JETRO
Invest Japan Report
2016

INVEST JAPAN

JETRO

Introduction **Message from the Chairman**

In the "Japan Revitalization Strategy," the government outlined its target of increasing inward foreign direct investment stock to 35 trillion yen by 2020 by inviting foreign companies, in order to attract excellent human resources and technologies to Japan for creation of employment and innovation. Inward foreign direct investment stock exceeded 20 trillion yen in 2014 for the first time and reached 24.4 trillion yen, renewing the historical high at the end of 2015. Further, inflow greatly exceeded withdrawal in the first half of 2016, bringing the stock to 26.7 trillion yen as estimated in June 2016. Behind the favorable growth of investments in Japan, there are positive changes in the evaluation of the investment environment of Japan.

The first change is re-evaluation of the Japanese market and expanded business opportunities. For foreign companies, the greatest appeal in doing business in Japan has been its "huge sophisticated market" with consumers and clients demanding high-quality products and services. Now, in addition to this, Japan is being recognized as a "trendsetter," in the sense that success in the Japanese market leads to success in Asian and global markets.

In addition to business costs coming down in Japan in comparison with Singapore, Hong Kong, Shanghai and other large cities, Japan's reputation as a "product development and R&D center" is also rising through collaboration with Japanese companies and research institutions in recognition of the research and technology development capabilities and reliable IPR protection in the country. Furthermore, the rapid increase of foreign tourists visiting Japan is calling attention to tourism-related businesses in Japan.

The second change is in the government's efforts for attracting foreign investments in Japan. The government has stimulated investments by foreign companies and hammered out various policies to make Japan "the most business-friendly country in the world." Corporate tax reduction, strengthening of corporate governance and other measures to improve the business environment, and regulatory reforms in pharmaceutical, medical equipment, power/energy and other fields are consistently expanding business opportunities in Japan. Its efforts toward TPP also constitute a major change.

To further improve the business environment, the government held a meeting of the Council for Promotion of Foreign Direct Investment in Japan in May 2016. The Council agreed upon a policy package which includes introduction of the "Japanese Green Card for Highly Skilled Foreign Professionals," which will be the most quickly obtainable green card in the world. To address administrative procedures and regulations which were pointed out as the top obstacles to foreign companies' doing business in Japan in the JETRO Invest Japan Report 2015, the government set up a working group, which is conducting a review toward radical simplification of regulations and administrative procedures.

The third change is in foreign companies' evaluation of Japan and their business activities. Foreign-affiliated companies doing business in Japan are already feeling these changes and many of them are planning to expand investment and employment in Japan.

For 14 years since 2003, JETRO as the central organization for attraction of inward investment has provided support for more than 15,000 projects to enter the Japanese market, and helped in the successful establishment of over 1,500 companies. Experienced staff members and specialists in industry, law, accounting and other fields cooperate to address the challenges faced by foreign companies starting up in Japan, including language, business practice, rules and regulations. In fiscal 2015, JETRO greatly increased the number of staff members handling investment in Japan and strengthened the efforts to support investment projects of foreign-affiliates already in Japan as well as initial investment from overseas. We are working to realize more projects by providing customized and highly-reliable services in cooperation with the central and local governments.

This report compiles the recent trend of foreign direct investment in Japan, related government policies, activities and the perception of foreign-affiliates concerning the business environment in Japan as well as JETRO's activities. This is the second publication following the 2015 edition. I hope this report will be useful for consideration of starting business in Japan or providing support for foreign companies' investment in Japan.

Hiroyuki Ishige
Chairman & CEO
Japan External Trade Organization (JETRO)

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I Steadily Increasing Investment in Japan

At the end of 2015, Japan's inward direct investment (FDI) stock remained mostly unchanged from the previous year but renewed the record high. The flow was slightly negative in consequence of pulling out of investments from Europe, whereas investments from Asia and the United States remained high. M&A in Japan in 2015 was not very active but is recovering the momentum with large projects in 2016. Investments in Japan by foreign companies are expected to continue to expand.

