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Japanese Manufacturing Affiliates in Europe and Turkey

- 2008 Survey -

May 2009

**Japan External Trade Organization
(JETRO)**

Preface

The survey on the “Japanese manufacturing affiliates in Europe and Turkey” has been conducted 24 times since 1983*. The latest survey conducted from June 2008 to July 2008 focused on research and analyzed the business situation of Japanese manufacturing affiliates operating in Europe and Turkey and the activities (outlook of operating profit, managerial issues, procurement of parts and materials, sales and production setups, impact of the FTAs under negotiation between the EU and other Asian countries, etc.).

We would like to express our great appreciation to the affiliates for their kind cooperation for our survey, which, over the years, has enabled us to constantly improve both the survey itself and report on the results. We hope that this report helps the affiliates and the other parties understand business development in Europe and Turkey

The questionnaire for this survey was conducted from June to July 2008, before the collapse of major U.S. investment bank Lehman Brothers in September 2008. After the collapse of Lehman Brothers, the financial crisis spread rapidly on a global scale, and the economic situation of the world and the business environment for all enterprises has drastically changed in a short period of time. Please take this into consideration when reading this report.

October 2008

Europe Division
Middle East and Africa Division
Overseas Research Department
JETRO centers/offices in Europe and Turkey
Japan External Trade Organization (JETRO)

* Countries in Central and Eastern Europe and Turkey were included in the survey from 1998 and 1999 respectively.

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Overview of the Survey

This is the 24th of a series of surveys that has been conducted annually since 1983 by the JETRO offices based in Europe and Turkey.

1. Purpose of the Survey

This survey analyzes the activities of Japanese manufacturing affiliates operating in Europe and Turkey (operating profit forecasts of each company, managerial issues, procurement of parts and materials, sales and production setups, impact of the FTAs under negotiation between the EU and other Asian countries, etc.) for the purpose of assisting the implementation of strategic business planning and business activities at the Japanese enterprises.

2. Targets of the Survey

The survey targeted manufacturing companies in Turkey, 16 countries in Western Europe* and 10 countries in Central and Eastern Europe** where Japanese manufacturing affiliates are located. The targeted companies derive 10% or more of their investment from Japanese companies, both directly and indirectly. Survey also included companies (subsidiaries) set up by the Japanese affiliates already operating in Europe and other regions as well as companies that have completed local corporate registration but have not yet started operations.

* 16 countries in Western Europe (Ireland, The Netherlands, Belgium, Luxembourg, Portugal, Finland, Sweden, Denmark, UK, Germany, France, Italy, Spain, Greece, Austria, and Switzerland)

**10 countries in Central and Eastern Europe (Lithuania, Poland, Czech Republic, Slovakia, Hungary, Romania, Bulgaria, Slovenia, Serbia, and Montenegro)

3. Method of Conducting the Survey

The survey was conducted by sending an e-mail containing an Internet link (URL) to the online questionnaire form to the respondents and asking them to reply directly on line. As exceptions, some of questionnaire sheets were sent by mail or facsimile. The answers to the surveys sent by mail and facsimile have also been included in the tabulated results.

As this survey covered a number of companies operating overseas in various countries and industries, we endeavored to learn to the extent possible the exact number of Japanese affiliates that have entered into (or withdrawn from) the surveyed regions since the previous (23rd) survey. In the process, we added or deleted Japanese affiliates established or withdrawn in the regions before 2006 but that we had been unable to access at the time of the previous survey.

4. Period of the Survey

June through July 2008

5. Response Status

Of the 1,041 Japanese manufacturing enterprises identified as active in Europe or Turkey, we sent questionnaires to the 641 enterprises that agreed to cooperate in the survey. Of those, we received

responses from 364 companies (response rate of 56.8%).

6. Notes on the Survey Results

(1) The number of Japanese manufacturing affiliates was totaled using information sources that can be considered reliable by the JETRO offices in Europe and Turkey and through the cooperation of each company. However, we do not guarantee the accuracy and comprehensiveness of the information.

(2) Not all the respondents answered every question. The percentages in this report were calculated using the number of respondents who actually answered the specific question (rounded to two decimal places). The percentages do not necessarily add up to 100.0%.

Europe

I. Overview of Japanese manufacturing affiliates in Europe

[Number of Japanese manufacturing affiliates in Europe]

- The latest survey shows that there were 1,024 Japanese manufacturing affiliates operating in Europe at the end of 2007, 785 in Western Europe and 239 in Central and Eastern Europe. A total of 27 Japanese companies established affiliates in Europe in 2007, 12 in Western Europe and 15 in Central and Eastern Europe.

[By country]

- The UK was home to the largest number of Japanese companies, with 203, followed by Germany with 146 and France with 130. These three countries accounted for 46.8% of the total number of Japanese manufacturing affiliates operating in Europe.
- The Czech Republic, which has the greatest number of Japanese affiliates (84 companies) among Central and Eastern European Countries, has become the 4th largest manufacturing base for Japan among all European countries, followed by Poland, which became The 5th largest European manufacturing base for Japan in 2006 with 70 companies.

[By industry]

- The transportation machinery parts industry (automobiles, motorcycles) accounts for the largest number of Japanese affiliates with 213 (20.8% of the total), followed by the general machinery industry (including parts, molds and machinery tools) with 149 (14.6%), the chemical/petrochemical industry with 90 (8.8%) and the electric and electronic parts industry with 87 (8.5%).
- Of the 27 Japanese companies that established affiliates in Europe in 2007, the greatest number of companies belonged to the electric and electronic parts industry with 5 companies (18.5% of the total number of Japanese companies that established new affiliates), followed by the general machinery industry (including parts, molds and machinery tools) with 4 companies (14.8%).

[Number of R&D and Design Centers]

- At the end of 2007, 456 Japanese companies operated R&D and Design Centers in Europe, of which 147 companies operated independent R&D and Design Centers.

1. Two of the top five European manufacturing bases for Japanese companies are in Central and Eastern Europe

The latest survey shows that there were 1,024 Japanese manufacturing affiliates operating in Europe at the end of 2007, 785 in Western Europe and 239 in Central and Eastern Europe. By country, the UK was home to the largest number of Japanese companies with 203 companies, followed by Germany (146) and France (130). These three countries accounted for 46.8% of the total number of Japanese manufacturing affiliates operating in all of Europe, and 61.1% of the total in Western Europe.

The Czech Republic was the 4th largest European manufacturing base for Japan with 84 companies followed by Poland with 70 companies, indicating the growing presence of the Central and Eastern European countries as centers for the Japanese manufacturing industry.

The industry with the largest number of Japanese manufacturers was the transportation machinery parts industry (automobiles, motorcycles) with 213 companies (20.8% of the total), followed by the general machinery industry (including parts, molds and machinery tools) with 149 companies (14.6%), the chemical/petrochemical industry with 90 (8.8%) and the electric and electronic parts industry with 87 (8.5%). Together, these four industries accounted for 52.6% of the total.

There are some dominant industries particular to certain countries and regions. In Western Europe the dominant industries are the general machinery (including parts, molds and machinery tools), the transportation machinery parts (automobiles, motorcycles) and the chemical/petrochemical industries. In the U.K., the transportation machinery parts (automobiles, motorcycles), the general machinery (including parts, molds and machinery tools) and the electric and electronic machinery industries take the top spots. In France, the transportation machinery parts (automobiles, motorcycles), the food products, agricultural and fisheries products and the general machinery (including parts, molds and machinery tools) industries are dominant. In Germany, the general machinery (including parts, molds and machinery tools), the transportation machinery parts (automobiles, motorcycles) and the electric and electronic parts industries are dominant. In Central and Eastern Europe, the Japanese manufacturing bases are highly concentrated in the transportation machinery parts industry (automobiles, motorcycles) with 87 companies, which accounted for 36.4% of the total number of Japanese manufacturing affiliates operating in Central and Eastern Europe, followed by the electric and electronic parts industry with 38 companies (15.9% of the total).

Table 1: Top 4 Industries by Region/Country

	1st	2nd	3rd	4th
Europe [1024]	Transportation machinery parts (automobiles, motorcycles) 213 (20.8%)	General machinery (including parts, molds and machinery 149 (14.6%)	Chemical/petrochemical 90 (8.8%)	Electric and electronic parts 87 (8.5%)
Western Europe [785]	General machinery (including parts, molds and machinery 127 (16.2%)	Transportation machinery parts (automobiles, motorcycles) 126 (16.1%)	Chemical/petrochemical 84 (10.7%)	Other manufacturing 56 (7.1%)
UK (203社)	Transportation machinery parts (automobiles, motorcycles) 46 (22.7%)	General machinery (including parts, molds and machinery 38 (18.7%)	Electric and electronic machinery 22 (10.8%)	Chemical/petrochemical 16 (7.9%)
France [130社]	Transportation machinery parts (automobiles, motorcycles) 22 (16.9%)	Food products, agricultural and fisheries production processing 21 (16.2%)	General machinery (including parts, molds and machinery 18 (10.0%)	Chemical/petrochemical 12 (9.2%)
Germany [146]	General machinery (including parts, molds and machinery 33 (22.6%)	Transportation machinery parts (automobiles, motorcycles) 16 (11.0%)	Electric and electronic parts 15 (10.3%)	Chemical/petrochemical 14 (9.6%)
Central and Eastern Europe [239]	Transportation machinery parts (automobiles, motorcycles) 87 (36.4%)	Electric and electronic parts 38 (15.9%)	General machinery (including parts, molds and machinery 22 (9.2%)	Electric and electronic machinery 22 (9.2%)
Czech Republic [84]	Transportation machinery parts (automobiles, motorcycles) 34 (40.5%)	Electric and electronic parts 16 (19.0%)	Ceramics, soil and stone 8 (9.5%)	General machinery (including parts, molds and machinery 7 (8.3%)
Poland [70]	Transportation machinery parts (automobiles, motorcycles) 19 (27.1%)	General machinery (including parts, molds and machinery 10 (14.2%)	Electric and electronic machinery 9 (12.9%)	Electric and electronic parts 6 (8.6%)

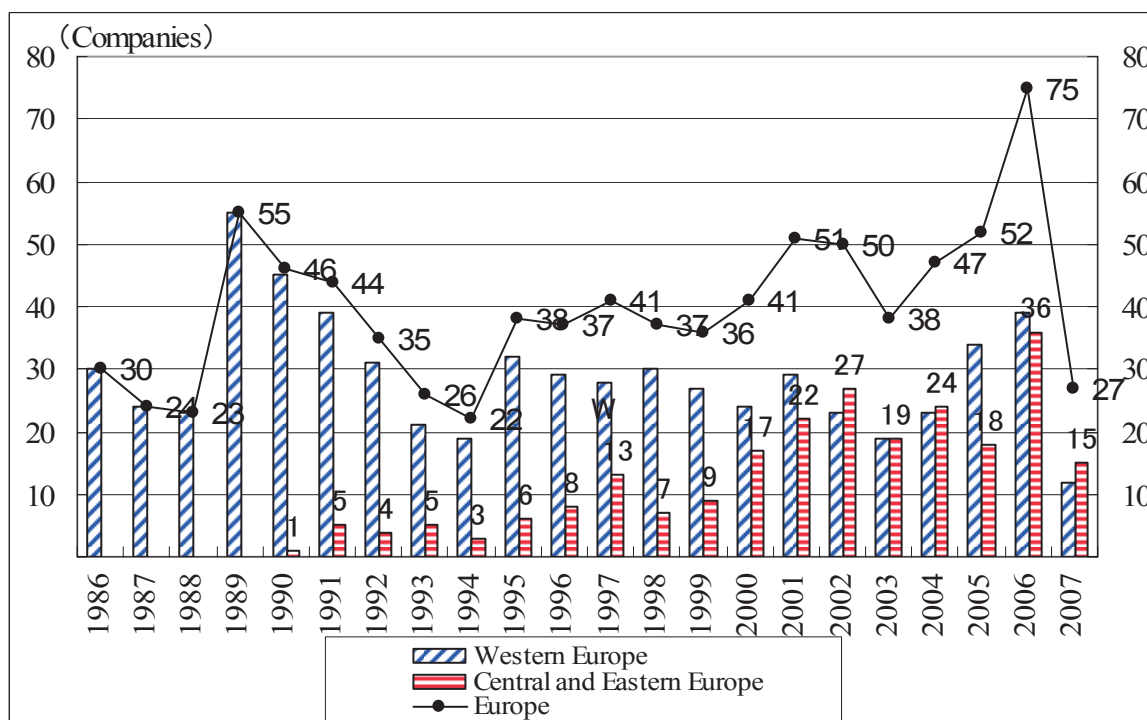
Source: JETRO Survey, Japan External Trade Organization

2. A slowdown in the number of Japanese companies establishing affiliates in 2007

During 2007, 27 Japanese companies established affiliates in Europe (12 in Western Europe and 15 in Central and Eastern Europe), which was a large decrease from the record 74 companies (39 in Western Europe and 35 in Central and Eastern Europe) established in 2006. The largest number of affiliates was established in the Czech Republic and Poland with 6 companies each, followed by Germany with 3 companies and Italy and Slovakia with 2 companies each.

Of the 15 companies that established affiliates in Central and Eastern Europe, 5 were in the electric and electronic machinery and parts industries. Of those 5 companies, 4 were related to LCD television production. Two of them were established in the Czech Republic and the other two in Poland. Because of the termination of analogue broadcasting and the transition to digital broadcasting, which started in 2007, a dramatic shift to flat-screen (LCD, plasma) televisions is now taking place in Europe. The EU imposes a 14% tariff for flat-screen TV imports into Europe, the largest market for flat-screen televisions. Consequently, from the second half of 2005 to 2006 there was a large influx of Japanese and other non-EU manufacturers of television sets and related parts into Central and Eastern Europe, mainly to the Czech Republic and Poland. These manufacturers were all determined to produce flat-screen television locally. Many of the manufacturers began full-production from 2007. This was also due to the fact that the tariffs on flat-screen panels were temporarily suspended until the end of 2006.

Diagram 2: Change in the number of Japanese Manufacturing Affiliates Established in Europe



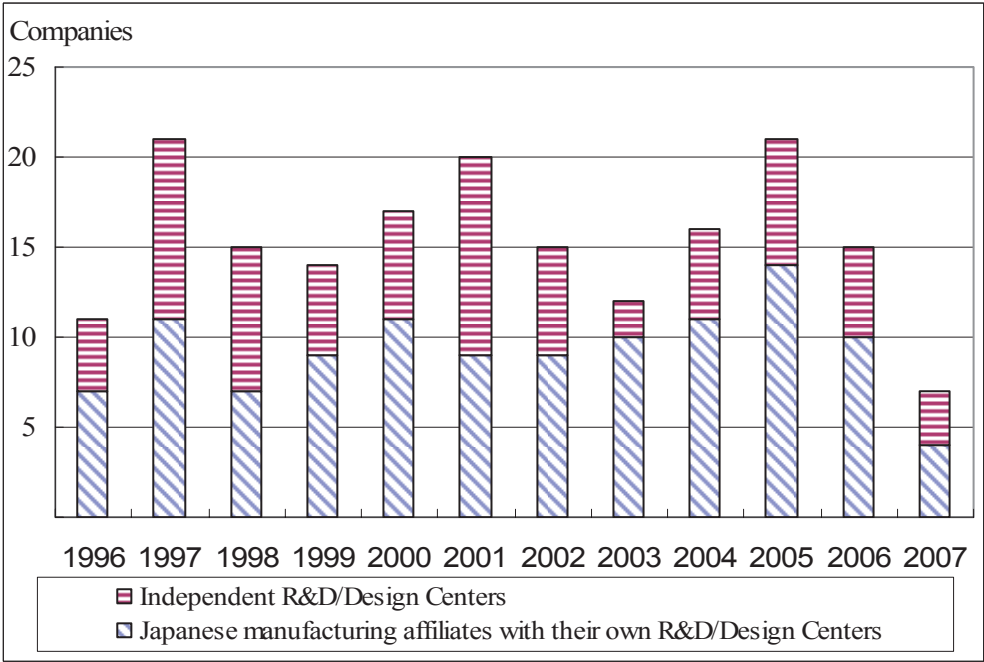
Source: JETRO Survey, Japan External Trade Organization

3. Concentration of R&D and Design Centers in Western Europe

At the end of 2007, 456 Japanese companies operating in Europe had R&D and Design Centers also located in Europe, out of which 147 operated independent R&D and Design Centers. 444 companies, or 97.4%, of these 456 companies had established R&D and Design Centers in Western Europe, and only 12, or 2.6%, had established such facilities in Central and Eastern Europe. By country, the UK had the most facilities with 153, followed by Germany (111) and France (54).

In 2007, 7 R&D and Design Centers were established in Europe, with the majority of them in Germany (with 4 facilities).

