Results of the 2013 JETRO Survey on Business Conditions of Japanese-Affiliated Firms in Canada

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Japan External Trade Organization
Overseas Research Department, North America Division

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Survey Method and Remarks

The present survey is the 24th in a series of surveys continuously carried out by the JETRO office in Canada since 1989 (no survey was conducted in 2004).

1. Survey Purpose

To survey and analyze the state of Japanese-affiliated firms in Canada (business confidence, performance, management challenges, etc.) with the aim of facilitating business activities and management strategy planning for Japanese-affiliated firms.

2. Survey Coverage

The definition of "a Japanese-affiliated firm" is one in which the capital contribution ratio of the parent firm in Japan is at least 10%, including direct and indirect investment. For example, if the Japanese parent firm owns 20% of the capital of its subsidiary Firm A in Canada, and Firm A, in turn, owns 50% of the capital of its subsidiary, Firm B, then, the parent firm in Japan holds 10% (0.2 x 0.5 x100) of the capital of Firm B which means that Firm B is defined as "a Japanese-affiliated firm." (Firm B is an indirectly owned subsidiary of the parent firm in Japan.) The same applies to subsidiaries of Firm B.

3. Survey Method

The respondents were informed of the URL of the website where we posted the questionnaire via the office in Toronto. Respondents entered their responses directly on the website.

4. Survey Period

September 6 to October 18, 2013

5. Collecting Responses

The questionnaire was sent to 189 Japanese firms in Canada and responses obtained from 126 firms. The response rate was 66.7%.

(N.B.) Each JETRO office used information sources thought reliable and collected the data with the cooperation of each firm, but JETRO does not guarantee that the information is completely accurate and comprehensive.

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1. Business Conditions

In 2013, business confidence (DI 14.3) declined from the previous year (DI 17.8).

- The diffusion index (the value obtained when subtracting the proportion of businesses reporting decreased operating profits from those reporting increased operating profits compared to the previous year), which indicates firms' business confidence in 2013, was 14.3 (Figure 1). Compared to the previous year, operating profits for the main industries (transportation machines and parts) remained the same, but the decrease was conspicuous for electric and electronic parts, and machines (including molds and power tools).

- Regarding the expectations for operating profits in 2013, only 37.3% of firms reported an increase from 2012 while 39.7% said operating profits would remain the same, and 23.0% reported a decrease (Figure 2). The reasons cited for the increase (multiple responses allowed) were "Sales increase in the local market" (46.8%) and "Sales increase due to expansion of exports" (29.8%) (Figure 3). On the other hand, the reasons cited for the decrease were "Sales decrease in the local market" (51.7%) and the "Effects of exchange rate fluctuations" (37.9%) (Figure 4).

- Compared to 2013, 46.8% forecast that operating profits will remain the same in 2014, 43.7% that they will increase and 9.5% forecast a decrease (Figure 2). The reasons cited for the increase (multiple responses allowed) were "Sales increase in the local market" (60.0%), "Improved sales efficiency" (30.9%), and "Reduction of other expenditures (administrative and energy costs etc.)" (25.5%) (Figure 6). On the other hand, the reasons cited for the decrease were "Sales decrease in the local market" (66.7%), and "Costs insufficiently passed along in the sales price" (41.7%) (Figure 7).

Conspicuous year-on-year decrease in operating profits for electric and electronic parts and machines*

- ➢ Because of the business slowdown in mining and oil sands in western Canada. (Electric and electronic parts)
- ➢ So far, sales partners have focused on commercially available products. We are pushing forward with activities to open up the market for industrial machinery OEM to break the deadlock, but we still haven't had the kind of results that would contribute to sales.

* *The comments indicated by arrowhead bullet points in the main text (type of industry indicated in parentheses) are quotes from interviews with the companies that responded to the questionnaire, and, in part, comments on the survey questionnaire.*

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(Machines, including molds and machine tools)

2. Business Outlook

Concerning future business expansion, “Remain the same” accounted for 60% of responses.