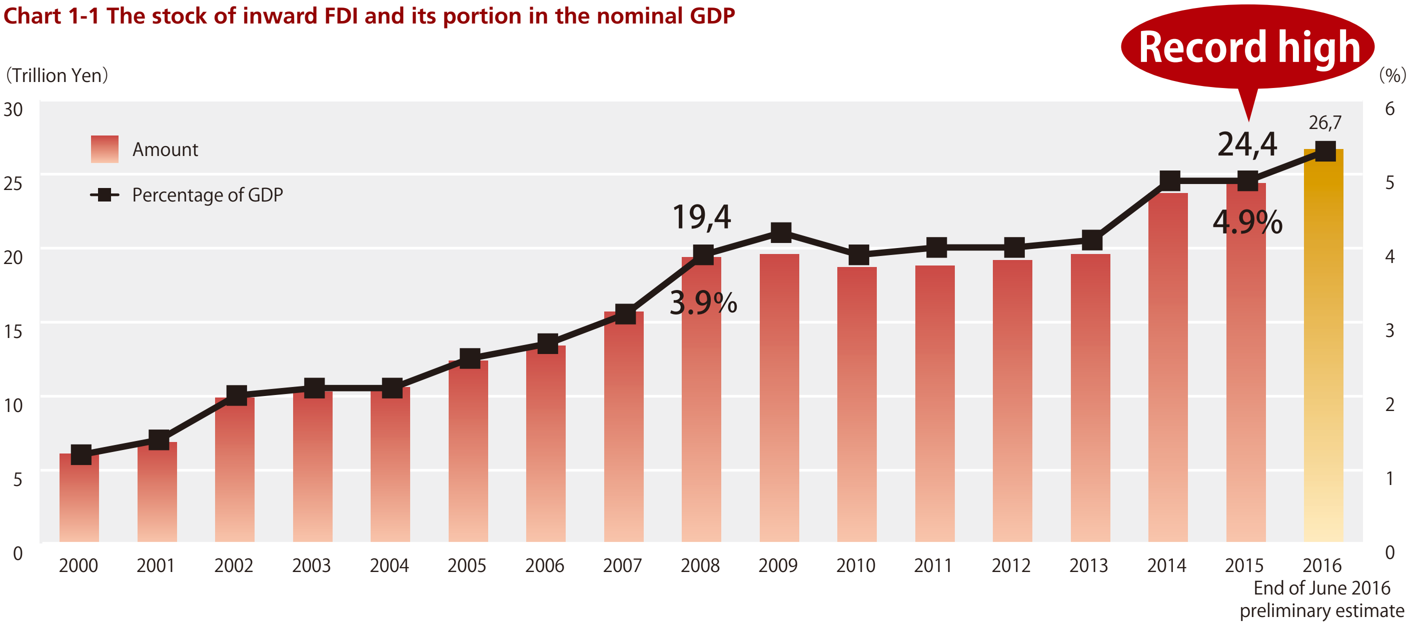
1. Inward FDI stock maintained last year's high level

At the end of 2015, Japan's inward direct investment stock was 24.4 trillion yen, increasing by 636.3 billion yen or 2.7% from 23.7 trillion yen at the end of the previous year and renewed the record high for the second consecutive year (Chart 1-1).

According to the provisional calculation by the Ministry of Finance, the major factor of the increase is estimated to be adjustment of statistical values. A slight decrease (16.4 billion yen) due to the negative net flow of direct investment in Japan and foreign exchange fluctuations (43.0 billion yen) in 2015 pushed down the stock value. However, the fluctuations of stock and bond prices and adjustment of statistics difference between the balance of payments and the international investment positions pushed up the value, resulting in an overall increase in the stock.

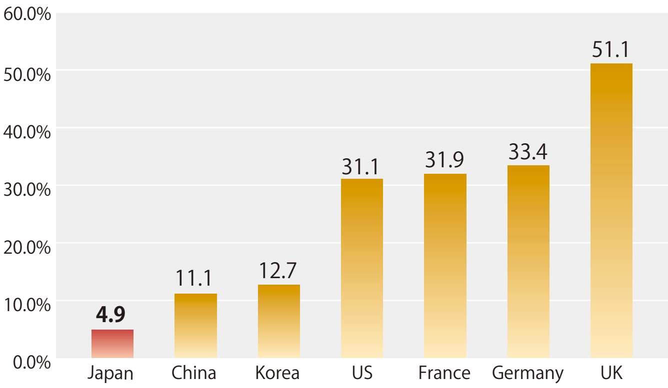
The ratio of foreign direct investment in Japan to its nominal GDP was 4.9%, the same as the ratio in the previous year and still low by international standards (Chart1-2). Comparing inward and outward investment stock, the inward-outward ratio was 1:6.2 as it has been in previous years, still maintaining the large gap (Chart1-3).

