

JAPAN

Overview

Saddled with stagnant private consumption and a financial credit squeeze, the Japanese economy remains in recession heading into mid-1999. External factors such as the Asian currency crisis and wide exchange rate fluctuations continue to have considerable negative impact on the world's second-largest economy, most noticeably by having negative effects on Japanese firms' ability to profitably export. Japanese government efforts to address various reforms, specifically covering six sectors, are promoting deregulation in some areas, most notably the financial sector, but these appear unlikely to bring immediate revival. However, Japan remains the second largest market for U.S. exports after Canada, and the U.S. remains the largest exporter of goods to Japan. Some sectors such as telecommunications are booming, and despite the sluggish performance of the overall economy, Japanese companies and consumers exhibit increasing demand for competitively priced foreign goods, services, and equipment, especially those products with technological advances. U.S. firms should be committed to this market, keeping in mind both Japan's current and immediate potential, both in terms of volume and the level of consumer sophistication, and the eventual recovery of the overall economy.

Defense Industry Environment

Japan's defense requirements in past years were driven primarily by the threat of the former Soviet Union's substantial force structure in Soviet Asia. This resulted in annual increases in Japanese defense spending during the 1980s of roughly 6 percent. However, the end of the Cold War triggered a re-evaluation of Japan's security requirements. Japanese security strategy is now primarily concerned with the potential threat of continued existence of major Russian forces in Siberia and an increasingly assertive and economically expanding China. Additionally, Japanese Self Defense Forces face new requirements for mobility and long range deployments to accomplish the relatively new objective of increased participation in U.N. peace keeping humanitarian and international relief operations.

The FY 1999 (April 1999-March 2000) Japanese defense budget is expected to increase by only 0.2 percent and this flat trend in defense spending is expected to continue into the near future. The budget also reflects a level of defense spending of a politically sensitive less than 1 percent of Japan's GDP. As in previous years, a large percentage of available funding will continue to be spent on personnel and provisions and somewhat less will be left over for new procurement of products.

Japan's defense budget, at around US \$48 billion, is the world's fourth largest behind the U.S., Russia, and China. Although Japan's procurement budget (about US \$10 billion) is large, a significant portion of it is devoted to only four very expensive programs: the Multiple Launch Rocket System (MLRS), the AWACS airborne early warning system, the Mitsubishi/Lockheed Martin F-2 air superiority fighter aircraft, and the AEGIS guided missile cruiser. All of these are

being either license produced, imported, or jointly developed with the United States.

Supply to the Japanese defense industry is dominated by twelve companies that account for approximately 95 percent of the Japan Defense Agency's (JDA) acquisition budget (see below). These companies include the so-called "heavy" industrial firms and several of Japan's largest electronics manufacturers. Since the mid-1980s, total defense production has been approximately 90 percent domestic and 10 percent overseas procurement, most of the latter from the U.S. Also, as noted above, there is a great deal of license production with the majority involving U.S. firms. The heavy industries average 50-75 percent license production while the electronics companies' license production averages 25-50 percent.

The twelve leading Japanese defense companies are:

- Mitsubishi Heavy Industries, Ltd. (ships, military vehicles, aircraft, missiles)
- Kawasaki Heavy Industries, Ltd. (ships, aircraft)
- Ishikawajima-Harima Heavy Industries, Co., Ltd. (ships, engines)
- Mitsubishi Electric Corporation (electronics, missiles)
- Toshiba Corporation (electronics, missiles)
- NEC Corporation (electronics)
- Fuji Heavy Industries, Ltd. (aircraft)
- The Japan Steel Works, Ltd. (artillery)
- Komatsu, Ltd. (small arms/ordnance, military vehicles)
- Hitachi, Ltd. (electronics, military vehicles)
- Oki Electric Industry Co., Ltd. (electronics)
- Daikin Industries, Ltd. (small arms/ordnance)

Compared to Japanese industrial production as a whole, the defense sector is comparatively small as a result of stringent Japanese government policies prohibiting export of military and military-related equipment, seriously constraining economical mass-production. Within the major companies as well, defense production accounts for a relatively small portion of their overall business. Consequently, Japanese corporations are generally hesitant to expend money and effort to develop military technology unless it has dual-use applications. Instead, they would rather buy military technology from abroad through licensed production or as hardware components to be integrated into Japanese systems. Many major license production and co-production programs such as the F-15, SH-60, and P-3C, though built in Japan, have a significant percentage of components imported from the U.S.