Diagram 3: Number of R&D and Design Centers Established by Year



Source: JETRO Survey, Japan External Trade Organization

II. Business Conditions and Prospects of Japanese Manufacturing Affiliates in Europe

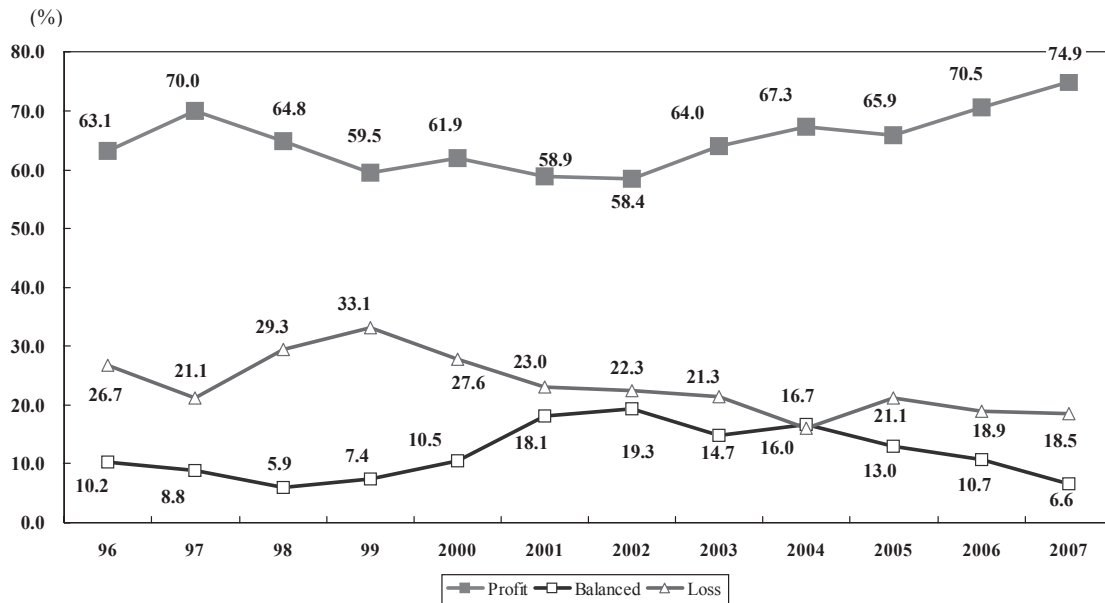
- 71.3% of the Japanese manufacturing affiliates in Europe recorded operating profits. In particular, the Japanese manufacturing affiliates in Western Europe continued to perform strongly, with 74.9% of them recording operating profits.
- For 2008, the number of companies projecting an “improvement” in operations decreased, while those projecting a “deterioration” increased.

1. Operating profits projected by 71.3%, losses by 21.5% for 2007

When asked about their operating results for 2007, 71.3% of the Japanese manufacturing affiliates operating in Europe replied that they recorded profits (up 2.5 points from the previous survey), while 7.2% replied that their profits and losses were “balanced” (down 4.3 points) and 21.5% replied that they recorded losses (up 1.8 points).

Of the Japanese manufacturing affiliates operating in Western Europe, 74.9% replied that they recorded profits (up 4.4 points from the previous year), while 18.5% replied that they recorded “losses (down 0.4 points). The percentage of companies recording profits was the highest since 1996.

Diagram 4: Operating Profits for Japanese Manufacturing Affiliates in Western Europe



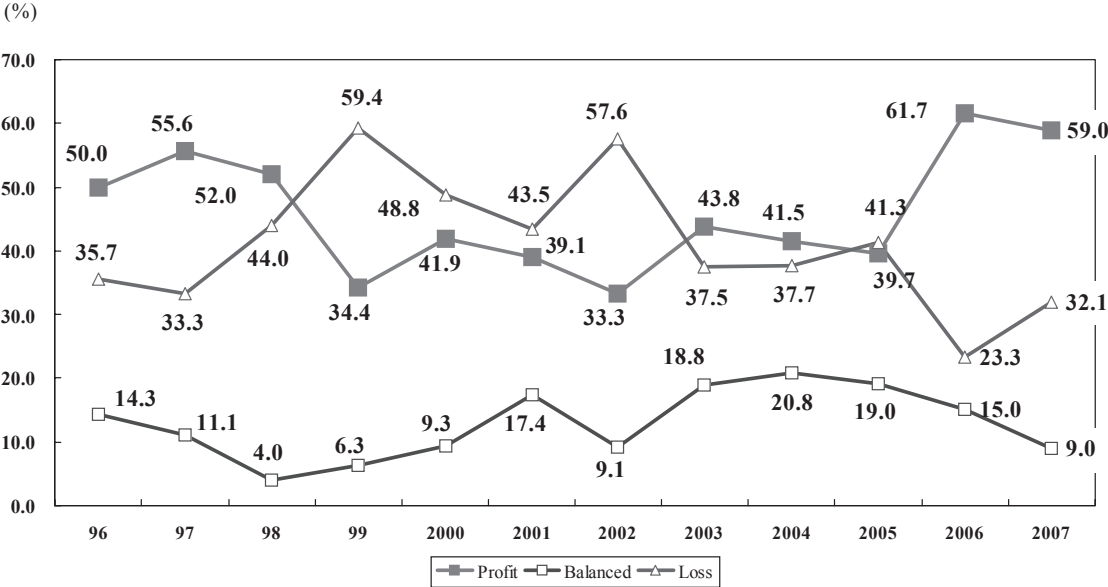
A country-by-country break down shows that a large portion of companies recorded profits in France (88.0% recording profits, 20.0% recording losses), the Netherlands (85.0% recording profits, 0.0% recording loss) and Spain (80.0% recording profits, 20.0% recording loss).

Among the industries with the largest numbers of Japanese manufacturing affiliates, the operating results were as follows: the transportation machinery parts industry (82.5% recording profits, 15.0% recording losses), the general machinery industry (76.9% recording profits, 15.4%

recording losses) and the chemical/petrochemical products industry (75.0% recording profit 18.8% recording loss).

On the other hand, of the Japanese manufacturing affiliates in Central and Eastern Europe, 59.0% replied that they recorded profits (down 2.7 points from the previous year), while 32.1% replied that they recorded losses (up 8.8 points). Although nearly 60% of the companies recorded profits, it was noteworthy that the percentage of companies that declared a loss had increased.

Diagram 5: Operating Profits for Japanese Manufacturing Affiliates in Central and Eastern



The percentage of companies recording profits was high in Hungary (73.7% recording profits, 21.1% recording losses) and the Czech Republic (71.4% recording profits, 19.0% recording losses).

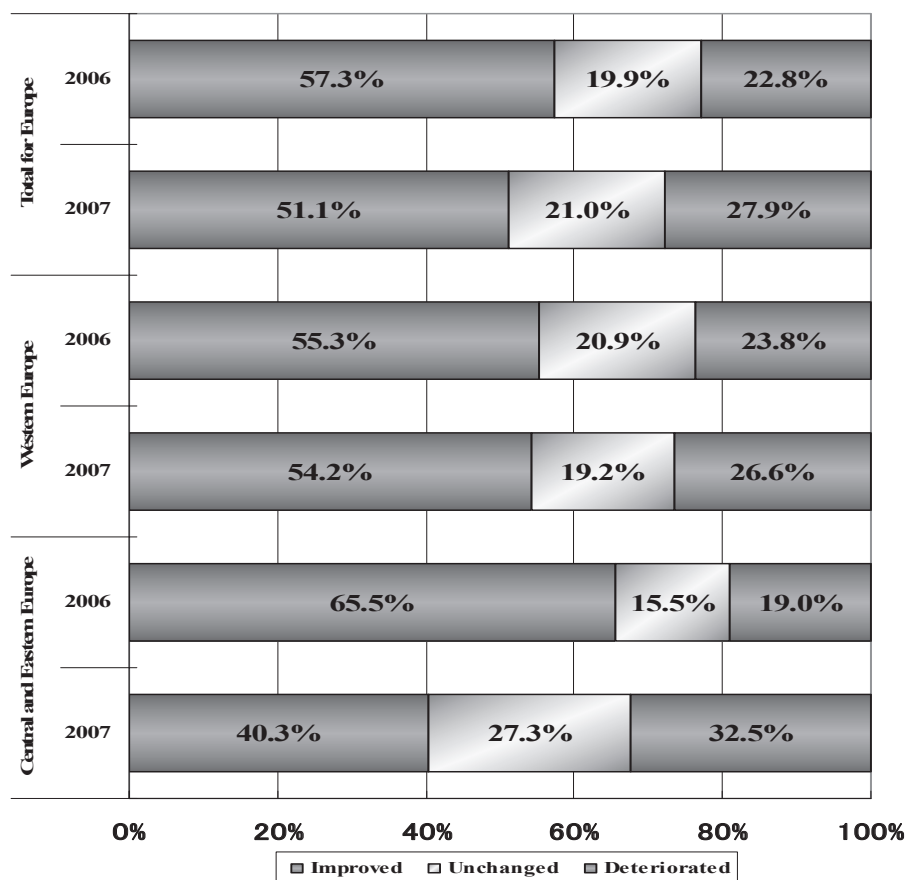
The percentage of companies recording profits in the three industries attracting the largest number of Japanese manufacturing affiliates are as follows: the transportation machinery parts industry (80.0% recording profits, 10.0% recording losses), the electric and electronic parts industry (37.5% recording profits, 50.0% recording losses) and the electric and electronic machinery industry (62.5% recording profits, 12.5% recording losses).

2. Decease in improvement on an operating basis in 2007; increased deterioration

The companies replying that their operating balance improved in 2007 compared to the previous year (2006) was accounted for 54.2% in Western Europe and 40.3% in Central and Eastern Europe. The percentage of companies replying that their operating balance deteriorated was 26.6% in Western Europe and 32.5% in Central and Eastern Europe. Compared to the previous survey on operating profit in 2006 relative to 2005, which was implemented from January to February 2007, the number of companies that answered “improved” decreased by 1.1%, and “deteriorated” increased by 2.8%. In Central and Eastern Europe, the number of companies that replied “improvements” dropped 25.2 %, “deterioration” rose by 13.5 %. These results indicate

slowdown of the European economy from its peak in 2006.

Diagram 6: Operating Results for Japanese Manufacturing Affiliates in Europe (Compared to the Previous Year)



Note: The figures for 2007 are from the previous survey which was conducted from January to February 2007.

Source: JETRO Survey, Japan External Trade Organization

As an reason of “improved” operating profit in 2007, the affiliates in Western Europe mentioned “increase in sales in market outside of the country where they have a base” most frequently (61.0%), followed by “increased sales in local markets” (56.8%). In addition to strong sales in Western Europe, increased sales to the rapidly growing markets of Central and Eastern Europe and Russia are thought to have contributed to the improvement of the affiliates’ operating results. “increased productivity” (45.9%) is also a frequent answer.

In Central and Eastern Europe, the most frequent answer is “increased sales in markets outside of our location”(cited by 68.0%), indicating brisk sales to Western Europe, the main export destination for production bases in Central and Eastern Europe. It is also noteworthy that a large percentage affiliates cited “increased productivity” (54.8%). Among the reasons given for deteriorating operating profits, the largest number of affiliates cited “increased personnel costs” (68.0%), which clearly proves that Japanese manufacturing affiliates in Central and Eastern Europe have trouble in absorbing rising labor cost.

**Table 7: Top Reasons for the Improvement (Deterioration) in Operating Profit in 2007
(Multiple responses allowed)**

**Reasons for Improvement of Operating Profit in
2007 (Multiple responses allowed)
Japanese Manufacturing Affiliates in Western
Europe**

Reason	Number of replies	Percentage
Increased sales in markets outside of our location	89	61.0%
Increased sales in local markets	83	56.8%
Increased productivity	67	45.9%
Increased the sales price	34	23.3%
Reduced personnel costs	23	15.8%

**Reasons for Deterioration of Operating Profit in
2007 (Multiple responses allowed)
Japanese Manufacturing Affiliates in Western
Europe**

Reason	Number of replies	Percentage
Decline in sales prices	28	38.9%
Increased personnel costs	27	37.5%
Increased energy prices	24	33.3%
Decreased sales in local markets	19	26.4%
Decreased sales in market outside of our location	19	26.4%

**Japanese Manufacturing Affiliates in Central and
Eastern Europe**

Reason	Number of replies	Percentage
Increased sales in markets outside of our location	20	64.5%
Increased productivity	17	54.8%
Increased sales in local markets	13	41.9%
Exchange rate gains	10	32.3%
Decrease in imports and procurement costs	9	29.0%

**Japanese Manufacturing Affiliates in Central and
Eastern Europe**

Reason	Number of replies	Percentage
Increased personnel costs	17	68.0%
Increased energy prices	13	52.0%
Decline in sales prices	11	44.0%
Increased administrative expenses/utilities	9	36.0%
Exchange rate losses	9	36.0%

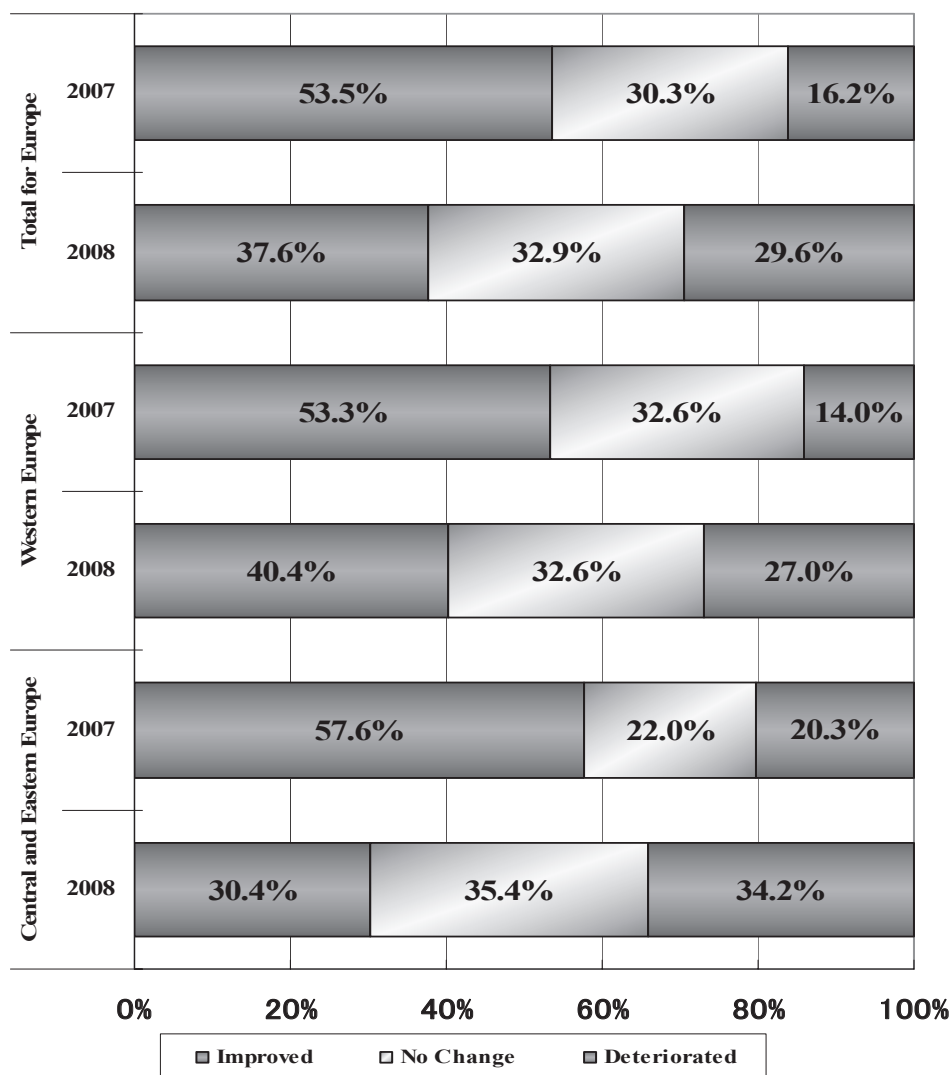
Source: JETRO Survey, Japan External Trade Organization

3. “Deterioration” on an operating basis projected for 2008 by more companies

To the question on outlook for operating profits in 2008, 62.6% of the Japanese manufacturing affiliates answered “improved”, 21.6% answered “unchanged”; and 15.8% answered “deterioration.” A breakdown into Western and Central/Eastern Europe shows that in Western Europe an “improvement” was projected by 66.8%, “unchanged” by 19.6%, and “deterioration” by 13.7%. In Central and Eastern Europe, on the other hand, “improvement” was projected by 48.1%, “unchanged” by 28.6%, and “deterioration” by 23.4%.

The percentage of companies that expected operating balanced in 2008 to be “improved” compared to the previous year (2007) stood at 37.6% (down 15.9 points compared to the previous year), while those forecasting operating balance to be “deterioration” rose to 29.6% (up 13.4 percents). A breakdown into Western and Central/Eastern Europe shows that in Western Europe an “improvement” was projected by 40.4% (down 12.9 points) compared to the previous year. In Central and Eastern Europe, an “improvement” was projected by 30.4% (down 27.2 points). On the other hand, a “deterioration” was projected by 27.0% in Western Europe (up 13.0 points) and by 34.2% in Central and Eastern Europe (up 13.9 points). Although this survey was conducted prior to the collapse of Lehman Brothers, the results indicate the deterioration of business conditions due to the deceleration of the European economy.

**Diagram 8: Operating Profit Outlook for Japanese Manufacturing Affiliates in Europe
(Compared to the Previous Year)**



Note: The figures for 2007 are from the previous survey which was conducted from January to February 2007.

Source: JETRO Survey, Japan External Trade Organization

As a ground for prospect for “improved” operating profit in 2008, “increased sales in markets outside of our location” and “increased productivity” are cited most frequently (52.3%, respectively), followed by “increased sales in local markets” (49.5%) in Western Europe. This indicates that in addition to sales in Western Europe these companies are anticipating increased sales in the emerging markets of Central and Eastern Europe and Russia, which continue to grow rapidly. On the other hand, the major reasons cited for “deterioration” were “increased energy prices” (45.8%), “decreased sales in markets outside of our location” (44.4%), and “increased personnel costs” (38.9%).

In Central and Eastern Europe, as well, “increased sales in markets outside of our location” and “increased productivity” were cited most frequently as reasons for expecting an improvement

(58.3% respectively), indicating that sales were brisk to Western Europe, the main export destination for production bases in Central and Eastern Europe. On the other hand, the major reasons cited for predicting “deterioration” operating balance were “decline in sales prices” (63.0%), followed by “increased personnel costs” (59.3%) and “increased energy prices” (55.6%).