Chart 1-1 The stock of inward FDI and its portion in the nominal GDP



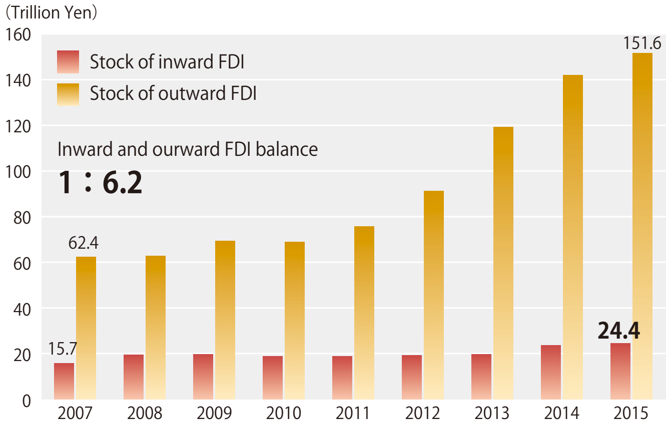
[Source] "Balance of Payments"(Ministry of Finance), "National Accounts of Japan" (Japan Cabinet Office)

Chart 1-2 International comparison of the inward FDI's ratio in nominal GDP (as of the end of 2015)



[Source] "World Investment Report 2016" (UNCTAD) (except Japan)
Japan: "Balance of Payments (as of the end of 2015)" (Ministry of Finance), "National Accounts of Japan" (Japan Cabinet Office)

Chart 1-3 Japan's outward and inward direct investment balance



[Source] "Balance of Payments" (Ministry of Finance)

2. Asia increased its share in the inward FDI

By region, Europe has the largest direct investment stock in Japan at 11.2 trillion yen (46%) followed by North America (7.0 trillion yen, 28.8%) and Asia (4.3 trillion yen, 17.6%) (Chart1-6). The ratio of investment from Asia, in particular, increased more than 2 percentage points from 15.5% in the previous year.

By country, the United States ranks first with 6.9 trillion yen or 28.1%, followed by the Netherlands (3.7 trillion yen), France (3.0 trillion yen) and the United Kingdom (1.9 trillion yen). The ranking of the top four countries remained the same as in the previous year. From Asia, Singapore (1.8 trillion yen, 5th) and Hong Kong (1.0 trillion yen, 8th) joined the top 10 countries. Hong Kong's direct investment stock in Japan exceeded one trillion yen following Singapore (Chart1-4). Other Asian countries including Taiwan (527.6 billion yen, 11th), South Korea (389.5 billion yen, 12th) and China (218.7 billion yen, 14th) moved up compared with 10 years ago and stepped up their presence (Chart 1-5).

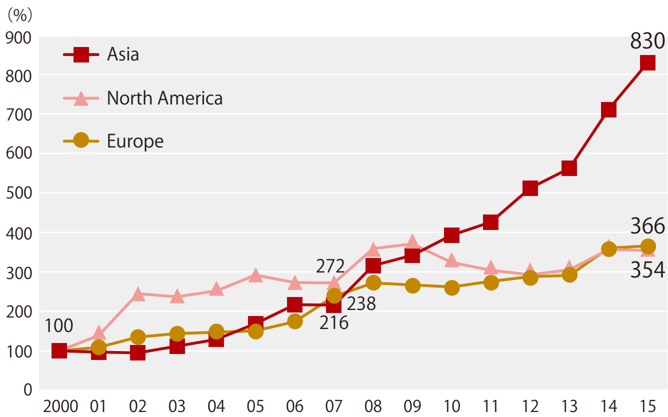
Other countries ranked in the top 10 are Switzerland (1.1 trillion yen, 6th), the Cayman Islands (1.0 trillion yen, 7th), Luxembourg (777.7 billion yen, 9th) and Germany (748.8 billion yen, 10th). Germany's investment stock was over one trillion yen at the end of 2014 but shrunk, moving down from 7th to 10th, partly influenced by the dissolution of the large-scale capital tie-up between Volkswagen and Suzuki.