Defense Opportunities

U.S. defense companies, systems, and equipment have excellent reputations in Japan. The Japanese defense industry sees itself as five to ten years behind the United States in systems integration, with little hope of closing the gap over the next decade. However, in the area of components and basic technology, Japan's defense industry sees itself as only slightly behind the U.S. with a good chance of surpassing U.S. industry in certain dual-use technologies. Excellent defense trade opportunities exist for U.S. firms in the following industry and/or technology areas:

- Missile technology (AAM, ASM, SAM)
- Air Defense Systems
- Target Acquisition Systems
- Defense Electronics (particularly upgrades)
- Avionics
- C3I (OTH Radar, Have Quick/JTIDS, GPS, Maritime Surveillance)
- Semiconductor components
- Logistics Software (CALs)
- Information Systems
- Signals Processing
- Simulation

Defense Procurement Process

The JDA operates a Central Procurement Office (CPO) that handles most military procurement, although in response to criticism to some of its procedures, it is likely that the CPO will be reorganized to some degree in the near future. In theory, a foreign company can sell directly to the JDA. However, in practice, the JDA buys commercially from a Japanese prime contractor (such as Mitsubishi Heavy Industries) or a trading company such as Nissho-Iwai or C. Itoh. They also purchase directly from the U.S. Government through the Foreign Military Sales (FMS) system. Furthermore, Japan is also adopting some U.S. defense acquisition reforms to promote more reliance on international military standards (versus Japan-specific standards) and increased off-the-shelf procurement for lower costs.

To successfully enter the Japanese defense market, it is highly advisable to establish a relationship with a Japanese manufacturer or trading company. Many of these organizations are particularly adept at navigating complicated, but not necessarily discriminatory, Japanese procurement and distribution networks. Moreover, in order to establish a successful business presence in the Japanese market, it is important to develop a long-term business relationship with a Japanese company based on mutual trust. A Japanese partner or trading company can play the role of trusted intermediary to the JDA on behalf of a U.S. firm that is new to the market.

Diversification/Commercial Opportunities

Due to ongoing deregulation and the continued opening of markets to foreign products and services, substantial opportunities exist for U.S. defense firms in dual use or related technology fields. In fact, with Japanese defense spending likely to remain flat for the near future, commercial opportunities may be more promising than direct military sales. Significant export opportunities offering near-term growth potential and/or a large market receptive to U.S. suppliers are listed below.

Telecommunications Equipment

As a result of U.S.-Japan agreements to further expand Japan's telecommunications

market, few overt barriers remain. The Japanese market is very competitive in almost all sub-sectors and its proposed National Information Infrastructure (NII) is expected to develop into a US \$1.4 trillion market by the year 2010 when a nationwide optical fiber-to-the-home network is expected to be in mid-phase.

The major player in both the NII and the Japanese telecommunications market is Nippon Telegraph and Telephone (NTT). NTT is the single largest purchaser of telecommunications equipment in the Japanese market, having purchased more than US \$1.5 billion worth of foreign products in FY 1997 (April 1997 – March 1998). Besides NTT, new entrants to Japan's telecommunications market (called "new common carriers" or NCCs), including electric power companies (who are often NCC shareholders), are excellent potential customers for U.S. equipment suppliers. The most promising sectors within this US \$30 billion market include: (1) internetworking equipment such as routers, frame relay switches, and ATM switches; (2) multimedia software and hardware, including CATV; (3) radio communications equipment; and (4) communications satellites.

Electronic Components

This is a nearly US \$51 billion market and is expected to grow approximately 25 percent in 1999. Despite intense competition from Japanese companies, this market is one of the world's largest and most attractive for U.S. suppliers. Particularly promising areas include semiconductors, especially in the multimedia sub-sector (1999 estimated overall sales of US \$30 billion), and liquid crystal display devices/panels (1999 estimated sales of US \$10 billion). The market for other (i.e., passive) components is expected to remain small due to continuing weak consumer demand.

