neither".



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