Chart 1-4 Inward FDI stock by country and region (as of the end of 2015) TOP10

	Country	Stock(Billion Yen)	Ratio(%)
1	US	6,856	28.1
2	Netherlands	3,703	15.2
3	France	3,075	12.6
4	UK	1,927	7.9
5	Singapore	1,814	7.4
6	Switzerland	1,118	4.6
7	Cayman Islands	1,065	4.4
8	Hong Kong	1,042	4.3
9	Luxembourg	778	3.2
10	Germany	749	3.1

[Source] "Balance of Payments" (Ministry of Finance)

Chart 1-5 Stock of Inward FDI by region (growth ratio when the stock as of 2000 is 100)



[Note] The stocks for 2014 and after are calculated based on BPM6. The stocks before 2013 were recalculated from BPM5-based to PBM6-based by JETRO
[Source] "Balance of Payments" (Ministry of Finance)

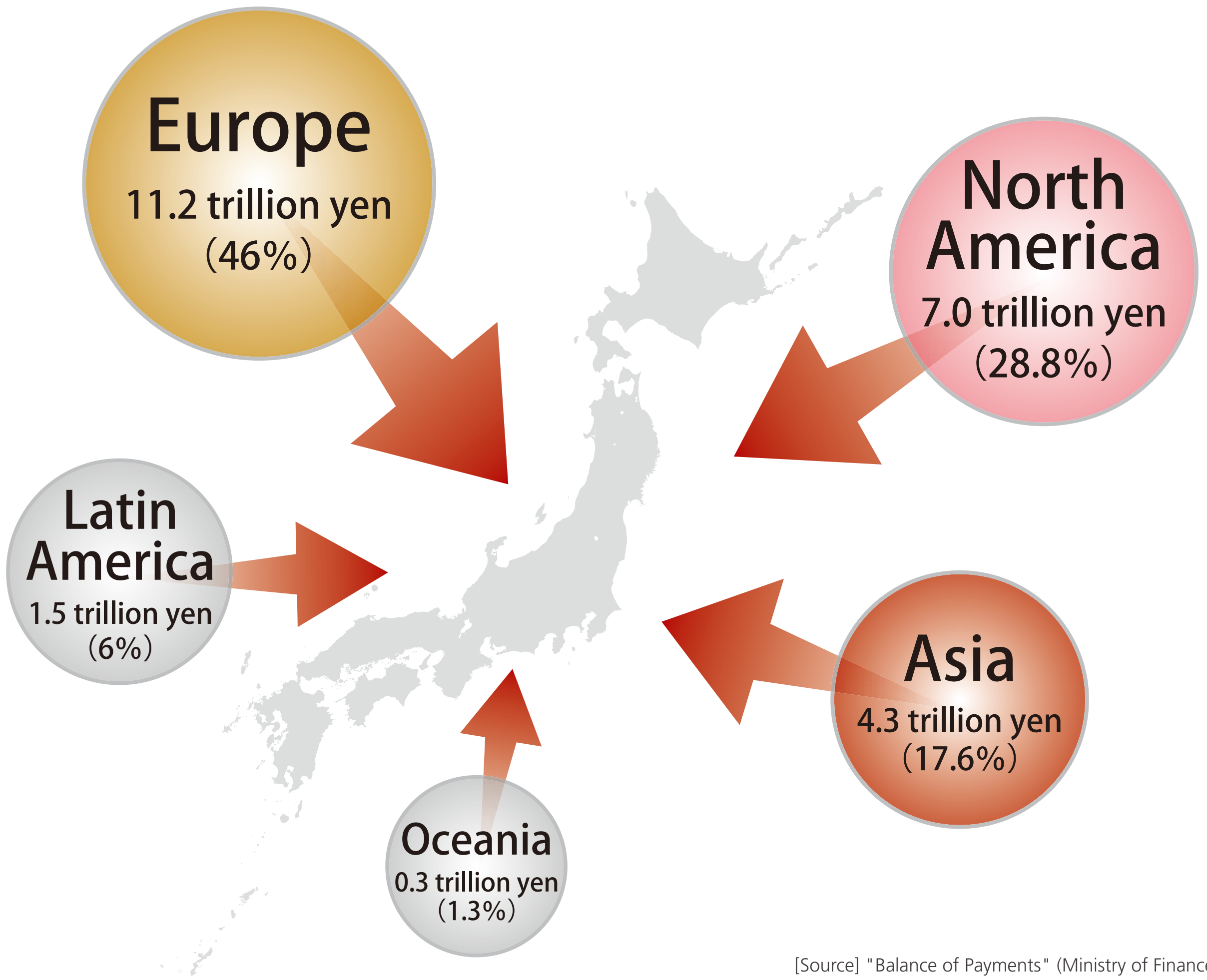
Stock by industry is largest for finance and insurance accounting for 36.6% of the total followed by transportation equipment manufacturing (13.1%), electric machinery manufacturing (12.8%), wholesale and retail (5.6%) and chemical and pharmaceuticals (4.5%) (Chart 1-7). In the past 10 years, there has been no change in the industrial structure where finance accounts for about 30 to 40%, with transportation equipment manufacturing and electric machinery manufacturing ranking high.