Table 9: Top Reasons for the Projecting an Improvement (Deterioration) in Operating Profits in 2008 (Multiple responses allowed)

Reasons for Improvement of Operating Profit in 2007 (Multiple responses allowed)

Japanese Manufacturing Affiliates in Western Europe

Reason	Number of replies	Percentage
Increased sales in markets outside of our location	89	61.0%
Increased sales in local markets	83	56.8%
Increased productivity	67	45.9%
Increased the sales price	34	23.3%
Reduced personnel costs	23	15.8%

Japanese Manufacturing Affiliates in Central and Eastern Europe

Reason	Number of replies	Percentage
Increased sales in markets outside of our location	20	64.5%
Increased productivity	17	54.8%
Increased sales in local markets	13	41.9%
Exchange rate gains	10	32.3%
Decrease in imports and procurement costs	9	29.0%

Reasons for Deterioration of Operating Profit in 2007 (Multiple responses allowed)

Japanese Manufacturing Affiliates in Western Europe

Reason	Number of replies	Percentage
Decline in sales prices	28	38.9%
Increased personnel costs	27	37.5%
Increased energy prices	24	33.3%
Decreased sales in local markets	19	26.4%
Decreased sales in market outside of our location	19	26.4%

Japanese Manufacturing Affiliates in Central and Eastern Europe

Reason	Number of replies	Percentage
Increased personnel costs	17	68.0%
Increased energy prices	13	52.0%
Decline in sales prices	11	44.0%
Increased administrative expenses/utilities	9	36.0%
Exchange rate losses	9	36.0%

Source: JETRO Survey, Japan External Trade Organization

III. Procurement, Sales and Production Setups

1. Procurement source of parts and materials and procurement policy

- Japanese manufacturing affiliates in Central and Eastern Europe are rapidly switching to local procurement.
- Central and Eastern Europe are the most targeted regions for “expansion/reinforcement” among present procurement sources, followed by ASEAN.
- Expectations are high for Central and Eastern Europe as well as for China as future procurement sources.

(1) Present procurement source

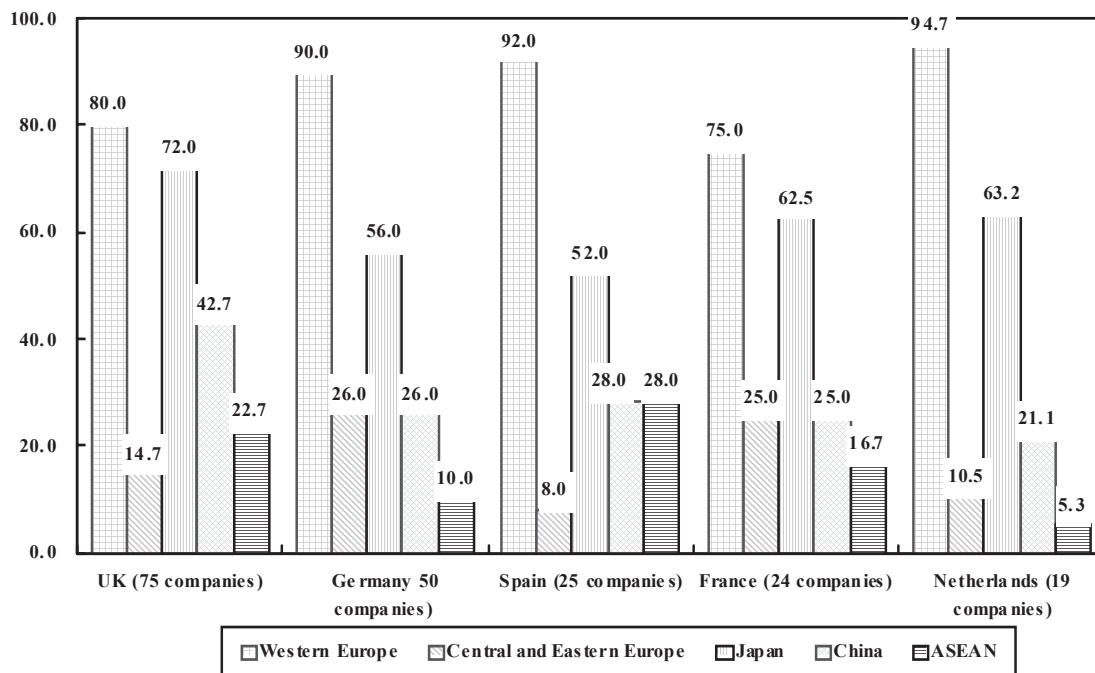
The major sources of procurement for parts and materials (excluding machinery parts for production facilities used in the production process; hereinafter the same applies) by Japanese manufacturing affiliates in Western Europe are Western Europe (cited by 85.0%) and Japan (61.7%), followed by China (29.3%), Central and Eastern Europe (17.7%) and ASEAN (16.9%).

Procurements from China (up 6.0 points compared to the previous year) and Western Europe (up 4.5 points) have increased while procurements from Japan (down 1.9 points) and Central and Eastern Europe (down 1.7 points) have decreased.

Country-by-country characteristics concerning procurement sources are as follows:

- U.K.: The ratio of procurement from China is significant (42.7%).
- Germany: The ratio from Central and Eastern Europe is larger than that for other procurement sources (26.0%).
- Spain: The ratio from ASEAN countries is larger than that for other procurement sources (28.0%).
- France: The ratio from Central and Eastern Europe is larger than that for other procurement sources (25.0%).
- Netherlands: The ratio of procurement from Western Europe is significant (94.7%).

Diagram 10: Major Procurement Sources for Japanese Manufacturing Affiliates in Western Europe (by region/country)



Source: JETRO Survey, Japan External Trade Organization

(Multiple responses allowed)

Major procurement sources by industry are as follows (numbers within parentheses indicate percentage of replies):

Transportation machinery parts: Western Europe (80%), Japan (67.5%), ASEAN (27.5%), China (22.5%)

Electric and electronic machinery: Western Europe (82.1%), Japan (71.4%), China (39.3%), ASEAN (25.0%)

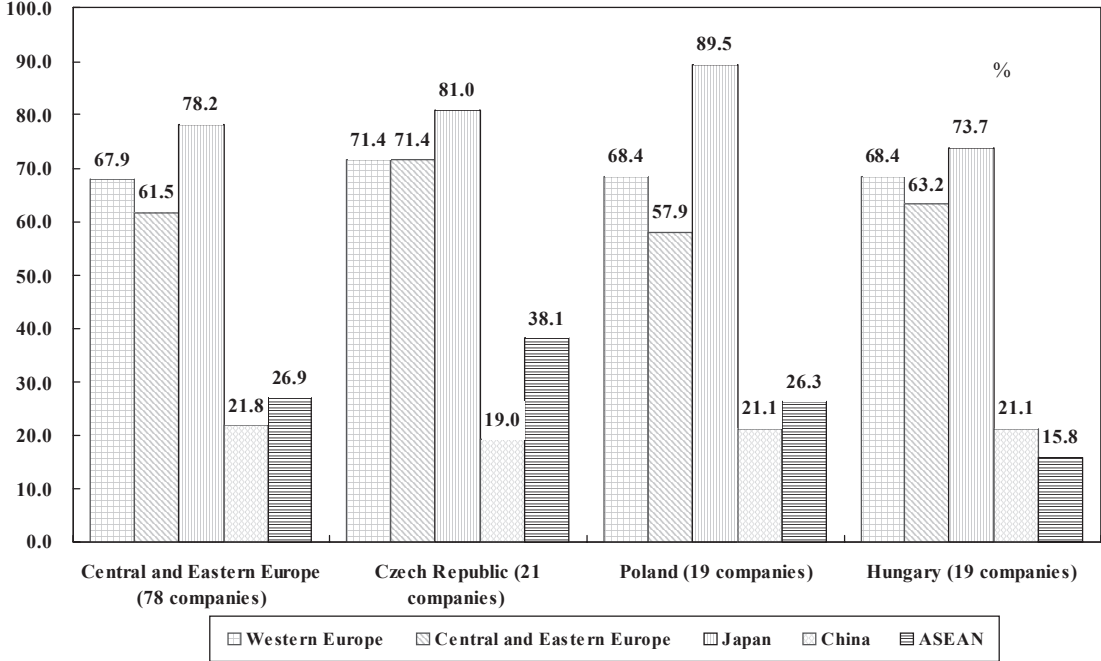
General Machinery: Western Europe (87.5%), Japan (71.4%), China (45.8), Central and Eastern Europe (37.5%)

The major procurement sources of parts and materials for Japanese manufacturing affiliates operating in Central and Eastern Europe, on the other hand, are Japan (cited by 78.2%), Western Europe (67.9%) and Central and Eastern Europe (61.5%). ASEAN and China were cited as procurement sources by only 26.9% and 21.8% of the respondents, respectively. Central and Eastern Europe, which are where the affiliates are located, have been growing rapidly as procurement sources, as indicated by the 17.4 point gain compared to the previous year. This fact proves that Central and Eastern Europe are becoming major procurement sources like Western Europe.

When broke down by industry, Japan (77.4%), Western Europe (77.4%) and Central and Eastern Europe (74.2%) are the main procurement sources of the transportation machinery parts sector;

over 70% are from Japan (75.0%) and Western Europe (75.0%) for the electric and electronic parts sector.

Diagram 11: Major Procurement Sources for Japanese Manufacturing Affiliates in Central and Eastern Europe (by region/country)



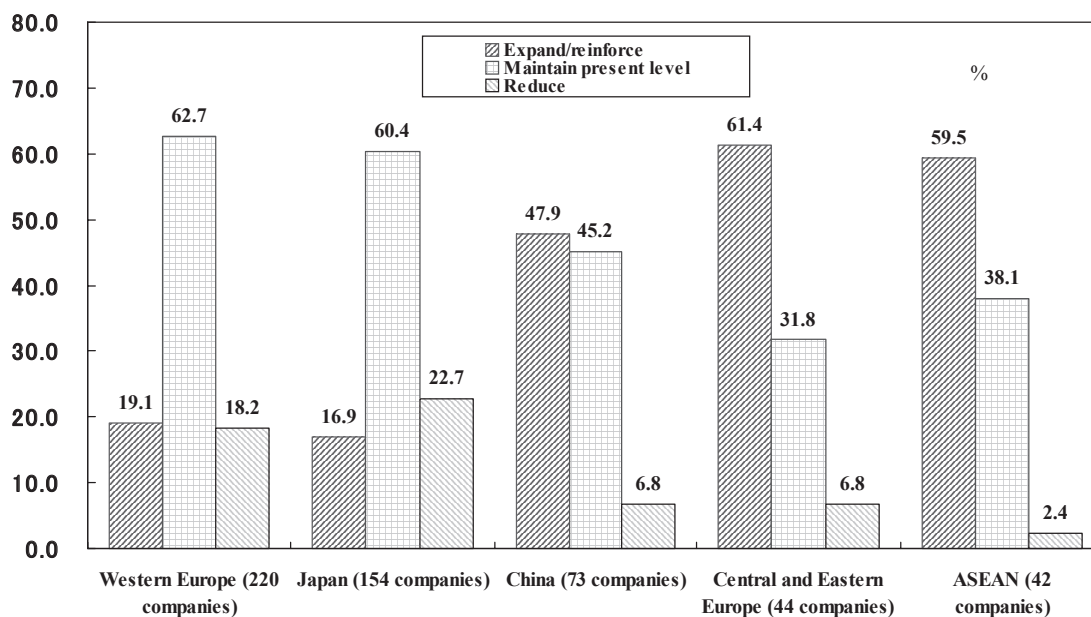
Source: JETRO Survey, Japan External Trade Organization (Multiple responses allowed)

(2) Future procurement policy

Central and Eastern Europe (61.4%) and ASEAN (59.5%) top the list of regions/countries where Japanese manufacturing affiliates operating in Western Europe plan to expand procurement. When the answers from the Central and Eastern Europe are broken down by country, the Czech Republic, Hungary and Poland have a majority.

With regard to procurement from Japan, 16.9% have plans for expansion/reinforcement, 60.4% plan to maintain the present level, while 22.7% plan a reduction.

Diagram 12: Future Procurement Policies of Japanese Manufacturing Affiliates in Western Europe for Current Major Procurement Sources



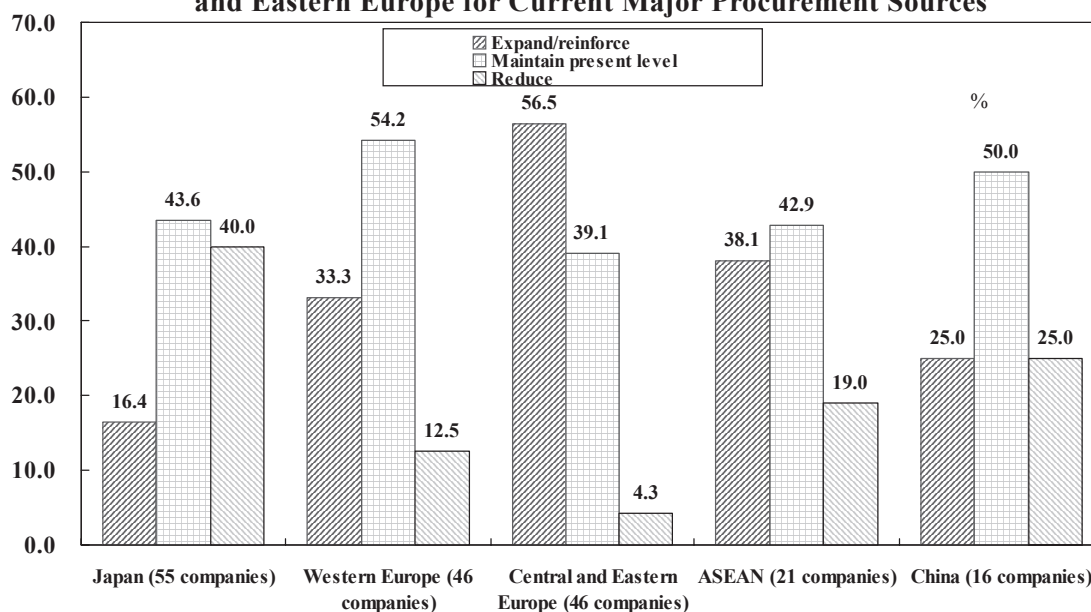
Source: JETRO Survey, Japan External Trade Organization

(Multiple responses allowed)

Central and Eastern Europe (56.5%) and ASEAN (38.1%) top the list of regions/countries where Japanese manufacturing affiliates operating in Central and Eastern Europe plan to expand procurement. As well as in Western Europe, procurement from Central and Eastern Europe is also expected to further increase.

With regard to procurement from Japan, 16.4% have plans for expansion/reinforcement, 43.6% plan to maintain the present level, while 40.0% plan a reduction.

Diagram 13: Future Procurement Policies of Japanese Manufacturing Affiliates in Central and Eastern Europe for Current Major Procurement Sources



Source: JETRO Survey, Japan External Trade Organization

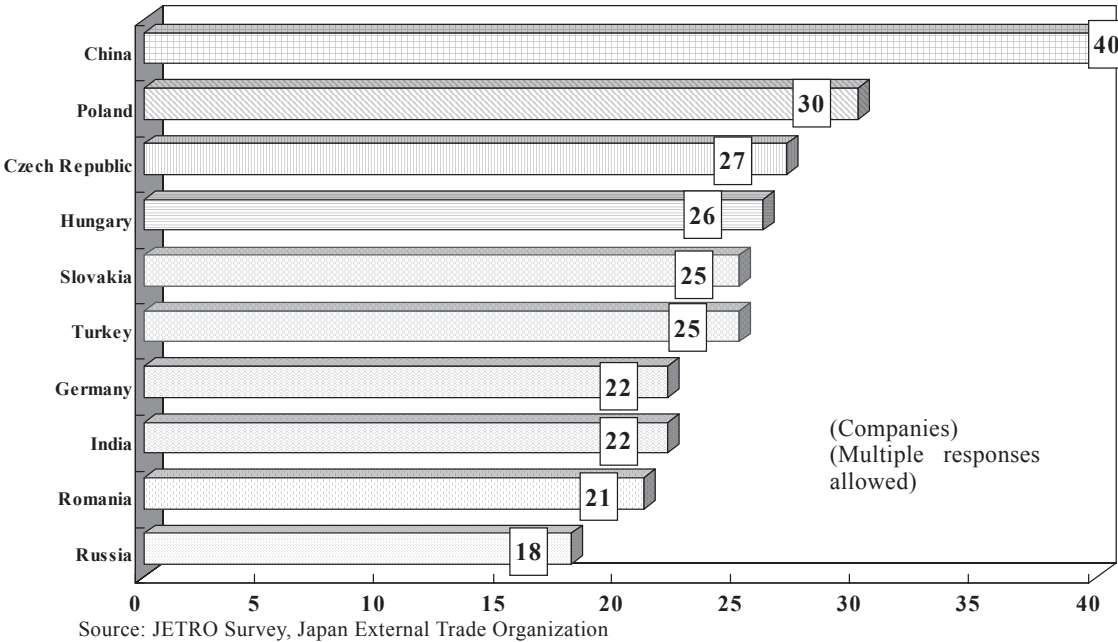
(Multiple responses allowed)

(3) Future procurement sources

Among the regions/countries being considered by the Japanese manufacturing affiliates operating in Europe as future procurement sources, China tops the list with 40 replies, followed by the Central and Eastern European countries of Poland with 30, Czech Republic with 27, Hungary with 26 and Slovakia with 25.