- In terms of trends in the few years, 55.6% expect the outlook to remain the same while 38.9% anticipate expansion (Figure 8). The reasons cited (multiple responses allowed) were “Increased sales” (93.9%), “High growth potential” (36.7%), and “Reviewing production and sales networks” (22.4%) (Figure 9). In terms of the specifics of what kinds of functions will expand, 63.3% cited “Sales function,” 32.7% “Production (high-value added products),” and 22.4% “Production (generic products)” (Figure 10). Concerning the reasons for reduction, transfer to a third country (region) or withdrawal, 71.4% cited “Sales decrease” while 57.1% mentioned “Low growth potential.”
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More than 60% of firms responded that there would be no change in hiring local employees. Regarding the problems related to management localization, “Capabilities and motivation of local employees,” “Difficulty in hiring executive-level employees,” and “No problems” had the same number of responses.

- The initiatives to pursue management localization (multiple responses allowed) were “Focus on the training of local employees” (53.2%), “Hiring experienced employees who can contribute to the localization of management” (46.0%), and “Hiring director or manager-level employees” (46.0%) (Figure 11). On the other hand, problems mentioned in the localization of management were “Capabilities and motivation of local employees” (28.6%), “Difficulty in hiring executive-level employees” (28.6%), and “No problems in particular” (28.6%) (Figure 12).

- 26.2% of firms reported an increase in local employees in the past year, and 57.1% responded with that there had been no change. 16.7% of firms reported a decrease. In terms of future plans, 26.2% responded that the number will increase, 62.7% thought there would be no change, and 11.1% of corporations reported a decrease (Figure 13).

- Regarding the number of Japanese expatriate employees, 73.0% of the firms reported no change in the past year. As for future plans, 83.3% of firms responded that the numbers would not change (Figure 13).

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We are striving to improve awareness by making good use of ambitious local employees

- We aren't yet at the point where we can leave final decisions up to local employees, but we make efforts to consult with some of the management staff. We differentiate between part-timers and local management staff on points like these. (Parts for transportation machines: motor vehicles and two-wheeled vehicles)
- We improve awareness by promoting sales staff who have ambitions for working in operating activities (sales staff with low awareness resign), paying the cost of self-directed studies, and dispatching people to sales conventions at affiliated firms in North America. (Metal goods, including plated products)
- A few years ago, we successfully localized when we promoted a Canadian employee, who had been with the firm since its foundation 25 years ago, to president and representative director. (Electric and electronic parts)
- We have set up a facility in a cluster city that is well-known as a center for advanced technology and innovation, and we have secured staff. (Electric and electronic parts)

3. Management Challenges

Increased labor costs and the prolonged rise in the value of the Canadian dollar (against the U.S. dollar) are the main factors for cost increases. Severe price competition is also a serious problem.

- In terms of challenges for management, the main reasons cited for the cost increases are “Increase in labor costs (including salaries and bonuses)” (60.3%), “Rise in the value of the Canadian dollar (against the U.S. dollar)” (31.0%), and “Increase in raw material, natural resources and commodity prices” (30.2%) (Figure 15). The high Canadian dollar is seen to influence the cost of procuring raw materials.

- On the other hand, the main factors for weak sales are “Severity of price competition” (79.4%), “Difficulties in distinguishing our products or ourselves from competitors” (43.7%), and “Popular products from competitors” (39.7%) (Figure 16).

Dealing with the increase in labor costs by cutting manufacturing costs, etc.

- To eliminate waste in the processes at stores and in-house, we continuously introduce programs for improvements. (Electric and electronic parts)
- (Concerning increased labor costs), we have unfortunately not introduced any new countermeasures. Even if we wanted to hire more employees, there are many cases where we cannot hire anyone because we cannot reach a compromise on wages. (Parts for

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transportation machines: motor vehicles and two-wheeled vehicles)

- We are economizing on manufacturing costs in Canada and switching to manufacturing of higher value-added products. (Electric and electronic parts)

The high Canadian dollar is an encumbrance for Japanese firms in Canada who do a lot of manufacturing for the United States