Looking at the breakdown of industry by region, investments in the non-manufacturing industry from Asia and North America are 86.5% and 79.9% respectively, greatly exceeding the investments in the manufacturing industry. Investments in financial businesses are particularly large. On the other hand, the manufacturing industry account for 66.9% of investments from Europe, with transportation equipment manufacturing (28.8%) and electric machinery manufacturing (21.9%) standing out.

In comparison with 10 years ago, the breakdown of investments by industry has undergone a huge transformation. Roughly half of investments from North America and Europe were in the manufacturing industry and the other half were in the non-manufacturing industry at the end of 2005. The ratio of investments from North America in electric machinery manufacturing has greatly decreased while investment in financial businesses increased at the end of 2015. This is attributed to the increase in North American banks, security businesses and financial services. On the other hand, the ratio of investments from Europe in the communications and wholesale and retail industries has decreased while investments in electric machinery manufacturing, by companies such as Bosch and Schneider Electric, have increased.

With rising investments in Japan, payments of direct investment returns from Japan are also on an increasing trend in the long term. The amount paid of direct investment returns in 2015 was 2.73 trillion yen, or 2.3 times the amount 10 years ago (1.2 trillion yen in 2005). Nearly 90% of the payees were in Europe or America but payment to Asia has grown with the increase of investments from Asia. By region, Asia gradually expanded its share in payment of direct investment returns from 3.6% in early 2000 to 13.4% in 2014 and 2015. A stronger investment relationship with Asia is also visible in terms of returns (Chart 1-8).

Chart 1-6 Stock of inward FDI into Japan by region (as of the end of 2015)



[Source] "Balance of Payments" (Ministry of Finance)

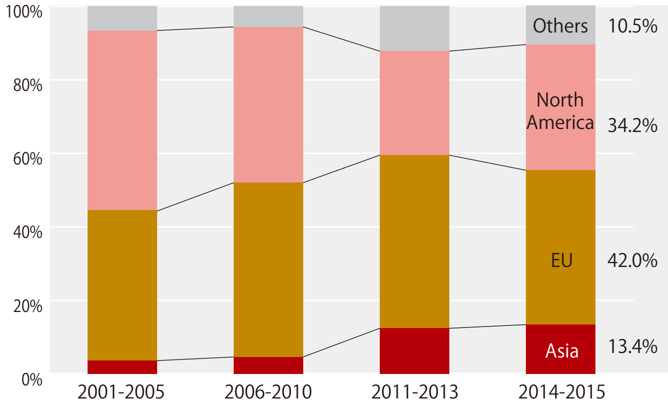
Chart 1-7 Stock of inward FDI by industry (as of the end of 2015) TOP10

	Industry	Stock (Billion Yen)	Ratio (%)
1	Finance and Insurance	7,527	36.6
2	Transportation equipment manufacturing	2,702	13.1
3	Electric machinery manufacturing	2,635	12.8
4	Wholesale and retail	1,142	5.6
5	Chemical and pharmaceutical manufacturing	923	4.5
6	Service	836	4.1
7	Communications	788	3.8
8	General machinery manufacturing	536	2.6
9	Real estate	392	1.9
10	Glass and ceramics manufacturing	378	1.8

〔Note〕 In the statistics of the inward FDI stock by industry, the investment made by a subsidiary to the parent company is counted as the withdrawal of investment by the parent company (Directional Principle). Therefore, the calculation method differs from that of the statistics for inward investment stock by region and investment type.

[Source] "Balance of Payments" (Ministry of Finance)

Chart1-8 Inward FDI payees by region



[Source] "Balance of Payments" (Ministry of Finance)

[Note] 1) Yearly average, 2) Statistics for before 2013 is calculated based on BPM5. Statistics for 2014 and after is calculated based on BPM6.

3. Negative flow in 2015 for the first time in four years, but inflow greatly exceeded in 2016

Looking at the net inflow of direct investment in Japan in 2015, the total inflow dipped negative for the first time in the 4 years since 2011, with a net amount of minus 16.4 billion yen. In gross amount, both the amount of investment and recovered amount due to withdrawal decreased about 45%. Overall, there were fewer activities during the year.