This Result implies that Central and Eastern Europe, where concentration of automobile industry and electric and electronic machinery industries is progressing, is highly expected to be future procurement sources.

Diagram 14: Countries Considered by Japanese Manufacturing Affiliates in Europe as Candidates for Future Procurement Sources



2. Sales destinations and sales policies

- The production bases of the Japanese manufacturing affiliates in Europe primarily focus on the local production of products intended for the European market, mainly Western Europe. They are also expanding sales to Central and Eastern Europe.
- Japanese manufacturing affiliates in Europe are planning to expand/reinforce their sales in Russia/CIS as well as in Central and Eastern Europe.
- Japanese manufacturing affiliates in Europe have high expectations for future sales in the rapidly growing Russian market. They also consider Eastern Europe and Turkey, which have thriving market, not only just as a production but also as promising markets.

(1) Present sales destinations

Currently, most of the Japanese manufacturing affiliates' sales in Europe are to Western Europe (cited by 93.1%) and Central Eastern Europe (54.5%), followed by Russia/CIS (22.8%), Turkey (19.3%) and Japan (17.8%). This result makes it clear that the production bases of Japanese manufacturing affiliates in Europe are established mainly as local bases to produce products intended for the European market.

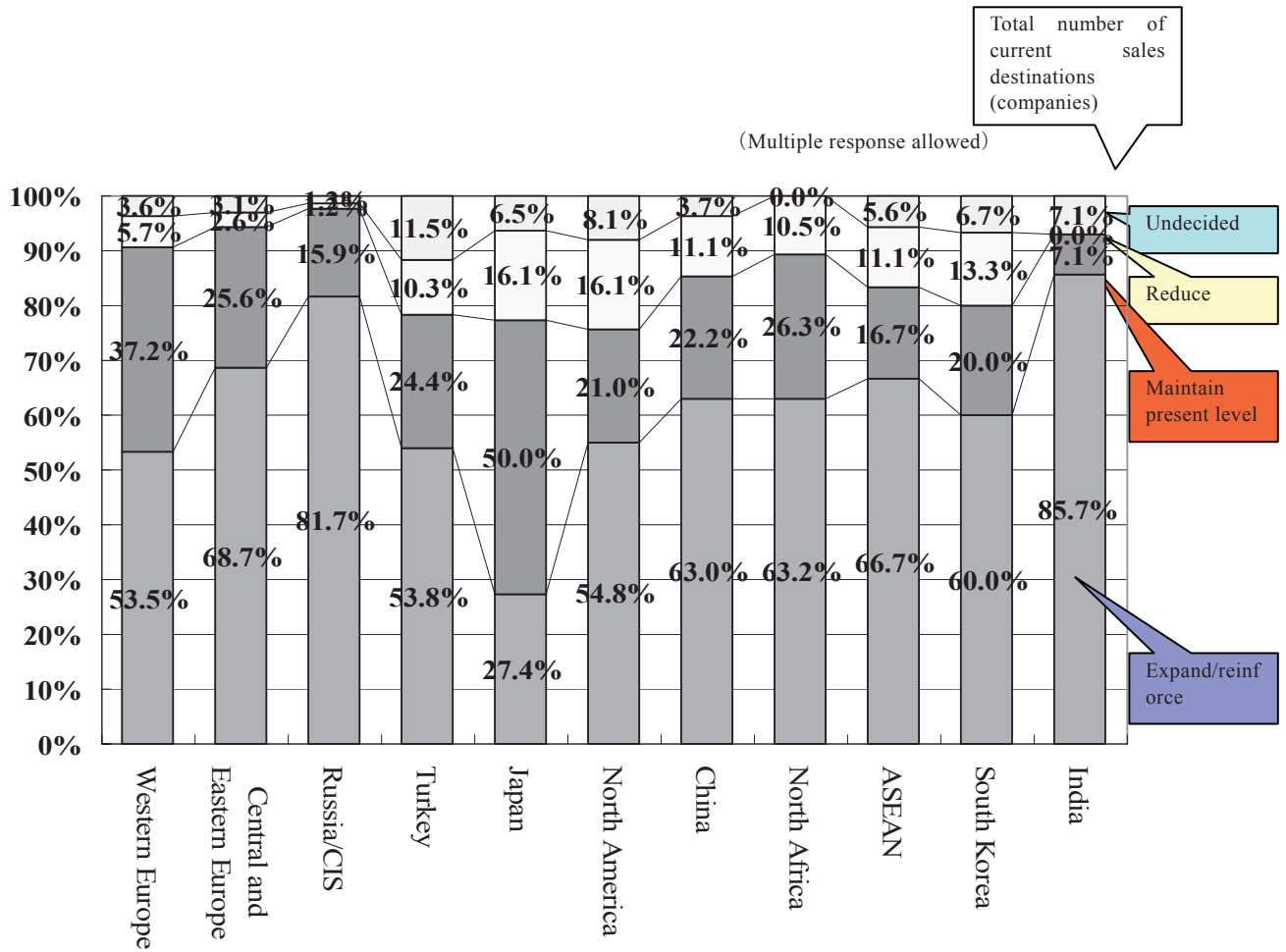
On the other hand, Japanese manufacturing affiliates in Western Europe currently develop business relationship with Western Europe (96.3%), followed by Central and Eastern Europe (48.3%). For Japanese manufacturing affiliates in Central and Eastern Europe, most of the sales are to Western Europe (82.1%) and Central and Eastern Europe (75.6%).

Moreover, compared to the previous survey (conducted from January to February 2007), more Japanese manufacturing affiliates in Western Europe and Central and Eastern Europe cited Central and Eastern Europe and Russia/CIS as major sales destinations. Compared to the previous survey, Japanese manufacturing affiliates operating in Western Europe that cited Central and Eastern Europe as a major sales destination increased from 39.1% to 48.3%. The number of Japanese manufacturing affiliates operating in Central and Eastern Europe with the same replies also increased dramatically from 61.8% to 75.6%. Similarly companies located in Western Europe that citing Russia/CIS increased from 17.4% to 25.7%, companies in Central and Eastern Europe with the same response increase from 9.1% to 12.8%.

(2) Future sales policy for established sales destinations

With regard to future sales policies for established sales destinations, many Japanese manufacturing affiliates in Western Europe plan to expand or reinforce their sales in Russia /CIS (cited by 81.0%) and Central and Eastern Europe (69.3%).

Diagram 15: Future Sales Policies for Current Major Sales Destinations

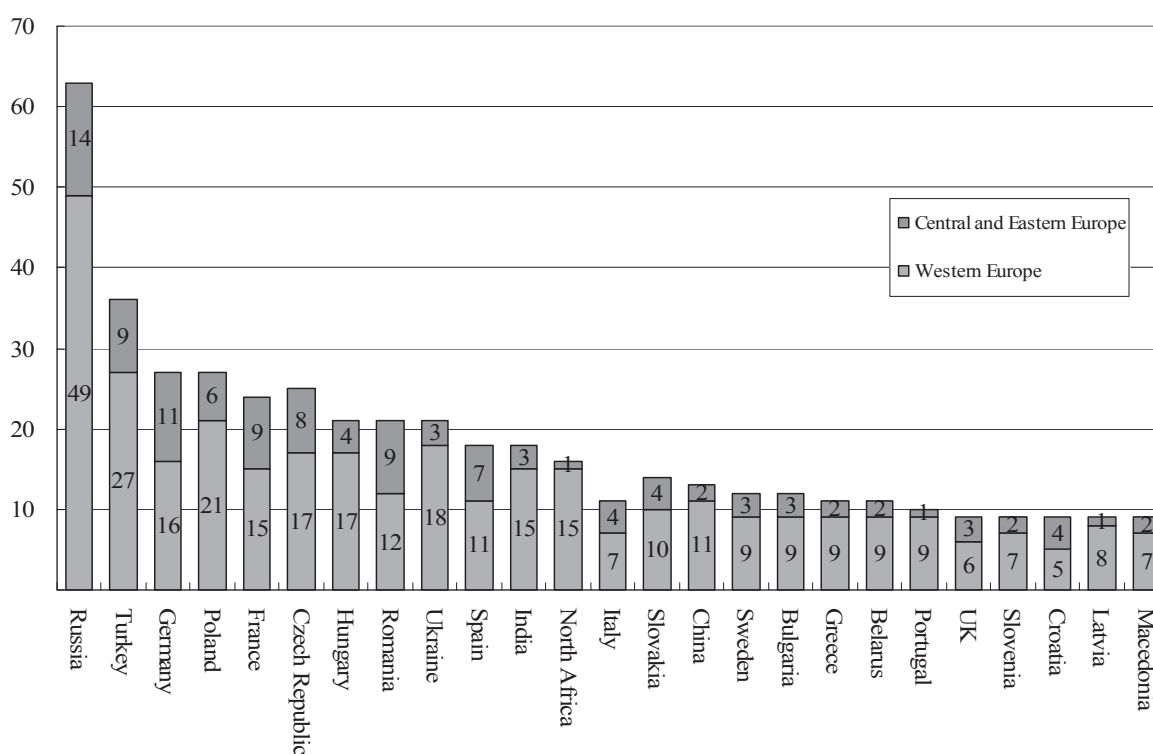


Source: JETRO Survey, Japan External Trade Organization

(3) Countries/regions being considered as candidates for future sales

Among the countries/regions that are currently not included in the target of sales but are being considered for future sales, Russia came first with 63 replies, followed by Turkey (36), Germany (27), Poland (27), Czech Republic (25), France (24), Hungary (21), Romania (21) and Ukraine (21).

Diagram 16: Countries/regions Being Considered for Future Sales



Source: JETRO Survey, Japan External Trade Organization

Responses to the questions "(2) Future sales policy for established sales destinations" and "(3) Countries/regions being considered as candidates for future sales" mentioned above clearly indicate that the Japanese manufacturing affiliates operating in Europe have high expectations for sales in the rapidly growing Russian market. It was also confirmed that Japanese manufacturing affiliates operating in Europe consider the thriving markets of Central and Eastern Europe and Turkey not only as production bases but also as potentially promising markets in their own rights. Moreover, it was evident that they are exploring the possibilities of expanding further into the neighboring emerging markets of Ukraine, North Africa and the Balkan countries.

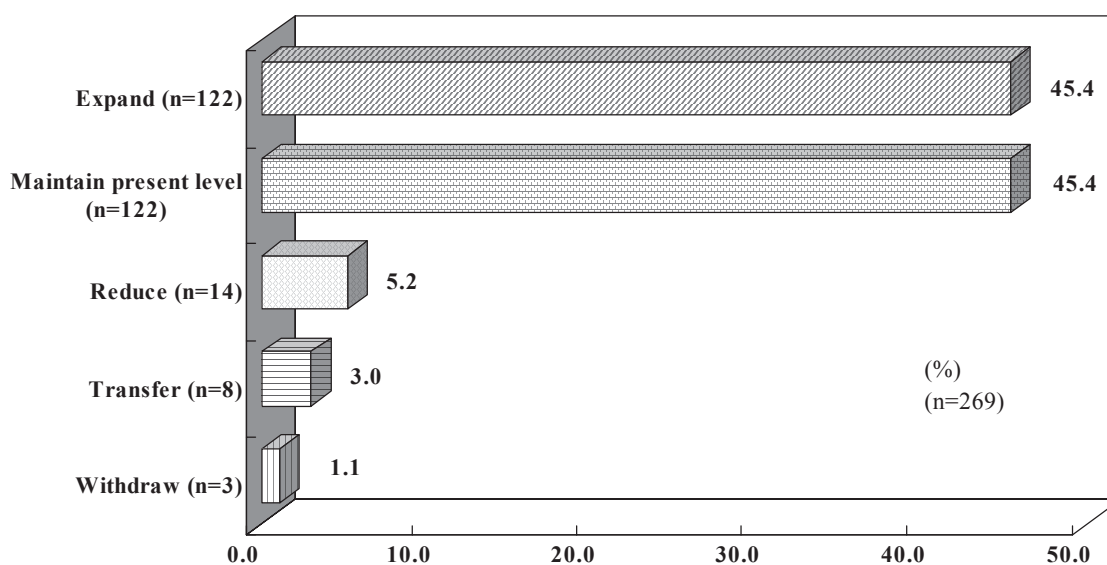
3. Production Setups

- 45.4% of Japanese manufacturing affiliates in Western Europe and 55.7% of Japanese manufacturing affiliates in Central and Eastern Europe plan to expand their operations in the next 1-2 years.
- Promising production bases in the mid-to-long-term (5-10 years) are Russia, Poland, Czech Republic, China, India and Romania.

(1) Business development in the next 1-2 years

With regard to business development in the next 1-2 years, 45.4% of Japanese affiliates operating in Western Europe plan to expand their operations, 45.4% plan to maintain the current level of production, 5.2% plan to reduce production, 3.0% plan to transfer production bases and 1.1% plan to withdraw. The percentage of companies planning to expand their business has not changed since the last survey (45.7% replied they were planning to expand).

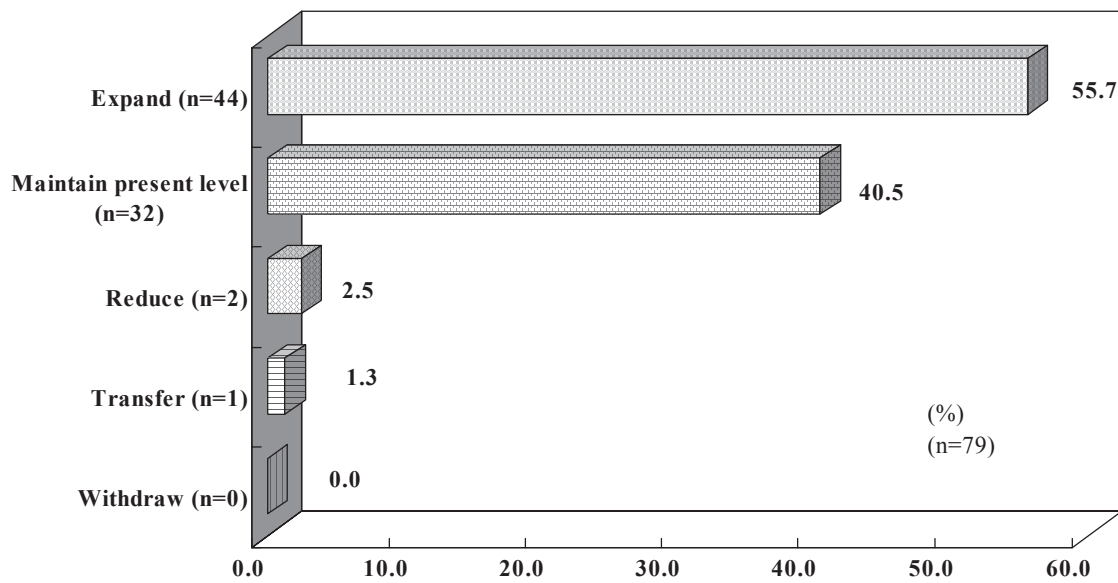
Diagram 17: Business Developments by Japanese Manufacturing Affiliates in Western Europe in the Next One to Two Years



Source: JETRO Survey, Japan External Trade Organization

With regards to the business development plan in the next 1-2 years for Japanese affiliates operating in Central and Eastern Europe, 55.7% plan to expand their operations, 40.5% plan to maintain the current level of production, and 2.5% plan to reduce production, 1.3% plan to transfer production bases and 0% plan to withdraw. The percentage of companies planning to expand decreased substantially (previous survey: 75.4%, current survey: 55.7%) since the last survey, while those planning to maintain the current level of production increased (previous survey: 21.3%, current survey: 40.5%)

Diagram 18: Business Developments by Japanese Manufacturing Affiliates in Central and Eastern Europe in the Next One to Two Years

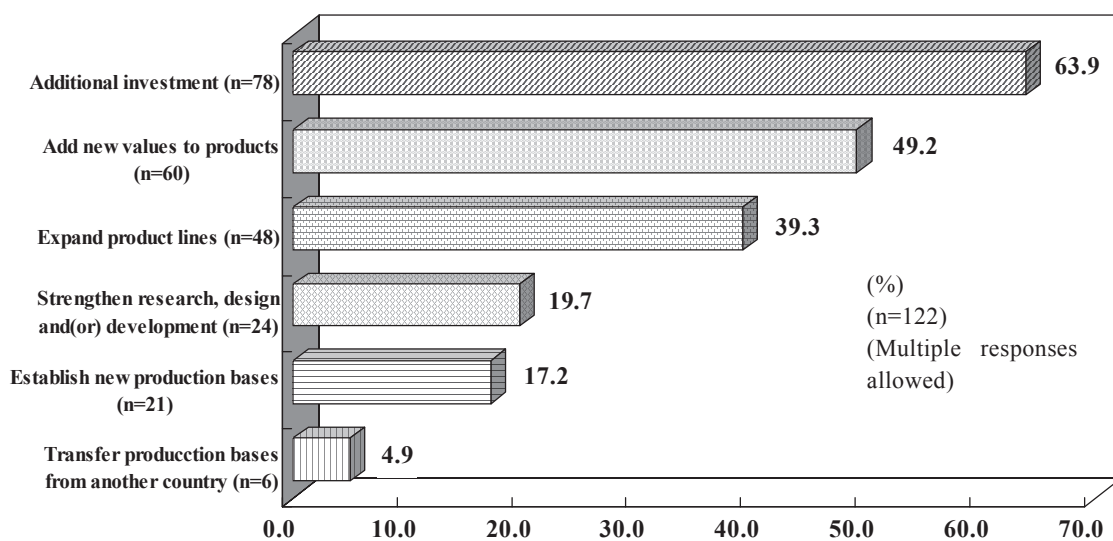


Source: JETRO Survey, Japan External Trade Organization

(2) Specific policies of the companies that intend to expand their business activities

When the Japanese manufacturing affiliates operating in Western Europe that indicated they plan to expand their business activities were asked about specific policies, expanding the size of their business through additional investment (63.9%) was the most frequently cited policy, followed by the adding new value to their products (49.2%) and expanding (diversifying) their product line (39.3%).