Medical/Diagnostic Equipment

As the "graying" of Japanese society continues, the Japanese Government is increasing expenditures for improvement of social infrastructure, including health and welfare facilities. This will increase demand for products for the elderly as well as for innovative medical systems equipment. Japanese physicians and other medical professionals generally look to the U.S. for innovative and advanced products, but some criticize the lack of good after sales service by U.S. suppliers.

The import market, of which the U.S. has a 2/3 share, currently accounts for some 30 percent of the total US \$18 billion market, and should expand by at least 5 percent annually into the foreseeable future. The most promising areas in the medical equipment market include implants such as pacemakers, artificial heart valves, and artificial joints; anesthesia equipment and laparoscopic surgery devices; and diagnostic imaging devices including high quality ultrasound, CT, and MRI equipment.

Aircraft and Parts

While the U.S. still maintains a commanding lead in global aircraft and component

manufacturing, European manufacturers have entered the Japanese market to a large degree and Japanese aircraft exports have been expanding in recent years (at present some 15 percent of total production in Japan). Recently, automotive superpower Toyota announced that it is considering production of light aircraft, probably from a subsidiary in the U.S. Due to the investment risk inherent in modern aviation projects, cooperative ventures among U.S., European, and Japanese firms have increased substantially in recent years.

Japan's general aviation market is very small as few companies or individuals own their own aircraft due to exorbitant costs and/or regulations. More than 70 percent of local production of aircraft is absorbed by Japan's Defense Agency. Airframes and parts account for 57 percent of total production, engines and parts 20 percent, and related equipment 23 percent. The most promising sub-sectors within the US \$9 billion dollar market include civil aviation jet aircraft, aircraft engines and parts, and general aviation aircraft including helicopters and executive jets.

Computers and Peripherals

This is a very large (US \$55 billion) market and is expected to grow more or less indefinitely. Market access for U.S.-made PC's has improved dramatically in recent years. The multimedia PC/workstation sub-sector is particularly attractive with forecast annual growth of 30 percent in 1999. U.S. suppliers have a leading market position in client/server and parallel processing systems although Japanese competitors are increasingly focusing on this area. Although less vibrant than the PC/Workstation sector, the market for large mainframe computers and peripheral systems is expected to grow 8-10 percent in 1999.

Computer Software

U.S. suppliers are extremely competitive in this market, which should expand from its current US \$11 billion to over US \$15 billion in 1999. PC software accounts for about 45 percent of the entire software market. Custom software for large and mid-range computers and workstations will have annual growth of 6-8 percent over the next several years, but packaged software will show annual growth of approximately 20 percent during this period. Particular demand is forecast for software for the Internet and personal computers as well as PC packaged software, CD-ROM software, and network software.

Security and Safety Equipment

According to the latest industry statistics, Japan's security equipment market in the last FY 1997 (April 1997-March 1998) grew by 4 percent to US \$2.8 billion and the market will increase by 6 percent in FY 1998 (April 1998-March 1999) due to increased security awareness resulting from rising crime incidents.

Japan's security equipment market is broken down into general crime-prevention products including EAS systems, sensors, and electric door locks (currently 28 percent); video surveillance systems including cameras, monitors, and transmitters (24 percent); central

monitoring systems including transmitters, alarms, and central station panels (24 percent); home security products including intercom, video camera systems, and fire alarms (13 percent); access control systems including IC card, proximity cards, and biometric systems (6 percent); and intruder detection systems including infra-red sensors, window sensors, and magnetic sensors (5 percent). Industry forecasts access control grow at 31 percent, followed by video surveillance (8 percent), home security (7 percent), central station monitoring (6 percent), and intruder detector (5 percent). The general security equipment is forecast to diminish by 3 percent due to sluggish housing starts.