By investment type, reinvestment of earnings, which is equivalent to changes in internal reserves of Japanese subsidiaries, was 1.21 trillion yen, while equity capital, which indicates stock acquisitions and capital contributions, was minus 16.8 billion yen. Debt instruments, which include debits and credits of fund transfers between parent and subsidiaries and acquisition/disposal of debts, were minus 1.20 trillion yen, and this offset the gain by reinvestment of earnings (Chart 1-9).

By region, negative flow was higher by 1.04 trillion yen for investments from Europe, whereas inflow was higher by 683.0 billion yen for investments from Asia and by 634.2 billion yen for North America, showing continuing high-level investments.

Overall, negative flow was higher caused by large-scale capital recoveries by multinational enterprises, which is represented by Suzuki's buying back of its stake held by Volkswagen of Germany (19.9% or about 500 billion yen). Investments from Europe were significantly negative in consequence of these capital recoveries, whereas investments from North America maintained the positive flow at the level of the previous year as a result of investments in the electric/electronic industry by companies such as Amkor Technology and investments in the tourism market including Bain Capital's acquisition of Ooedo-Onsen Holdings operating Japanese inns at hot-spring resorts and hot spring facilities.

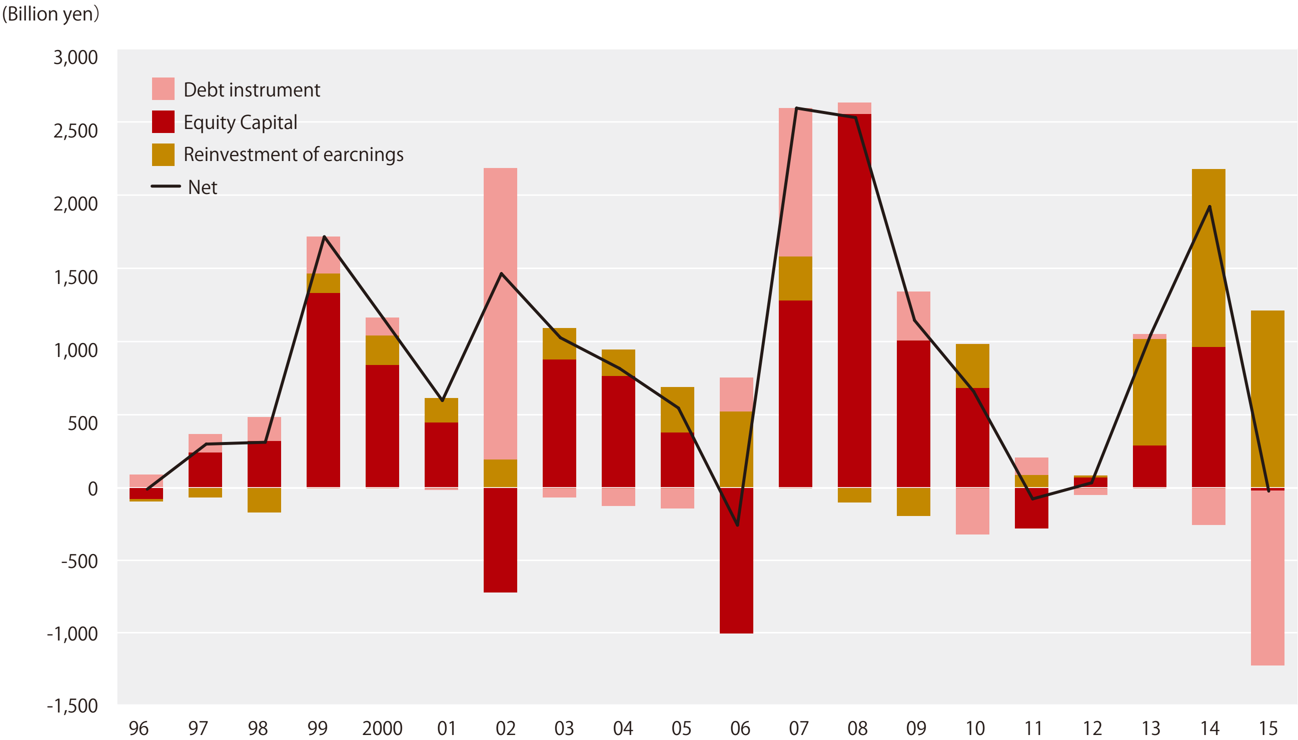
Investments from Asia were 683.0 billion yen. They slightly decreased from the level of the previous year that had large projects, but exceeded investments from North America and Europe. Asia further increased its presence as investor. By country, investments from countries with a financial center were strong, including 234.3 billion yen from Singapore and 154.1 billion yen from Hong Kong. Backed by the growth of the tourism market thanks to increasing tourists visiting Japan mostly from Asia, real estate investment trusts and other investment funds acquired properties such as commercial buildings and hotels one after another. Inflow of Asian capital continued with focus on tourism (Chart1-10, 1-11).