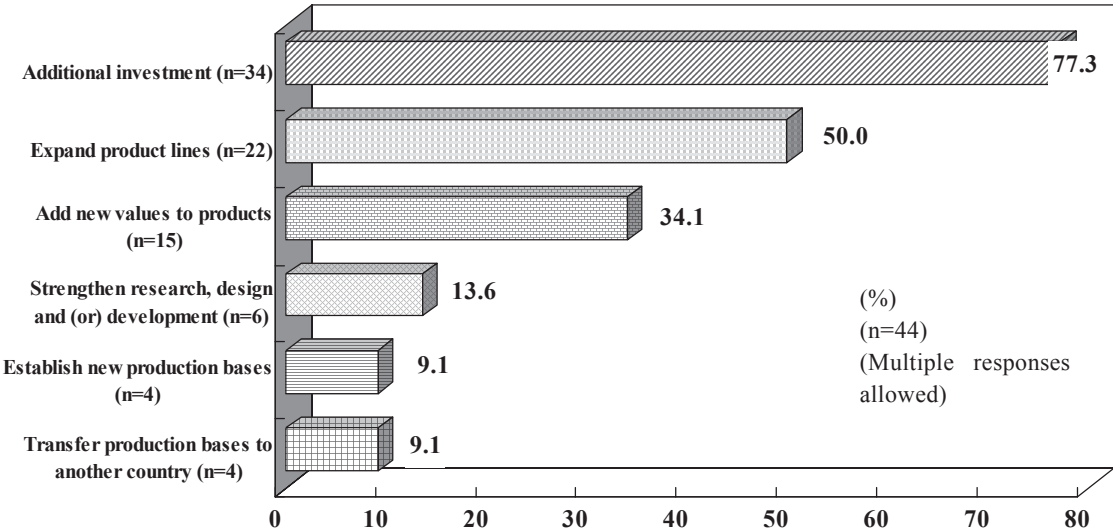
Diagram 19: Specific Policies of Japanese Manufacturing Affiliates in Western Europe



Source: JETRO Survey, Japan External Trade Organization

On the other hand, concrete business expansion policies of Japanese manufacturing affiliates in Central and Eastern Europe are additional investment (77.3%), expanding (diversifying) their product line (50.0%) and adding new value to their products (34.1%), in descending order.

Diagram 20: Specific Policies of Japanese Manufacturing Affiliates in Central and Eastern Europe

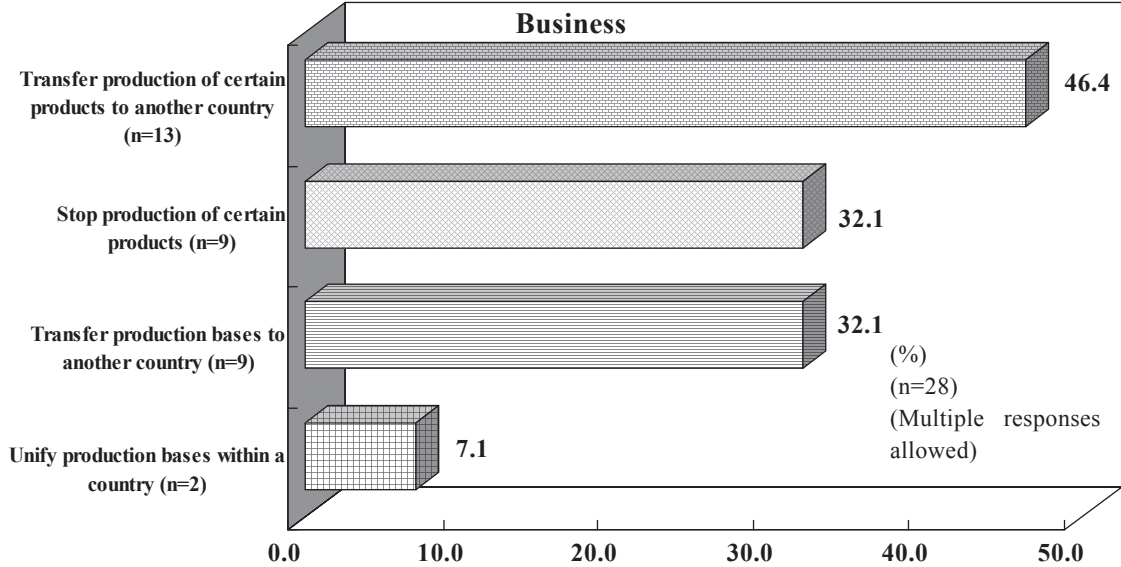


Source: JETRO Survey, Japan External Trade Organization

(3) Specific policies of the companies that answered that they plan to reduce or transfer or withdraw their business activities

There were 28 companies (25 in Western Europe and 3 in Central and Eastern Europe) that indicated they plan to reduce, transfer or withdraw their business activities in the next 1-2 years. The most frequently cited policy was transferring production of certain products to another country (cited by 46.4%), followed by stopping production of certain products (32.1%) and transferring production bases to another country (32.1%).

Diagram 21: Specific Policies of Japanese Manufacturing Affiliates in Europe Reducing Business



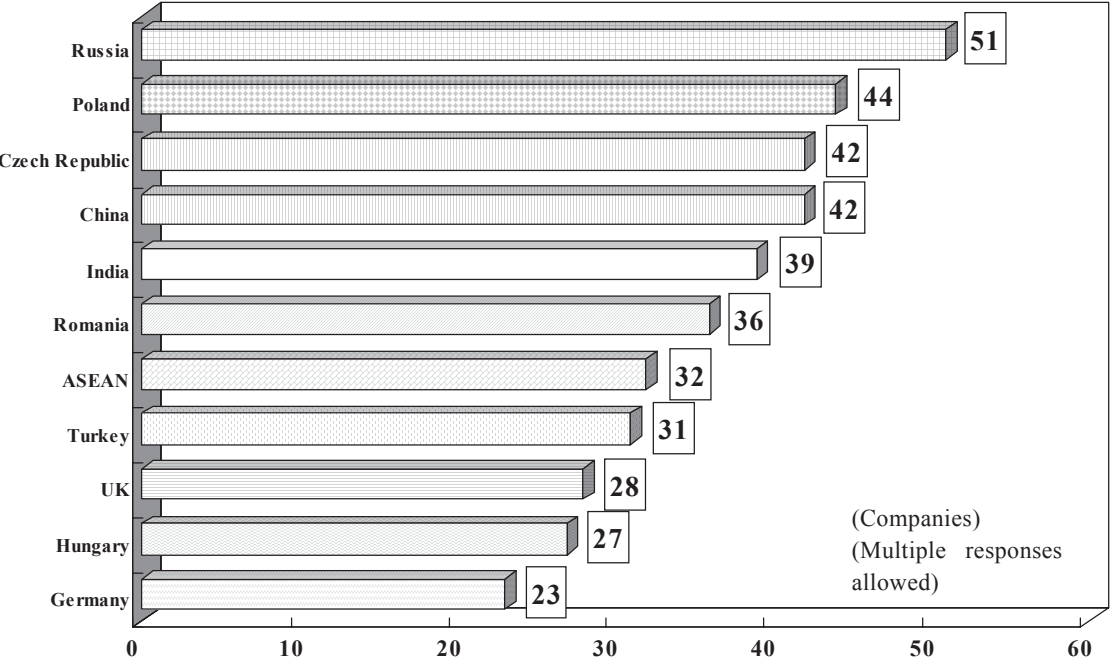
Source: JETRO Survey, Japan External Trade Organization

(4) Countries/regions being considered as promising locations for production

The country/region most frequently cited as a promising production base over the mid-to-long term (5-10 years) was Russia (51 companies), confirming Russia’s status as not only a potential sales destination but also as a promising production base.

Russia was followed by Poland (44), China (42) and Czech Republic (42), continuing the trend from the previous year that views Central and Eastern Europe, as well as China, as promising production bases. The list was filled mostly by the emerging countries, while the industrialized nations were only represented by the UK in 9th place (28) and Germany in 11th place (23).

Diagram 22: Countries and regions considered to be promising production bases over the mid-to-long term (5-10 years)



Source: JETRO Survey, Japan External Trade Organization

IV. Managerial Issues

- Managerial issues common to Japanese manufacturing affiliates in Western Europe, Central and Eastern Europe are increased energy prices, (materials and parts) procurement costs, securing specialized personnel, exchange rate fluctuations, REACH, and CE Mark.
- Major issues for companies located in Western Europe are the direct costs of production, such as high labor costs, increased energy prices, and (materials and parts) procurement costs.
- For companies located in Central and Eastern Europe, the high increase of labor costs is the most serious issue. Also, shortage of human resources emerged as a problem, mainly in the technical field.

1. Managerial Issues Common to Japanese Manufacturing Affiliates operating in Western Europe and in Central and Eastern Europe

Among the managerial issues encountered by Japanese manufacturing affiliates operating in Europe, increased energy prices, (materials and parts) procurement costs, securing specialized personnel, exchange rate fluctuations, REACH, CE Mark, and visa/work permits are the common issues encountered by Japanese manufacturing affiliates operating in Western Europe as well as those operating in Central and Eastern Europe.

Table 23: Managerial Issues for Japanese Manufacturing Affiliates in Europe (Multiple responses allowed)

Japanese Manufacturing Affiliates in Western Europe (No. of Respondent Companies: 265)				Japanese Manufacturing Affiliates in Central/ Eastern Europe (No. of Respondent Companies: 79)			
Category	Problem	Responses	Percentage	Category	Problem	Responses	Percentage
Labor problems	High labor costs	145	54.7 %	Labor problems	High increase in labor costs	67	84.8 %
Other	Increased energy prices	144	54.3 %	Labor problems	Securing specialized personnel	50	63.3 %
Materials and parts procurement	Procurement costs	137	51.7 %	Other	Increased energy prices	46	58.2 %
Finance	Exchange rate fluctuations	106	40.0 %	Finance	Exchange rate fluctuations	45	57.0 %
Product environmental regulations	REACH	103	38.9 %	Labor problems	Securing general factory workers	36	45.6 %
Other	Increased commodity prices (other than energy)	98	37.0 %	Materials and parts procurement	Procurement costs	34	43.0 %
Labor problems	Securing specialized personnel	90	34.0 %	Product environmental regulations	REACH	32	40.5 %
Labor problems	High increase in labor costs	84	31.7 %	Standards, certification and regulations	CE mark	30	38.0 %
Investment legislation/procedures	Visa/work permits	59	22.3 %	Investment legislation/procedures	Visa/work permits	29	36.7 %
Standards, certification and regulations	CE mark	51	19.2 %	Labor problems	Securing managerial personnel	29	36.7 %
Labor problems	Poor quality of workers	49	18.5 %	Labor problems	Social security system	26	32.9 %
Materials and parts procurement	Product quality	49	18.5 %	Insufficient infrastructure	Roads	24	30.4 %
Materials and parts procurement	Deliveries	44	16.6 %	Other	Increased commodity prices (other than energy)	22	27.8 %
Labor problems	Labor union activities/strikes	42	15.8 %	Tax systems/procedures	Complex/nontransparent administrative procedures	20	25.3 %
Labor problems	Securing managerial personnel	41	15.5 %	Labor problems	Securing clerical personnel	20	25.3 %
Other	Economic situation	41	15.5 %	Investment legislation/procedures	Frequent legislation revisions	18	22.8 %
Trade legislation/procedures	Tariffs	37	14.0 %	Materials and parts procurement	Product quality	18	22.8 %
Tax systems/procedures	Tax rates	33	12.5 %	Other	Economic situation	18	22.8 %
Labor problems	Securing general factory workers	30	11.3 %	Investment legislation/ procedures	Complex/nontransparent administrative procedures	17	21.5 %
Product environmental regulations	RoHS	29	10.9 %	Materials and parts procurement	Deliveries	17	21.5 %
Labor problems	Securing clerical personnel	24	9.1 %	Trade legislation/procedures	Tariff	16	20.3 %
Trade legislation/procedures	Complex/nontransparent administrative procedures	23	8.7 %	Trade legislation/procedures	Complex/nontransparent administrative procedures	15	19.0 %
Tax systems/procedures	Complex/nontransparent administrative procedures	21	7.9 %	Insufficient infrastructure	Power supply	15	19.0 %
Labor problems	Social security system	20	7.5 %	Tax systems/procedures	Tax rates	14	17.7 %
Finance	Collection of bills	19	7.2 %	Labor problems	Poor quality of workers	13	16.5 %
Trade legislation/procedures	Point-of-origin rules	18	6.8 %	Investment legislation/procedures	Nontransparent applications for the preferential treatment of investments	12	15.2 %
Investment legislation/procedures	Complex/nontransparent administrative procedures	17	6.4 %	Labor problems	High labor costs	11	13.9 %
Other	EU Competition Law	16	6.0 %	Other	Living environment for foreigners	11	13.9 %
Tax systems/procedures	Double taxation with Japan	14	5.3 %	Product environmental regulations	RoHS	9	11.4 %
Standards, certification and regulations	Other	13	4.9 %	Insufficient infrastructure	Other public transportation	8	10.1 %
Insufficient infrastructure	Communication	13	4.9 %	Finance	Collection of bills	6	7.6 %
Insufficient infrastructure	Power supply	12	4.5 %	Tax systems/procedures	Double taxation with Japan	5	6.3 %
Investment legislation/procedures	Frequent legislation revisions	10	3.8 %	Labor problems	Labor union activities/strikes	5	6.3 %
Labor problems	Other	10	3.8 %	Labor problems	Other	5	6.3 %
Other	Living environment for foreigners	10	3.8 %	Insufficient infrastructure	Communication	5	6.3 %
Finance	Fund procurement	9	3.4 %	Other	Political situation	5	6.3 %
Product environmental regulations	WEEE	9	3.4 %	Other	EU Competition Law	5	6.3 %
Product environmental regulations	ELV	8	3.0 %	Trade legislation/procedures	Point-of-origin rules	4	5.1 %
Investment legislation/procedures	Nontransparent application for preferential treatment of investments	7	2.6 %	Materials and parts procurement	Other	4	5.1 %
Materials and parts procurement	Other	7	2.6 %	Standards, certification and regulations	Other	3	3.8 %
Other	Political situation	7	2.6 %	Finance	Fund procurement	3	3.8 %
Trade legislation/procedures	Other	6	2.3 %	Insufficient infrastructure	Other	3	3.8 %
Tax systems/procedures	Other	6	2.3 %	Product environmental regulations	Euro5	3	3.8 %
Standards, certification and regulations	Plant/animal quarantine	6	2.3 %	Other	Other	3	3.8 %
Insufficient infrastructure	Roads	6	2.3 %	Tax systems/procedures	Other	2	2.5 %
Insufficient infrastructure	Port facilities	6	2.3 %	Finance	Other	2	2.5 %
Insufficient infrastructure	Other public transportation	6	2.3 %	Insufficient infrastructure	Water supply	2	2.5 %
Product environmental regulations	Euro5	6	2.3 %	Other	Public security/social situation	2	2.5 %
Trade legislation/procedures	Anti-dumping measures	5	1.9 %	Trade legislation/procedures	Anti-dumping measures	1	1.3 %
Other	Public security/social situation	5	1.9 %	Trade legislation/procedures	Other	1	1.3 %
Product environmental regulations	Other	4	1.5 %	Product environmental regulations	WEEE	1	1.3 %
Insufficient infrastructure	Other	3	1.1 %	Product environmental regulations	ELV	1	1.3 %
Other	Insufficient protection of intellectual property rights	3	1.1 %	Product environmental regulations	Other	1	1.3 %
Other	Other	2	0.8 %	Trade legislation/procedures	Most-favored-nation treatment	0	0.0 %
Trade legislation/procedures	Most-favored-nation treatment	1	0.4 %	Investment legislation/procedures	Other	0	0.0 %
Investment legislation/procedures	Other	1	0.4 %	Standards, certification and regulations	Plant/animal quarantines	0	0.0 %
Finance	Other	1	0.4 %	Insufficient infrastructure	Port facilities	0	0.0 %
Insufficient infrastructure	Water supply	1	0.4 %	Product environmental regulations	EuP	0	0.0 %
Product environmental regulations	EuP	1	0.4 %	Other	Insufficient protection of intellectual property rights	0	0.0 %

Source: JETRO Survey, Japan External Trade Organization

2. Managerial Challenges Encountered by Japanese Manufacturing Affiliates Operating in Western Europe – the distinctive problem of high production costs-

Responses from Japanese manufacturing affiliates operating in Western Europe indicate that the direct costs of production are the main managerial issue. High cost of labor was cited as a managerial issue most frequently (54.7%), followed by increased energy prices (54.3%) and (materials and parts) procurement costs (51.7%). The increase in commodity prices (other than energy) was also pointed out by many respondents (37.0%).

There was an obvious difference in the ratio of companies citing high labor costs between Japanese manufacturing affiliates operating in Central and Western Europe (the ratio of companies located in Central and Eastern Europe was 13.9%), suggesting that high labor costs are more distinct in Western Europe compared to Central and Eastern Europe.

Other frequently cited issues were exchange rate fluctuations (40.0%), REACH (38.9%), and securing specialized personnel (34.0%).