Environmental and Pollution Control Equipment

Both the Japanese central government and local municipalities continue to strengthen environmental protection and pollution control regulations; however, the market for all forms of pollution control equipment is expected to decline in 1999 due to the recession. Japan's adoption of the ISO 14000 standard for environmental management and auditing should expand future market opportunities. The Japanese market is quite competitive, but there is substantial U.S. export potential for state-of-the-art U.S. equipment and services, particularly those utilizing biotechnology applications for waste treatment and contamination remediation. Also, cost-effective U.S. technology for water and wastewater treatment and soil and groundwater contamination has high sales potential.

Doing Business in Japan

There are few or no shortcuts when selling to Japan. In-country representation is crucial as well as a long-term commitment to the Japanese market. Sales, service, customer support, competitive prices, technical excellence, a proven track record, and second-to-none quality are critical.

Commercial success in Japan tends to be directly correlated with the strength of a company's personal relationships with its Japanese business partners and customers. Although a U.S. firm may have a high quality, innovative, competitively priced product, a company will generally not succeed unless it builds and cultivates good personal relationships. It is strongly recommended that U.S. firms establish a presence in the market by establishing a representative or branch office in Japan. If this is not possible, a Japanese partner, in the form of an agent, representative, distributor, or joint venture partner is key to success in Japan.

The basics for commercial success in Japan are briefly described below:

- Be committed to the market
- Build a positive company image
- Demonstrate patience
- Do adequate research prior to market entry
- Appoint a manager for Japan operations
- Develop personal relationships

- Find, attract, choose, and keep a quality Japanese business partner
- Follow-up is essential
- Listen to the Japanese partner and customer
- Adapt products to the Japanese market
- Competitive pricing
- Provide quality sales and customer service
- Learn how things are done in Japan

Government Procurement Process

On January 1, 1996, Japan entered into an “Agreement on Government Procurement” in an effort to expand opportunities for foreign firms and to increase international competition in government procurement in Japan. The agreement calls for the procurement of services and the procurement throughout Japan by what are referred to as sub-central government entities. These entities include all of the prefectural (regional) governments in Japan, major cities and designated municipalities, and a host of other quasi-governmental agencies, corporations, companies, and authorities. As of early 1999, however, actual results are disappointing.

There are three main types of government tendering in Japan covered by the 1996 agreement: (1) open tendering, (2) selective tendering, and (3) limited or single tendering. Under an open tender, the procuring entity publishes an invitation for qualified suppliers to participate in the tendering process. Contracts are awarded to the bidder that offers the greatest advantages to the tender in terms of price. Selective tendering is done when open tendering is not necessary because only a small number of suppliers can participate due to the nature of the contract, or when open tendering is otherwise regarded as inappropriate. In this case, the procuring entity designates companies it considers capable from a list of qualified suppliers and invites them to bid. Again, the contract is awarded to the bidder with the best price advantage.

The limited (single) tender process awards contracts without open competition. Limited tenders may be used for procurements such as where products could not be obtained through open or selective procurement procedures, where there has been an absence of bids in response to a public notice, and where it has been determined there is a need for protection on exclusive rights, procurement of extreme urgency, for reasons of national security.

Open tender and selective tender invitations are published in Japan’s official (central) government procurement gazette, called the “Kanpo,” or in an equivalent regional level (“Kanpo” or “Ken-Ko-Ho”) publication, or similar. To increase access opportunities for foreign suppliers, as a voluntary measure many procuring entities publish notices on the use of limited tenders at least twenty days in advance of the awarding of a contract.

U.S. companies wishing to participate in open or selective tenders of a particular Japanese government agency must first be qualified by and registered as a qualified supplier on the tendering agency’s permanent list of qualified suppliers. In most cases, Japanese subsidiaries, agents, or distributors of a U.S. company can register on behalf of the firm. In order to qualify, all related companies must apply for qualification jointly.

Every procuring entity in Japan specifies qualifications for the kinds of suppliers they desire to see participate in open or selective tenders. Procuring entities are allowed to review the capabilities of a company, including scale of business and past business performance, prior to decision making. Decisions to award a contract, as a rule, are made on the basis of tendered prices.

Trade Barriers

Over the past several years, the Japanese Government has removed most formal barriers to the import of goods and services. Most goods now qualify as “freely importable” and do not require an import license. Also, the average applied tariff in Japan is one of the world’s lowest.