Just as in the previous year, major Asian companies cooperated with Japanese companies with a view to the Asian market. Representative cases include the establishment of a joint venture by Cheung Kong (Holdings) Limited that is a large conglomerate of Hong Kong and MC Aviation Partners (MCAP) that is an aircraft leasing company under Mitsubishi Corporation. Through the joint venture, Cheung Kong entered the Asian aircraft leasing business, which is expanding with the emergence of low cost carriers (LCC).

By industry, negative flow was higher for transportation equipment and chemical and pharmaceutical manufacturing in 2015, making the total of the manufacturing industry minus 289.4 billion yen. Inflow was higher for finance and insurance and communications but this was offset by the excess negative flow in wholesale and retail. As a result, direct investment in Japan for the non-manufacturing industry remained low at 17.0 billion yen.

In 2016, direct investment in Japan is picking up its liveliness. Direct investment for the period from January to June was 2.60 trillion yen, increasing by 709% on a year-to-year comparison (Chart1-10). As indicated in the results of a survey conducted by JETRO (described in the subsequent chapters), direct investment in Japan by foreign-affiliated companies is becoming more active.

Chart1-9 Changes in the flow of inward FDI by investment type



[Source] "Balance of Payments" (Ministry of Finance)

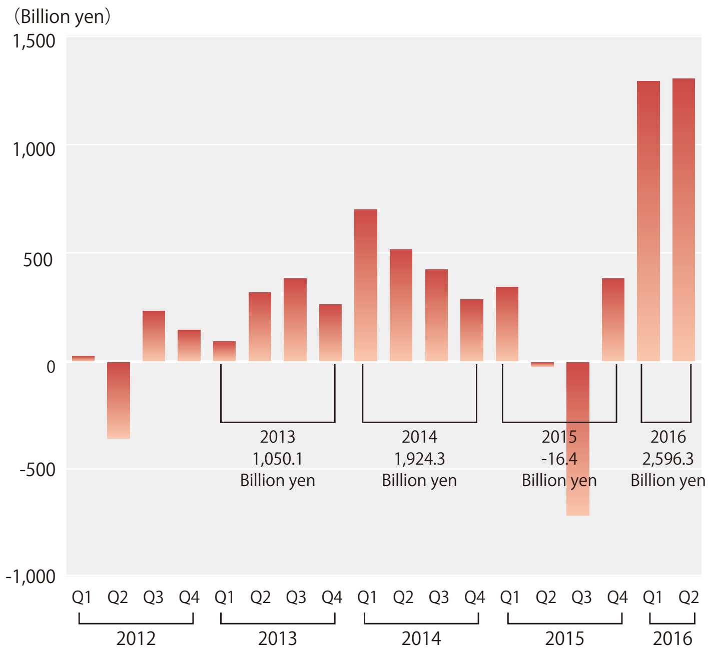
Chart1-10 Changes in the inward FDI flow by region

(Billion yen)

	2013	2014	2015	2016 Jan.-Jun. (P)	Year-on-year growth (%)
Asia	86	687	683	1,313	383%
China	14	80	67	3	-
Hong Kong	17	246	154	90	17%
Taiwan	18	118	74	29	11%
Korea	4	58	100	25	10%
ASEAN	32	185	286	1,173	796%
Singapore	33	155	234	1,132	1,060%
North America	136	725	634	378	92%
US	132	724	631	382	100%
Latin America	- 131	67	-257	41	49%
Oceania	37	61	75	28	-
Europe	97	317	-1,042	827	-
EU	128	268	-1,003	786	-
World	225	1,924	- 16	2,596	709%

[Note] Because of the changes in the calculation method of the balance of payments, there is no continuity between the data before 2013 and the data after 2014. The data for 2016 is provisional.
[Source] "Balance of Payments" (Ministry of Finance)