The ratio of companies pointing out the issues involving REACH (a new set of regulations for chemicals) substantially increased from 21.8% in the previous survey (January-February 2007). This seems to indicate a rapid increase in awareness of REACH among enterprises as the pre-registration of chemical substances specified by REACH is scheduled to start on June 1 this year. REACH is one of the environmental regulations established by the EU for the purpose of regulating the registration, evaluation, authorization and restriction of approximately 30,000 types of chemical substances. It requires that any person who imports or manufactures chemical substances in quantities of one ton or more per year in EU must register the toxic information, etc. of all the chemical substances handled by that person that are covered by REACH, including those chemicals that have already been dealt with at ECHA (European Chemicals Agency).

The issue of securing sufficient specialized personnel reflects the growing need for specialized personnel. This issue has become particularly pressing with the improvement in the labor market supported by steady growth of the European Economy in recent years.

One of the tendencies of Japanese manufacturing affiliates operating in Western Europe that is distinctively different from those in Central and Eastern Europe is the low ratio of companies in Western Europe that cited complex/nontransparent administrative procedures and insufficient infrastructure. These were instead frequently cited by respondents in Central and Eastern Europe. Regarding complex/nontransparent administrative procedures, the issue of trade legislation/procedures was cited by 19.0%, investment legislation/procedures was cited by 21.5%, and tax systems/procedures was cited by 25.3% of respondents operating in Central and Eastern Europe, while these ratios for companies operating in Western Europe were only 8.7% for trade legislation/procedures, 6.4% for investment legislation/procedures, and 7.9% for tax

systems/procedures. Regarding insufficient infrastructure, roads was mentioned by 30.4% and power supply was mentioned by 19.0% of respondents in Central and Eastern Europe, while the matter of communication, cited mostly frequently by affiliates in Western Europe, was only 4.9%. These results show that the business environment is well developed in Western Europe in terms of the operational systems and infrastructure.

Analysis of managerial issues faced by Japanese manufacturing affiliates operating in Europe by country clearly illustrates the differences in managerial issues encountered in each country.

Table 24: Managerial Issues Encountered by Japanese Manufacturing Affiliates Operating in Western Europe in Descending Order (UK, Germany, France and Spain) (Multiple responses allowed)

UK (No. of Respondent Companies:79)	Germany (No. of Respondent Companies:49)	France (No. of Respondent Companies: 25)	Spain (No. of Respondent Companies: 25)
Increased energy prices 69.7%	High labor costs 49.0%	High labor costs 60.0%	High increase in labor costs 64.0%
(Materials and parts) procurement costs 61.8%	REACH 40.8%	Labor union activities/and strikes 48.0%	Increased energy prices 60.0%
Exchange rate fluctuations 56.6%	(Materials and parts) procurement costs 36.7%	REACH 48.0%	(Materials and parts) procurement costs 60.0%
High labor costs 53.9%	Increased energy prices 34.7%	Increased commodity prices (other than energy) 48.0%	Increased commodity prices (other than energy) 56.0%
REACH 43.4%	Securing specialized personnel 34.7%	Increased energy prices 44.0%	Visa/work permits 52.0%
Securing specialized personnel 35.5%	Exchange rate fluctuations 32.7%	(Materials and parts) procurement costs 40.0%	High labor costs 48.0%
Increased commodity prices (other than energy) 34.2%	Increased commodity prices (other than energy) 26.5%	Visa/work permits 36.0%	Labor union activities/strikes 40.0%
CE mark 28.9%	High increase in labor costs 22.4%	Exchange rate fluctuations 36.0%	REACH 36.0%
Poor quality of workers 27.6%	RoHS 20.4%	High increase in labor costs 32.0%	CE mark 36.0%
High increase of labor costs 23.7%	Securing managerial personnel 16.3%	Securing specialized personnel 24.0%	Securing specialized personnel 32.0%
Deliveries (of materials and parts) 23.7%	Quality (of materials and parts) 16.3%	Social security system 24.0%	Exchange rate fluctuations 32.0%
Quality (of materials and parts) 22.4%	EU Competition Law 14.3%	Securing managerial personnel 20.0%	Economic situation 32.0%
Economic situation 19.7%	CE mark 12.2%	Complex/nontransparent administrative procedures (tax systems) 20.0%	Quality (of materials and parts) 24.0%
Visa/work permits 18.4%	Securing clerical personnel 12.2%	Quality (of materials and parts) 16.0%	

Source: JETRO Survey, Japan External Trade Organization

In the UK, the ratio of companies that cited exchanges rate fluctuations was 56.6% (43 out of 76), far exceeding the 32.2% (56 out of 174) for the Euro zone. This may be attributable to the impact of prolonged depreciation of the pound against the euro, which has been disadvantageous for the import of materials, etc.

In France and Spain, the high number of companies that cited the issue of labor union activities/strikes is noteworthy. This ratio is also high in Italy (71.4%; 5 out of 7), although it was not included in the above table. This ratio for companies operating in the rest of Western Europe excluding these three countries was 7.2% (15 out of 208). This indicates that the issue of labor union activities/strikes is a problem unique to these three countries. In France and Spain, many respondents mentioned the issue of visa/work permits. The application procedures and the processing period for visa and work permits vary by country, and the results also vary in each country. In Spain, the high increase in labor costs comes top of the list, cited by 64.0% of respondents. This ratio is far higher than that in the UK (23.7%), Germany (22.4%) and France (32.0%). In Spain, the ratio of companies that mentioned high labor costs was also high at 48.0%. Labor costs in Spain represent one of the challenges facing companies both in terms of the cost level and the rate of increase.

3. Managerial Issues Encountered by Japanese Manufacturing Affiliates Operating in Central and Eastern Europe

-High increase in labor costs and the shortage of human resources-

High increase rate of labor cost was cited by the majority of the Japanese manufacturing affiliates operating in Central and Eastern Europe, accounting for 84.8% of the respondents. On the other hand, only 13.9% of the respondents felt that the labor costs at their present level are high. These results clearly indicate that Japanese manufacturing affiliates operating in Central and Eastern Europe are struggling to absorb the high increase in labor costs, even though they do not think the present level of labor costs is high. In Central and Eastern Europe, Increase in wage has been high because of the tight correlation between supply and demand in the labor market due to the improvement in the domestic labor market and migrant labor, particularly from Poland and Slovakia, to Western European countries. However, the global economic recession is expected to help ease this situation. In the Central and Eastern European countries where the labor costs used to be particularly low, such as Romania, Bulgaria and former member states of Yugoslavia, the wage increases are even higher than that in Poland, Czech Republic and Hungary. When establishing a production base, etc. in these countries, careful consideration needs to be given to the trends in the labor market and the wage levels.

Personnel shortages were also pointed out by many respondents. Of the respondents, 63.3% mentioned the issue of “securing specialized personnel”, 45.6% mentioned “securing general factory workers”, 36.7% mentioned “securing managerial personnel” and 25.3% mentioned “securing clerical personnel”. These figures are far higher than the ratio among Japanese

manufacturing affiliates operating in Western Europe (34.0% for specialized personnel, 15.7% for managerial personnel, 11.3% for general factory workers, and 9.1% for clerical personnel). Also, the issue of securing specialized personnel was mentioned by many of the respondents. There are two main reasons for the shortage of specialized personnel in Central and Eastern Europe. First, as active investment in the manufacturing industry has been made mainly by foreign enterprises in these countries that produce products for Europe, the supply in the job market in general has not been able to keep up with the demand. Second, because specialized personnel are also in short supply in Western European countries, many EU Western European countries that impose restrictions on the entry of foreign workers have removed or relaxed their restrictions on the entry of specialized workers (particularly skilled workers). As a result, there has been a flow of specialized workers from Central and Eastern Europe to Western Europe.

With respect to the complex/nontransparent administrative procedures mentioned by the respondents, the number of respondents who pointed out issues in the trade legislation/procedures, investment legislation/procedures, and tax systems/procedures has been decreasing, although it is still higher than the number of companies operating in Western Europe that point out the same issues. There has been a particularly sharp decline in the number of companies encountering issues involving trade legislation /procedures among the companies located in an EU member country. The number of companies mentioning the issue of trade legislation/procedures that are located in Central and Eastern European countries that have joined the EU was 19.7% (15 out of 76), marking a substantial decrease from the 63.2% (36 out of 57) recorded in the last survey before the previous one (January-February 2006) and 30.0% (18 out of 60) in the previous survey (January-February 2007). This is probably because now that four years have passed since the accession to the EU (or one year for Romania and Bulgaria), the EU systems, such as the simplified customs procedures within the EU and common policies for trade with countries outside the EU, have taken root. In addition, transparency within the system has increased, and operations are being conducted better.

The fact that the issue of REACH is ranked high (40.5%) indicates that, like in Western Europe, businesses located in Central and Eastern Europe are under pressure to comply with the environmental regulations.

An analysis of the managerial issues faced by Japanese manufacturing affiliates operating in Central and Eastern Europe shows that some problems are commonly faced by many companies. At the same time, some differences can also be seen.

Table 25: Managerial Issues Reported by Japanese Manufacturing Affiliates Operating in Central and Eastern Europe in Descending Order (Poland, Hungary and Czech Republic) (Multiple responses allowed)

Czech Republic (No. of Respondent Companies: 21)	Poland (No. of Respondent Companies: 19)	Hungary (No. of Respondent Companies: 19)
High increase in labor costs 85.7%	High increase in labor costs 94.7%	High increase in labor costs 89.5%
Securing specialized personnel 81.0%	Securing general factory workers 68.4%	Increased energy prices 73.7%
Exchange rate fluctuations 81.0%	Exchange rate fluctuations 68.4%	(Materials and parts) procurement costs 63.2%
REACH 57.1%	Increased energy prices 68.4%	Securing specialized personnel 52.6%
Increased energy prices 57.1%	Securing specialized personnel 63.2%	REACH 47.4%
Visa/work permits 52.4%	Roads (insufficient infrastructure) 63.2%	(Tax systems) tax rates 42.1%
Securing general factory workers 52.4%	CE mark 47.4%	Securing managerial personnel 42.1%
CE mark 47.6%	(Materials and parts) procurement costs 47.4%	CE mark 36.8%
Securing managerial personnel 42.9%	REACH 47.4%	Exchange rate fluctuations 36.8%
Securing clerical personnel 38.1%	Securing managerial personnel 42.1%	(Investment legislation) Frequent legislation revisions 31.6%
Social security system 38.1%	Quality (of materials and parts) 42.1%	Social security system 31.6%
(Materials and parts) procurement costs 38.1%	Tariffs 36.8%	(Trade legislation) complex/nontransparent administrative procedures 26.3%
Economic situation 38.1%	(Tax systems) complex/nontransparent administrative procedures 36.8%	(Tax systems) complex/nontransparent administrative procedures 26.3%
Increased commodity prices (other than energy) 33.3%	Social security system 36.8%	Deliveries (of materials and parts) 26.3%
		Economic situation 26.3%

Source: JETRO Survey, Japan External Trade Organization

The ratio of companies that regarded exchange fluctuations as a managerial issue was as high as 81.0% in Czech Republic and 68.4% in Poland. As of the time this survey was conducted (June-July 2008), the value of the local currencies, such as the Czech koruna and the Polish zloty, had been rising against the euro and dollar, and Japanese affiliates in the manufacturing industry saw their sales to the Euro zone suffer due to the disadvantageous currency exchange rate. This situation is considered to be a factor in the high ratios.

In Poland, 63.2% of Japanese manufacturing affiliates mentioned that the roads are insufficient. This ratio was higher than that in the Czech Republic (19.0%) and Hungary (0%). This is likely due to the fact that the development of roads has not been progressing rapidly in Poland partly due to its large size.

V. FTAs between EU and Asian Countries

- EU-South Korea FTA is expected to be a major disadvantage because the elimination of tariffs will lead to a decline in relative competitiveness.
- EU-ASEAN FTA is expected to be a major advantage due to the reduction of the procurement cost of parts
- EU-India FTA is not expected to have any impact on a majority of the companies, although some companies expect that it will help develop the Indian market.
- As more than a year has passed since the start of negotiations, the FTAs with Asian countries have become more recognized by companies in the EU.

In October 2006, the EU announced the “Global Europe: competing in the world,” the strategy that defines a new external trade strategy and set out a policy of actively pursuing bilateral FTAs with countries that can satisfy certain requirements. Based on this strategy, the EU began negotiations for FTAs with ASEAN and South Korea in May 2007 and with India in June 2007. If FTAs are established between the EU and these countries and the Asian region, the deregulation and liberalization of trade and investments, such as the elimination of tariffs, will bring both advantages and disadvantages to Japanese manufacturing affiliates operating in Europe. We asked the respondent companies about the expected impact.

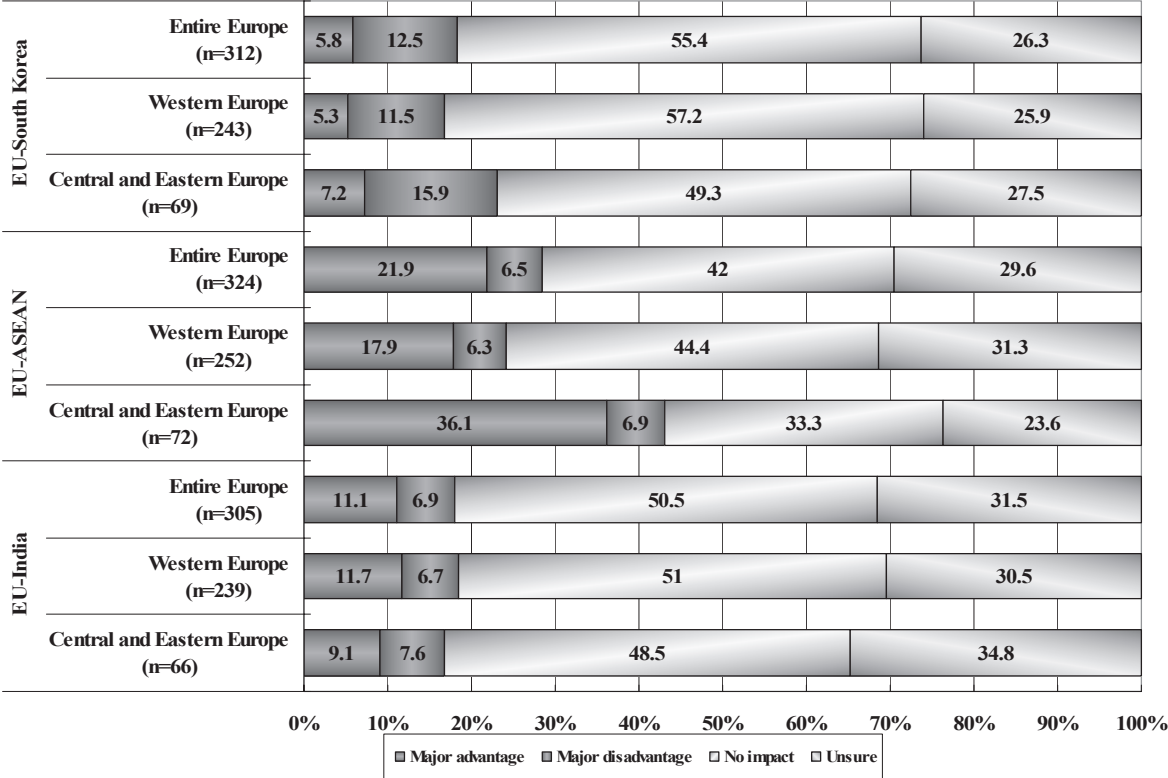
1. EU-South Korea FTA

In terms of advantages and disadvantages, the answers varied depending on the participants of the FTA. With respect to EU-South Korea FTA, 12.5% (39 companies) of the respondents expect major disadvantages, which was higher than the 5.8% (18) that expect major advantages. By region, of companies operating in Western Europe the 11.5% expect major disadvantages and 5.3% expected major advantages, while in Central and Eastern Europe the number of companies that expect major disadvantages was 15.9% and that for major advantages was 7.2%. These numbers indicate that the number of companies that expect the FTA to bring major disadvantages was a little higher in Central and Eastern Europe.

By industry, the number of companies in the transportation machinery and parts sector that indicated expectations for major disadvantages was 17.7%, accounting for nearly 30% of the total. The second highest was in the electric and electronic machinery sector. The EU imposes high tariffs on automobile bodies, TVs, etc. Therefore, Japanese manufacturers seem to be afraid of decline in their competitiveness against Korean products in European market due to elimination of tariff, which probably happen if the EU-South Korea FTA is realized. In the transportation machinery and parts sector, the EU imposes high tariffs on automobile bodies, ranging from 10% (passenger car, etc.) (MFN base; the same hereinafter) up to 22% (trucks). The tariffs on automotive parts are 3-4.5%. For electric and electronic machinery, a maximum 14% tariff (TV) is imposed.

On the other hand, manufacturers of general machinery (tariff rates are less than 5% for most items) expect to be less affected by the tariff reductions, and there was only a small number of answers indicating concern over the impact of the EU-South Korea FTA in spite of the fact that Japanese manufacturers are already in competition with South Korean products.