- Since our main customers are manufacturers or Group firms in the United States, transactions are centered on the U.S. dollar. When the Canadian dollar strengthens, profits decrease and the advantages and competitiveness of die manufacturing in Canada are lost. At the moment, we are not taking any special measures, but since we need the Canadian dollar for the fixed operating costs, we keep an eye on exchange rate fluctuations and convert U.S. dollars to Canadian dollars when the Canadian dollar goes down. (Parts for transportation machines: motor vehicles and two-wheeled vehicles)
- We have replaced the machinery in our factory to lower overall manufacturing costs. (Electric and electronic parts)

Not only from Asia, but price competition with manufactured goods from Latin America has also heated up.

- It's not only Asia; price competition with goods manufactured in Latin America is also intensifying. We have no particular countermeasures. The specifications are determined by the demands of the intended destination. (Parts for transportation machines (Motor vehicles and two-wheeled vehicles))
- When customers request low-quality goods, we lose business to low-priced Chinese-made goods on the market, due to the price difference. In terms of countermeasures, we are shifting to high quality products, obtaining quality certification for areas that are important to OEM customers, and providing technical support and training. (Metal goods, including plated products)

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4. Capital Investment

Seventy percent of respondents said that capital investment had remained the same.

- Although 66.7% of firms reported that compared to 2012, capital investment in 2013 had remained the same, increases over the previous year (19.8%) exceeded the decreases (13.2%) (Figure 17). In order of the number of responses by purpose of investment (multiple responses allowed), 37.3% cited “Streamlining and improving efficiency at the plant (include expanding or renewing of machines and facilities)” and 26.2% listed “Investment in IT for more efficiency” (Figure 18).

5. The Changing Business Environment

- **Twenty-five firms (19.8%) have experience of moving all or part of manufacturing facilities in Canada to another country. When asked about moving manufacturing back to Canada, five firms (20.0%) responded affirmatively, six firms (24.0%) said that they possibly would move back in the future, and 14 firms (56.0%) responded negatively.**
- **In terms of the fields in which the market is most likely to grow in the next two to three years, many responses converged on environment/energy, and medical/health. The reasons for focusing attention on medical and health are the aging population and the increasing awareness of health among the populace.**
- **Concerning the impact of the shale revolution in North America, 32.5% said it had had a positive impact, far outweighing the 4.0% who said it was negative. The positive reasons cited included “Because it creates new opportunities for business” (Parts for transportation machines: Motor vehicles and two-wheeled vehicles) and “Orders for machinery will increase” (Machines). On the other hand, the reasons for negative responses included “Increases in raw materials cost, labor costs, and other manufacturing costs” (Nonferrous metals).**

- About moving manufacturing facilities back to Canada

  Sixteen firms (19.8%) responded that they have had experience of moving all or part of manufacturing in Canada to another country. When asked about moving manufacturing back to Canada, five firms (20.0%) responded affirmatively, six firms (24.0%) said that they possibly would move back in the future, while 14 firms, or more than half, (56.0%) responded negatively (Figures 19, 20). The main reason given for an affirmative response was “We switched to local manufacturing because of rises in transportation costs” (Parts for transportation machines: Motor vehicles and two-wheeled vehicles) On the other hand, the reasons given for the negative response were “No expectation for expansion on the Canadian market” (Transportation machines (Motor vehicles and two-wheeled vehicles) and “Due to the

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strong Canadian dollar, the competitiveness of the Canadian manufacturing industry is severe" (Parts for transportation machines: Motor vehicles and two-wheeled vehicles).

- Fields where the market is most likely to grow in the next two to three years

Asked about in which fields the Canadian market is most likely to grow in the next two to three years (maximum of three), the responses were energy (65.1%), environment (38.1 %), medical (32.5%), and health (25.4%) (Figure 21). Since Canada is a resource-rich country, there is no change in the interest in energy and environment, but the aging population and increasing awareness of health were cited as the reasons for the interest converging on medical and health.

The medical sector is attracting attention due to the aging society and the heightened awareness of health.