Chart1-11 Changes in the quarterly flow of inward FDI



[Note] Q1(Jan. ～ Mar.), Q2(Apr. ～ Jun.), Q3(Jul. ～ Sep.), Q4(Oct. ～ Dec.)
[Source] "Balance of Payments" (Ministry of Finance)

4. M&A in Japan was slow in 2015. Number of large projects increased in 2016 with expanded entry into the service market

M&A in Japan in 2015 (completed) decreased 27.0% from a year ago to 919.6 billion yen. Though the amount decreased due to fewer large projects, the number of projects was almost as high as the previous year (140 projects), with 120 projects. The amount turned to significant increase in 2016. M&A in Japan during the period from January to June already reached 2.7 trillion yen, which is second to the record high (3.6 trillion yen) in 2007. The amount was pushed up by acquisition of the operating rights of Kansai and Osaka International Airports by the consortium led by VINCI Airports (a leading airport operating company of France) and ORIX Corporation of Japan. The total transaction amount reached 2.25 trillion yen. The largest M&A in Japan in 2015 was the acquisition of USJ by NBCUniversal of the United States (183.0 billion yen). Both acquisitions are in the service sector. M&A in Japan in the service sector is expanding to hotels, business service and healthcare.

By industry, in the electric and electronic field where investment from the United States has been active, investment fund Kohlberg Kravis Roberts (KKR) acquired the DJ equipment business of Pioneer Corporation (59.0 billion yen). Investment from Europe stood out in medical care and pharmaceuticals. LEO Pharma of Denmark acquired the dermatology business of Astellas Pharma (89.2 billion yen) and AstraZeneca of UK acquired the respiratory business of Takeda Pharmaceutical Company (69.2 billion yen) (Chart 1-12).

In M&A in recent years, the trend of cooperation between Japanese companies and Asian companies is taking root. In addition to the project by Cheung Kong (Holdings) of Hong Kong and an aircraft leasing company under Mitsubishi Corporation described above, there was a capital tie-up between Mahindra & Mahindra (M&M) that is a dominant conglomerate of India and Mitsubishi Agricultural Machinery under Mitsubishi Heavy Industries.

Chart1-12 Top inward M&A deals (2015 to June 2016)

	Date Effective	Target Name	Industry Sector	Acquirer Name	Parent Nation	Industry Sector	Value (Billion ¥)	% Owned After Transaction
1	Apr. 2016	New Kansai Intl-Op Concession	Transportation & Infrastructure	Kansai Airports, a SPV formed by ORIX-VINCI Airports consortium	Japan, France	Transportation & Infrastructure	2,250.0	100.0
2	Nov. 2015	USJ Co Ltd	Recreation & Leisure	NBCUniversal Media LLC	United States	Broadcasting	183.0	51.0
3	Feb. 2016	One M Logistics 2 G.K	Real Estate	LaSalle LOGIPORT REIT	United States	Real estate Investment trusts	117.2	100.0
4	Apr. 2016	Astellas Pharma-Dermatology	Pharmaceuticals	LEO Pharma A/S	Denmark	Pharmaceuticals	89.2	100.0
5	Mar. 2015	MC Aviation Partners-15	Business Services (Leasing)	Cheung Kong(Holdings)Ltd	Hong Kong	Real Estate	83.3	100.0
6	May. 2016	Takeda Pharm-Respiratory	Pharmaceuticals	AstraZeneca PLC	United Kingdom	Pharmaceuticals	69.2	100.0
7	Mar. 2016	Nissin Kogyo-Brake Business	Automobiles & Components	Autoliv Holding Inc	Sweden	Automobiles & Components	65.0	100.0
8	Mar. 2015	Pioneer Corp-DJ Equipment	Electronics	KKR & Co LP	United States	Investor	59.0	85.1
9	Aug. 2015	ORIX Corp-Kirarito Ginza	Real Estate	SOFAZ	Azerbaijan	Investor	52.3	100.0
10	Oct. 2015	Bit-isle	Business Services (Data Center)	Equinix	United States	Business Services (Data Center)	52.0	96.8

〔Note〕1) As of June 2016, 2) Ranking according to single transaction amount, 3) Acquirer Name is the name of the final acquirer (including corporate group), 4) Acquisition of less than 10% of the stocks is not included in the Balance of Payments statistics.

〔Source〕Thomson Reuters