Diagram 26: Impact of the FTAs between EU and Asian Countries (as cited by Japanese manufacturing affiliates in Europe)

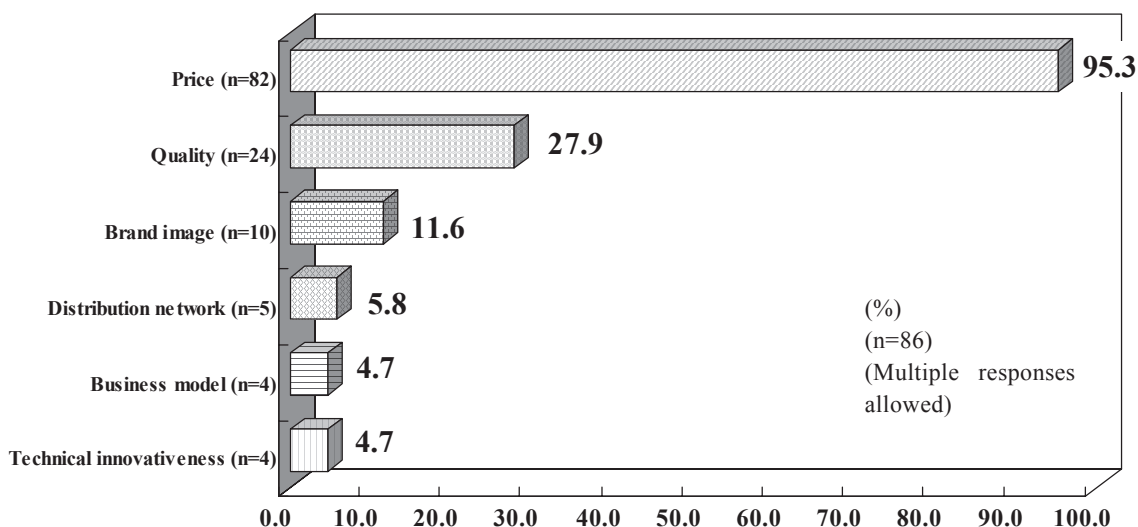


Source: JETRO Survey, Japan External Trade Organization

In connection with the expected impact of the EU-South Korea FTA, questions were asked in regards to competition with Korean Products. A number of companies answered that their products are competitive with Korean products (29.1%). By industry, the number of companies was particularly high in the sector of general machinery (46.4%), electric and electronic machinery (42.4%), transportation machinery and parts (40.0%) and electric and electronic parts (32.1%).

As to the competitive elements, a vast majority of companies (95.3% of all respondents in Europe) mentioned price, followed by quality (27.9%), brand image (11.6%) and distribution network (5.8%). Only 4.7% mentioned business models and technical innovativeness.

Diagram 27: Elements Competing with Korean Products (as cited by Japanese manufacturing affiliates operating in Europe)



Source: JETRO Survey, Japan External Trade Organization

2. EU-ASEAN FTA

Concerning the EU-ASEAN FTA, the number of companies that expect major advantages was 21.9% (71 companies), much higher than the number of companies that expect major disadvantages, which was 6.5% (21 companies). The number of companies that expect major advantages was particularly high among companies operating in Central and Eastern Europe at 36.1%. By industry, 33.3% of the respondents in the transportation machinery and parts sector answered that they expect major advantages.

The reasons cited by respondents indicate that not only the companies that procure parts from the ASEAN region but also many other companies expect that the elimination of tariffs under the EU-ASEAN FTA could result in reduced costs of procuring parts from the ASEAN region. Some Japanese manufacturing affiliates operating in Europe also have factories in ASEAN countries, so they could consider establishing a business model, in which they procure parts from the ASEAN region, assemble the products in Central and Eastern Europe, and supply the fully assembled products to Western Europe.

On the other hand, for companies that have their own plants producing finished products both in Europe and ASEAN countries, the FTA is expected to bring advantages for globalization in that it will contribute to cost reductions by helping to integrate those companies' production sites. However, at the same time it can be a threat to plants in Europe, which is the cause of concern for the respondent companies who found disadvantage. (Similar opinions were mentioned regarding the FTA with India). Since plants in Europe and ASEAN countries have, until now, been targeting different markets, it is unlikely that there will be much competition for many products in the short term. However, in a medium to long term, the conclusion of an FTA can be a factor in the

relocation and integration of production sites. (However, as a measure to prevent “free rides” on the EU-ASEAN FTA, it is highly likely that strict rules of origin are enforced. If this is the case, in order for companies that export finished products from ASEAN countries to the EU to be able to enjoy the advantages of the FTA, they will need to increase their local procurement substantially. Therefore, depending on the application of rules of origin, competition will not necessarily occur among the producers of finished products.)

3. EU-India FTA

Concerning the EU-India FTA, the number of companies that expect major advantages was 11.1% (34 companies), exceeding the number of companies that expect major disadvantages, which was 6.9% (21 companies). On the other hand, more than half of the respondents answered that they expect no impact. The answers indicated that one of the expected major advantages is that the EU-India FTA may lead to the development of the Indian market. Also, the EU-India FTA is expected to bring about regulation reform and liberalization. The number of these answers was larger for the EU-India FTA than that for other FTAs probably because 1) India has been maintaining not only tariffs but also other various domestic regulations even after its accession to WTO, and that 2) Japan has already entered into an EPA with ASEAN

The number of companies that answered “unsure”, the highest ranking answer in the same question in the previous survey (January-February 2007), decreased substantially in this survey (South Korea: 47.0%→26.3%, ASEAN: 46.9%→29.6%, and India: 50.2%→31.5%). When the previous survey was conducted, negotiations for each FTA had not yet begun. The results of this survey, which was conducted more than one year after the FTA talks began, indicate that the FTAs have become better known by the companies targeted by this survey. For all FTAs, the largest number of companies answered that they expect no impact, occupying about half of all answers (Korea: 55.4%, ASEAN: 42.0%, and India 50.5%).

Turkey

I. Overview of Japanese Manufacturing Affiliates in Turkey

14 out of the 17 Japanese manufacturing affiliates are based in the automotive and related industries

The latest survey revealed that 17 Japanese manufacturing affiliates are currently operating in Turkey (as of the end of 2007). By industry, 3 out of the 17 affiliates are based in the transportation machinery sector and 11 are based in the transportation machinery parts sector, which indicates that the presence of Japanese manufacturing affiliates in Turkey is concentrated primarily on the automotive industry. The remaining three affiliates are involved in the food, agricultural and fisheries product processing, rubber products, and other manufacturing industries. Automobiles and their parts constitute the country's largest export item (accounting for a share of 14.8% in the statistics for 2007).

II. Business Conditions and Prospects of Japanese manufacturing affiliates in Turkey

- Of the respondent affiliates, 92.3% recorded operating profits, 7.7% recorded balanced profit and none recorded operating losses in 2007.
- For 2008, a majority of the respondents projected the results would deteriorate in comparison with the previous year.

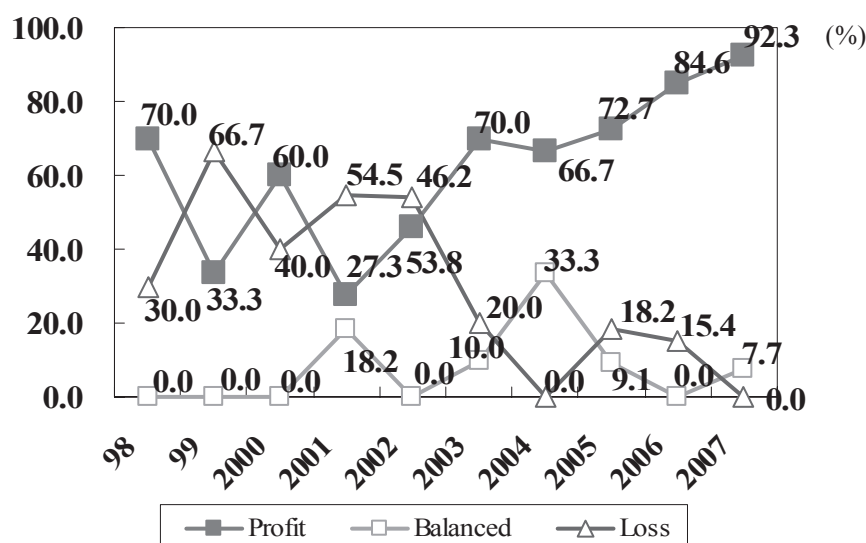
1. Operating profits projected by almost all the affiliates for 2007

For 2007, 12 of the 13 respondent affiliates reported operating profits, outnumbering the 11 affiliates (out of the 13 respondent affiliates) in the previous survey (conducted from January to February 2007). One affiliate reported a balanced profit and none reported operating losses (compared with one in the previous survey.)

Compared with the operating profits from 2006, the outlook for 2007 was divided with five affiliates projecting an improvement, four affiliates projecting unchanged results and four affiliates projecting deterioration in the results. The most dominant reason among the respondents that projected improvement was an increase in sales in and outside the countries where they are located, while an increase in personnel costs was cited as the reason profits were expected to deteriorate most frequently.

According to the Automotive Manufacturers Association (OSD) in Turkey, domestic automobile production in 2007 (excluding tractors) increased to 1.099 million cars (an increase of 11% from the previous year) while the number of exported cars increased to 830 thousand (an increase of 17% from the previous year), rising the export ratio from 69.7% to 75.5% in 2006. Turkey has thus positioned itself as a production and export base for the EU market more clearly than before.

Diagram 1: Operating profits for Japanese Manufacturing Affiliates in Turkey



Source: JETRO Survey, Japan External Trade Organization

2. Majority of affiliates project operating profits to deteriorate in 2008

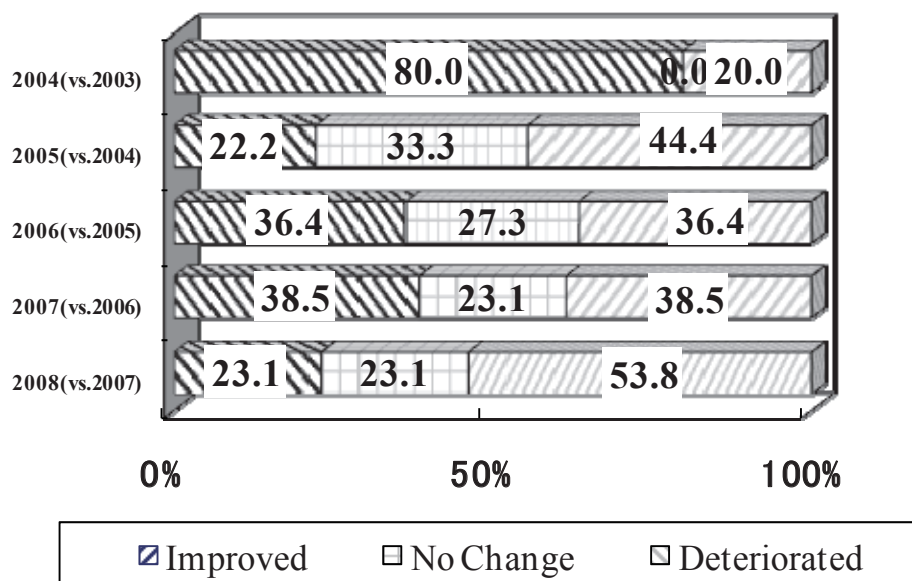
In the outlook for 2008 (responses were received from 13 affiliates), 9 affiliates (69.2% of respondents) projected operating profits (while three affiliates projected a balanced profit and one projected losses.)

In the outlook for 2008 compared to that for 2007, 7 companies (53.8% of respondents) responded that they expected profits to deteriorate, which have been the highest percentage in the last five years. (Improved and unchanged profits were projected by three companies each.)

Among the leading reasons for expecting the deterioration (multiple responses allowed), a decrease in sales in the domestic market was given by 4 companies, and a decrease in sales price and an increase in energy prices were each cited by 3 companies.

Although the Turkish economy achieved a high annual growth rate 7.0% on average (real GDP growth) from 2002 through 2006, the rate decreased to 4.5% in 2007. In 2008, the growth rate further decelerated to 4.2% in the first half, far below market expectations. In the second quarter, growth shrank to 1.9% year on year. Individual consumption, which accounts for 70% of the GDP, sharply decreased from 7.6% in the preceding period to 2.8%, which had a negative impact on the growth. The growth rate of exports in goods and services also drastically declined from 12.2% in the preceding period to 2.3%, which was apparently caused by decreased demand from the EU, the major export destination.

Diagram 2: Operating Profit Outlook for Japanese Manufacturing affiliates in Turkey



Source: JETRO Survey, Japan External Trade Organization

III. Procurement, Sales and Production Setups

1. Procurement source of parts and materials and procurement policy

- The number of companies that procure parts from domestic sources in Turkey has remarkably increased.
- Procurement from domestic sources in Turkey is to be expanded and reinforced while procurement from Japan be reduced.

(1) Present Procurement Sources and Future Procurement Policies

The country or region named most often by Japanese manufacturing affiliates operating Turkey as the major procurement source (multiple responses allowed) was Japan, which was named by all of the respondents (13), followed by Turkey, which was named by 10 affiliates, and Western Europe, which was named by 7 affiliates. In the previous survey (in 2006), Japan and Western Europe were named by 8 affiliates while Turkey was named by 6 affiliates. (Refer to Diagram 3.)

When questioned about their future procurement policies, 9 out of the 10 affiliates that procure from the sources in Turkey answered that they plan to expand and reinforce those sources (with 1 affiliate answering that they plan to maintain the present level). Out of the affiliates that procure from the sources in Japan, 7 plan to reduce their procurement from Japan and 5 answered that they will maintain the present level of procurement (1 answered unknown). The present status and future policies suggest that the affiliates have been enhancing their procurement from domestic

sources in Turkey (mainly for cost reasons). Out of the affiliates that procure from the sources in Western Europe, 4 companies, the largest number, answered that they plan to maintain the present level of procurement (with 1 answering that it plans to expand and reinforce procurement, and 2 answered that they plan to reduce procurement).

Regarding other countries and regions, 5 respondents currently procure from sources in Central and Eastern Europe, 3 affiliates procure from sources in ASEAN and North America, 2 affiliates procure from the Republic of Korea and 1 affiliate procures from China. None of the affiliates answered that they procure from Russia and CIS countries or the North African region. In their future procurement policies, 3 affiliates (the largest number) plan to maintain their present level of procurement from Central and Eastern Europe, and the 3 affiliates currently procuring from North America and the 1 affiliate procuring from China also intend to maintain their present level. Out of the 2 affiliates that procure from sources in South Korea, 1 will expand and reinforce its procurement while the other will maintain its present level of procurement.

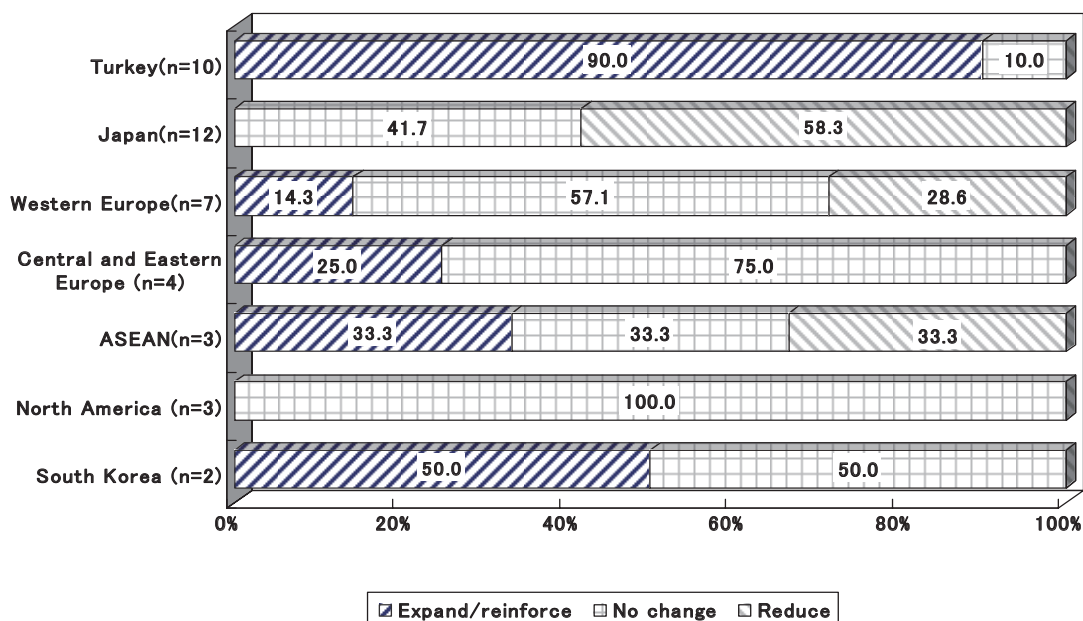
When asked about future procurement sources (multiple responses allowed), each 2 companies identified Russia and ASEAN as potential sources while Germany, UK, Italy, Greece, Bulgaria, North Africa and China were each nominated by 1 company.

**Table 3: Status of Major Procurement Sources (Countries and Regions)
(Multiple responses allowed)**

Japan	Western Europe	Turkey	Central and Eastern Europe	ASEAN	The number of respondents
13	7	10	5	3	13

Source: JETRO Survey, Japan External Trade Organization

Diagram 4: Future Procurement Policies of Japanese Manufacturing Affiliates in Turkey in regards to Current Procurement Sources



Source: JETRO Survey, Japan External Trade Organization

2. Sales Destinations and Sales Policies

- The principal sales destinations are Turkey and Western Europe, expanding to Central and Eastern Europe.
- The affiliates plan to expand and reinforce sales in Turkey, Western Europe and Russia and CIS countries.

(1) Present sales destinations

Turkey was the leading sales destination for Japanese manufacturing affiliates operating in Turkey. It was named by 11 out of the 13 respondents, followed by Western Europe, which was named by 10, and Central and Eastern Europe, which was named by 6, Russia and CIS countries, which was named by 3, North Africa, which was named by 2, and Japan, which was named by 1. Compared to the previous year, the affiliates naming Western Europe and Central and Eastern Europe as their principal sales destination increased in number by 4 companies each.