However, major obstacles to selling in to Japan remain which do not fit into conventional trade barrier categories. Instead of tariffs and official discrimination against imports, American exporters face a number of factors that raise costs and inhibit access. Examples include: the importance of personal relationships, tangles of government red tape, preferential treatment of domestic products (often via extremely complicated and non-transparent indirect government or quasi-governmental-initiated subsidies), lack of transparency in import certification and approval procedures, extremely high entry infrastructure costs (land, personnel, services, etc), an outdated and fragmented distribution system, close ties among Japanese competitors, and skeptical attitudes towards foreign suppliers by many government and business executives.

Taxation

A 5 percent consumption tax, essentially a value-added sales tax, is levied at the time of each resale, starting with customs clearance into Japan at which time it is levied on the c.i.f. value plus import tariff. Retail sales are also subject to the 5 percent consumption tax. Royalties, including licensing royalty payments, are subject to a 20 percent withholding tax, which can be reduced to ten percent under the 1971 U.S.-Japan Double Taxation Treaty. Local branches of foreign firms are generally taxed only on income derived from within Japan. Calculation of taxable income and allowable deductions, and payments of the consumption tax for U.S. firms in Japan are similar to the tax regulations faced by Japanese companies.

Licensing of Technology

Companies should carefully consider the suitability of this approach. Licensing product technology can immediately contribute to a company’s bottom line with little investment or direct cost. However, licensing is a very limited form of market participation. High potential returns from marketing and manufacturing efficiencies are lost, and very little market information is gained. Often licensing agreements prove to be short-lived as the Japanese licensee improves upon the imported product or technology and then exports the improved product back to the country of origin or third countries -- thereby becoming a major competitor.

The wisdom of licensing technology depends on the status of a company’s patents in

Japan, together with the degree to which the company must disclose trade secrets to its licensee. The key to success in a licensing agreement is to have a partner whose goals coincide with those of the U.S. company. The American firm should maintain close contact with the licensee and keep current on the Japanese market by visiting Japan regularly. Also, it may be important to reinforce license rights by maintaining tight control over trademarks, patents, or copyrights.

In cases where a foreign company wishes to grant a license to an independent Japanese corporation, to its wholly owned Japanese subsidiary, or to a joint venture corporation in Japan, the Ministry of Finance must be notified through the Bank of Japan. In some instances, it may be necessary to also notify the Japanese Fair Trade Commission. More stringent regulations apply to "designated technologies" that have been determined to have significant influence on the security of the nation and the national economy.

Foreign Investment Restrictions

In various sectors such as broadcasting, telecommunications, electric power generation, domestic rail and air transportation, firearms, gunpowder, atomic energy, aircraft, space development, pharmaceuticals, vaccine manufacturing, security guard services, agriculture, forestry and fisheries, and petroleum refining and marketing, 100 percent foreign capital-based companies are still not permitted.

Intellectual Property Rights

Although Japan has signed the Paris Convention for the Protection of Industrial Property and other treaties governing the protection of industrial property rights, deficiencies remain in its intellectual property laws and in enforcement. Problems involving protection of patents, copyrights, and trademarks are frequent. Thus, U.S. firms should take the steps necessary to obtain and protect their intellectual property through patents, trademarks, copyrights, and other intellectual property rights in Japan to the strongest degree possible.

U.S. Exporter Assistance

Entering the Japanese market, particularly its complicated distribution system, requires commitment and a systematic well thought out approach. It is highly advisable for prospective exporters to take advantage of export assistance offered by several U.S. Government agencies. The U.S. & Foreign Commercial Service, which promotes exports of non-military goods and services, maintains offices in Tokyo, Osaka, Nagoya, Sapporo, and Fukuoka. Staff report on commercial developments, identify trade barriers, prepare market research reports, counsel U.S. exporters on business practices and opportunities, coordinate U.S. participation in and organize trade events, and introduce exporters to Japanese buyers. US&FCS works closely with the American Chamber of Commerce in Japan.

U.S. Government and Private Sector Points of Contact

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