Table 5: Sales Destinations (Countries and Regions)
(Multiple responses allowed)

Japan	Western Europe	Turkey	Central and Eastern Europe	ASEAN	Number of respondents
1	10	11	6	-	13

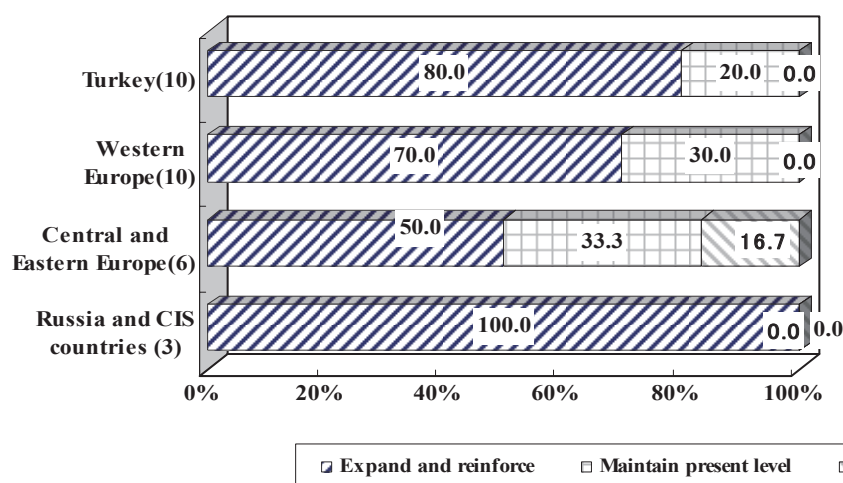
Source: JETRO Survey, Japan External Trade Organization

(2) Future sales policies

8 out of the 11 affiliates selling products intended for the domestic market in Turkey and 7 out of the 10 affiliates selling products intended for the Western Europe market said that they plan to expand sales in the future. The 6 affiliates selling products intended for the Central and Eastern Europe market were divided with 3 companies planning to expand and reinforce sales, 2 companies planning to maintain the present level and 1 company planning to reduce sales in the future. All of the 3 affiliates selling products intended for Russia and CIS countries stated plans to expand and reinforce sales in the future. In regards to the present sales destinations where the affiliates plan to expand and reinforce sales, UK was named by 5 affiliates, France by four and Ukraine by 3 affiliates.

Among the leading potential future markets, Russia was named by 4 affiliates, followed by Italy, which was named by 3.

Diagram 6: Future Sales Policies for Present Sales Destinations



Source: JETRO Survey, Japan External Trade Organization

3. Production Setups

- The number of affiliates planning to expand production setups is equal to outlook for future production is almost evenly divided with a similar number of affiliates planning to expand as those that plan to maintain present levels.
- Specifically, many of the affiliates that plan to expand production aim to expand the size of their business through additional investment and to expand their product line.
- In the medium to long range, Russia is rated highest by the affiliates as a promising production base for their products.

(1) Business development over the next 1~2 years

Out of the 13 Japanese manufacturing affiliates in Turkey that responded to this survey, 7 companies answered that they are going to expand their business activities in the next one or two years, and 6 companies answered that they will maintain the present level. No companies, as in the previous year, answered that they plan to reduce, transfer or withdraw production. A smaller number of companies than in the previous year responded that they plan to expand, and a larger number of the companies responded that they plan to maintain the present level.

When the companies that said that they planned to expand their business activities were asked about specific policies, out of the 7 companies that responded, 5 companies answered that they planned to expand the size of their business through additional investment, and 5 companies answered that they plan to expand (diversify) their product line (multiple responses allowed). Adding more value to products (which was pointed out by many companies in the previous survey) was cited by only 1 company in this survey. In addition, 2 companies answered that they plan to establish new production bases. Both companies answered that they plan to establish the new production bases in Turkey.

In regards to the question pertaining to manufacturing functions (lines) or plants that have been transferred to Turkey over the past five years, responses were received from 10 companies. 1 company each responded that the transfer was made from Japan and from the UK.

(2) Countries/regions considered as promising mid-to-long-term (5-10 years) locations for production

When Japanese manufacturing affiliates operating in Turkey were questioned about the countries and regions that they consider to be promising potential production bases for their products on a medium to long term basis (5~10 years), responses were received from 9 companies. Russia was selected by 6 companies, which was at the top of the poll, followed by Turkey and India, each selected by 2 companies, and Bulgaria, Rumania and North Africa, each selected by 1 company.

IV. Managerial Issues

- Managerial issues are concentrated on issues related to costs, country risks and CE marks.

Companies are concerned about the high increase in labor costs, exchange rate fluctuations and energy prices as well as the impacts thereof on the costs of their products.

In this survey, 12 out of the 13 respondent companies answered that labor management, namely the high increase in labor costs was the greatest managerial issue. The second most frequently cited issue was finance. Specifically, exchange rate fluctuations were mentioned by 10 companies. This was followed by other issues, such as the increase in energy prices (cited by 8 companies). When the fifth most frequently cited issue of raw materials. Component procurement and procurement costs (cited by 6 companies), are included, 4 of the top 5 issues are cost related issues. This supports the following changes that were noticed in the cost-related elements referred to in other surveys. When the 2007 operating profits are compared to those in the previous year, a larger number of companies reported deteriorating profits, and in a similar survey for 2008, a larger number of companies projected deteriorating profits and expressed their plans to procure parts in Turkey.

Regarding the top-ranking problem of the high increase in labor costs, the Comparative Survey on Investment Costs by Cities in the World conducted by JETRO has revealed that the wages in Turkey (Istanbul) are higher than those in the major Central and Eastern countries (Poland, Hungary, Bulgaria and Croatia, etc.), particularly at the management and engineer level. (Note: Data from a survey conducted in early 2008)

As to quality of Turkish workers, the local Japanese affiliates unanimously rated it considerably high, saying that Turkish workers are suitable for positions in craftsmanship (manufacturing industry). In considering further development in (investment in) Turkey, it is one of the significant points to be considered after comparing the rising labor costs with the high quality of the workers.

Concerning the second largest problem of exchange rate fluctuations, the Turkish lira, which remained strong (against U.S. dollar) from 2003 through 2007 began to weaken in the first half of 2008 but has been on an appreciating trend since then. This has left the automotive and other export-oriented industries in a difficult position. In the area of finance, other than the comments that exchange rate fluctuations were too sudden, their impacts on transactions in foreign currencies and borrowings were pointed out. Furthermore, fluctuations in interest and exchange rates deriving from the structural factors, including inflation and a rigid currency system, were also cited.

Regarding the increase in energy prices (which was ranked as the third largest problem), the increase in electricity costs resulting from the higher oil prices in recent years has been significant in Turkey, which is dependent on imports for its energy resources.

Nearly half of the respondent companies replied to the questions used to assess country risk. Specifically, the questions concerned issues such as the political situation, economic situation and social/security situation, and these issues were ranked among the leading problems. Regarding the political situation, following the victory of the ruling Justice and Development Party (AKP) in the July 2007 general election, the AKP administration now has a solid foundation and has secured the posts of the President, Prime Minister and Chairman of the Parliament. However, the constitutional amendment enacted by AKP in February 2008 that lifted a ban on female students from wearing Islamic scarves at universities invited the action filed by the Prosecutor's office in April seeking the party's dissolution, etc. (based on the recognition of a deviation from secularism). The Turkish military attacks on the Kurdistan Worker's Party (PKK) across the northern Iraqi border in 2008 led to further instability in the Turkish political situation.

Since Turkey is dependent on imports for its raw materials and energy supplies, they suffer from a chronic structural trade deficit where a growth in exports is always accompanied by an increase in imports. The increasing trade deficits and the balance of payments, including capital accounts, have been offset by the increase in inward investments in recent years, but attention should remain focused on the future steering of the country's economy.

The standards, certification and regulations, namely the CE marks, which were cited by 7 companies (the fourth largest problem), still remain one of the major problems. Attention must be paid to the fact they are not applied as they are inside the EU area. The CE marks, which are originally required to be affixed only to end products in Turkey, are also required to be affixed to parts and other intermediate goods in the EU area.

Table 7: Managerial Issues (2007)

Category	Problem	Responses	Percentage
Finance	Exchange rate fluctuations	13	100.0%
Labor problem	Labor cost	10	76.9%
Trade legislation/procedures	Complex administrative procedures	9	69.2%
Investment legislation/procedures	Visa/working permit	8	61.5%
Standards, certification and	CE mark	8	61.5%
Materials and parts procurement	Quality	8	61.5%
Trade legislation/procedures	Tariff	6	46.2%
Investment legislation/procedures	Insufficient infrastructure	6	46.2%
Insufficient infrastructure	Roads	5	38.5%
Insufficient infrastructure	Communication	5	38.5%
Labor problem	Unions/strikes	4	30.8%
Materials and parts procurement	Costs	4	30.8%
Insufficient infrastructure	Other transport situation (Public transport	3	23.1%
Trade legislation/procedures	Other	2	15.4%
Tax systems/procedures	Tax rates	2	15.4%
Tax systems/procedures	Double taxation	2	15.4%
Tax systems/procedures	Complex procedures	2	15.4%
Labor problem	Securing human resources	2	15.4%
Labor problem	Social security system	2	15.4%
Materials and parts procurement	Deliveries	2	15.4%
Insufficient infrastructure	Power supply	2	15.4%
Environmental regulations	ELV	2	15.4%
Tax systems/procedures	Other	1	7.7%
Standards, certification and	Other	1	7.7%
Insufficient infrastructure	Port facilities	1	7.7%
Insufficient infrastructure	Other	1	7.7%
Trade legislation/procedures	Anti-dumping measures	0	0.0%
Trade legislation/procedures	Point-of-origin rules	0	0.0%
Trade legislation/procedures	Most-favored-nation treatment	0	0.0%
Investment legislation/procedures	Complex administrative procedures	0	0.0%
Investment legislation/procedures	Other	0	0.0%
Standards, certification and	Animal/plant quarantine	0	0.0%
Labor problem	Quality of workers	0	0.0%
Labor problem	Other	0	0.0%
Finance	Funds procurement	0	0.0%
Finance	Other	0	0.0%
Materials and parts procurement	Other	0	0.0%
Environmental regulations	WEEE	0	0.0%
Environmental regulations	RoHS	0	0.0%
Environmental regulations	REACH	0	0.0%
Environmental regulations	EuP	0	0.0%
Environmental regulations	Euro5	0	0.0%
Environmental regulations	Other	0	0.0%
Other	Competition law	0	0.0%

Source: JETRO Survey, Japan External Trade Organization

Table 8: Managerial Issues (2008)

Category	Problem	Response	%
Labor problems	High increase in labor costs	12	92.3 %
Finance	Exchange rate fluctuations	10	76.9 %
Other	Increased energy prices	8	61.5 %
Standards, certification and regulations	CE mark	7	53.8 %
Materials and parts procurement	Procurement costs	6	46.2 %
Other	Political situation	6	46.2 %
Other	Economic situation	6	46.2 %
Other	Security and social situation	6	46.2 %
Trade legislation/procedures	Complex and murky administrative procedures	5	38.5 %
Investment legislation/procedures	Visa/working permits	4	30.8 %
Labor problems	Securing engineering personnel	4	30.8 %
Materials and parts procurement	Quality	4	30.8 %
Insufficient infrastructure	Power supply	4	30.8 %
Other	Increased commodity prices (other than energy)	4	30.8 %
Investment legislation/procedures	Frequent legislation revisions	3	23.1 %
Investment legislation/procedures	Complex and nontransparent administrative procedures	3	23.1 %
Labor problems	High labor costs	3	23.1 %
Finance	Funds procurement	3	23.1 %
Insufficient infrastructure	Roads	3	23.1 %
Insufficient infrastructure	Communication	3	23.1 %
Trade legislation/procedures	Tariffs	2	15.4 %
Tax systems/procedures	Tax rates	2	15.4 %
Tax systems/procedures	Other	2	15.4 %
Labor problems	Low quality of workers	2	15.4 %
Materials and parts procurement	Deliveries	2	15.4 %
Product/Environmental regulations	REACH	2	15.4 %
Other	Residential environment for foreign workers	2	15.4 %
Trade legislation/procedures	Point-of-origin rules	1	7.7 %
Trade legislation/procedures	Other	1	7.7 %
Investment legislation/procedures	Nontransparent operation of favorable measures for investment	1	7.7 %
Investment legislation/procedures	Other	1	7.7 %
Tax systems/procedures	Complex and nontransparent administrative procedures	1	7.7 %
Labor problems	Securing managerial personnel	1	7.7 %
Labor problems	Securing clerical workers	1	7.7 %
Labor problems	Unions/strikes	1	7.7 %
Labor problems	Other	1	7.7 %
Finance	Collection of accounts receivable	1	7.7 %
Materials and parts procurement	Other	1	7.7 %
Insufficient infrastructure	Port facilities	1	7.7 %
Insufficient infrastructure	Other transportation situation (Public transport)	1	7.7 %
Insufficient infrastructure	Water supply	1	7.7 %
Insufficient infrastructure	Other	1	7.7 %
Product/Environmental regulations	RoHS	1	7.7 %
Product/Environmental regulations	ELV	1	7.7 %
Trade legislation/procedures	Anti-dumping measures	0	0.0 %
Trade legislation/procedures	Most-favored-nation treatment	0	0.0 %
Tax systems/procedures	Double taxation with Japan	0	0.0 %
Standards, certification and regulations	Animal/plant quarantine	0	0.0 %
Standards, certification and regulations	Other	0	0.0 %
Labor problems	Securing of general factory workers	0	0.0 %
Labor problems	Social security system	0	0.0 %
Finance	Other	0	0.0 %
Product/Environmental regulations	WEEE	0	0.0 %
Product/Environmental regulations	EuP	0	0.0 %
Product/Environmental regulations	Euro5	0	0.0 %
Product/Environmental regulations	Other	0	0.0 %
Other	EU competition law	0	0.0 %
Other	Insufficient protection of intellectual property rights	0	0.0 %

Source: JETRO Survey, Japan External Trade Organization

V. Compliance with the Body of EU Law (Acquis communautaire)

- The existing laws and systems, as well as the standards and certification procedures may be altered to harmonize Turkey's domestic laws with the body of EU law.
- Only a quarter of the respondent companies are taking concrete countermeasures against such alterations.

The screening (examination of how Turkey's domestic laws comply with EU legislation in preparation for its introduction and enforcement of the EU legislation) has been gradually implemented in the 35 areas of negotiation as a part of Turkey's EU accession negotiations and was finally completed on October 13, 2006. Formal negotiations in the area of science and technology were also completed in June 2006. Negotiations were initiated in the area of business and industrial policies in March 2007, in the areas of financial controls and statistics in June 2007, in the areas of Trans-European networks as well as consumer and health protection in December 2007 and in the areas of business and intellectual property law in June 2008.

Although the EU foreign ministers concluded to freeze eight chapters in the accession negotiation agenda while allowing negotiations in the remaining 26 chapters to be initiated but not to be completed (unless Turkey signs a customs agreement with Cyprus) in the meeting held at the end of 2006, the negotiations resumed in the areas mentioned above after the temporary interruption.

The Turkish government still maintains the policy of bringing the country's laws in line with the body of EU law (Acquis Communautaire), and it is possible that the existing laws and systems, as well as the standards and certification procedures may be drastically revised. When asked about their reaction to the process of the legislative compliance based on this situation, only 3 out of the 12 companies answered that they were taking some kind of countermeasure to deal with the situation and the remaining 9 companies answered that they are taking no action. Regarding the specific countermeasures, 3 companies referred to information gathering, one company referred to an estimation of the costs to be required for compliance and one company referred to a review of its production system, including the reduction of costs. Some of the respondent companies have already acquired EU certification.

The EU progress report issued in November 2008 commended the developments made on the part of Turkey in the aforementioned areas already in negotiation but also comments that the country's compliance with the Copenhagen criteria (which ask for the protection of human rights and democratization) is limited, especially in the area of political reform (although it mentioned to the legislation developed concerning freedom of expression).

Table 9: Reactions to the Process of Legislative Compliance

Taking measures	Not taking measures	Respondents
3	9	12
25.0	75.0	100.0

Upper column: Number of respondent companies

Lower column: Component ratio (%)

Source: JETRO Survey, Japan External Trade Organization

VI. FTAs with Neighboring Countries

- Only 3 out of 12 companies are utilizing the FTA framework.
- All 3 companies answered that their specific intended use is the development of export destinations.

At present, Turkey has free trade agreements (FTA) with Israel, Macedonia, Bosnia-Herzegovina, Croatia, Morocco, Tunisia, Syria, Egypt, Albania and Georgia. Preferential duty treatment and other measures are being accorded by some of the countries with which Turkey has an FTA. When asked about the influence Turkey's FTA strategy may have on their business activities, responses were received from 12 Japanese manufacturing affiliates operating in Turkey.

While 3 companies stated that they are currently using the FTA framework in their business activities and 2 companies replied that they are considering the use of the FTA framework in their present or future business activities, the remaining 7 companies answered that they have no plan to use the FTA framework.

When the 3 companies that stated that they currently use the FTA framework in their business activities were asked about their use in specific terms, all 3 companies answered that they use it for the development of export destinations. They named Israel, Bosnia-Herzegovina, Morocco and Egypt as trade partners. The 2 companies considering the use of the FTA framework also intended to use the framework to develop export destinations. Israel, Morocco, Tunisia and Egypt were cited as their trade partners.

Table 10: Influence of Turkey's FTA Strategy on Business Activities

Currently using the FTA framework in business activities.	Considering the use in present or future business activities	Not planning to use the framework at this time	Respondents
3	2	7	12
25.0	16.7	58.3	100.0

Upper column: Number of respondent companies

Lower column: Component ratio (%)

Source: JETRO Survey, Japan External Trade Organization