- The graying of Canadian society (Timber and wood products, excluding furniture and interior design products)
- The Canadian medical system is advanced even among developed countries, but in the future, we believe even more people than now will pay attention to their health. In particular, the diet business and medical care will flourish in the future. (Parts for transportation machines: Motor vehicles and two-wheeled vehicles)
- We are looking into purchasing a medical care business to supplement current sales in the area of medical care. (Electric and electronic parts)

- Utilization of bilateral or multilateral FTAs/EPAs

Concerning the NAFTA member countries of the United State and Mexico, the U.S. accounted for 50.0% of exports and 52.6% of imports, and Mexico for 52.9% of exports and 64.3% of imports, indicating a high rate of utilization (Figure 22).

- Impact of the shale revolution in North America

Firms that reported a positive impact (32.5%) to the question about the impact of the shale revolution in North America far outweighed the negative responses (4.0%) (Figure 23). The positive reasons included "Because it creates new business opportunities" (Parts for transportation machines (Motor vehicles and two-wheeled vehicles), "Increased orders for machinery" (Machines, including molds and machine tools), "Because transportation costs will go down" (Transportation/Warehouse), and "Positive influence of the Canadian boom" (Other). On the other hand, the reasons for responding negatively included "Increases in raw materials cost, labor costs, and other manufacturing costs" (Nonferrous metals).

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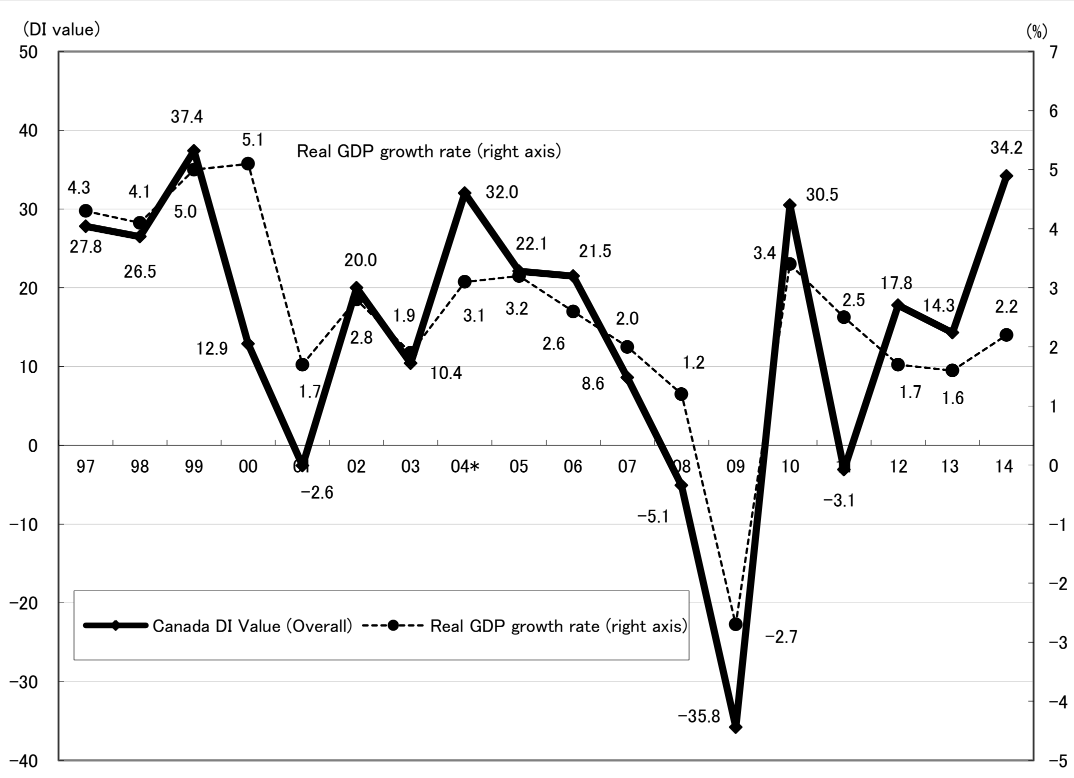
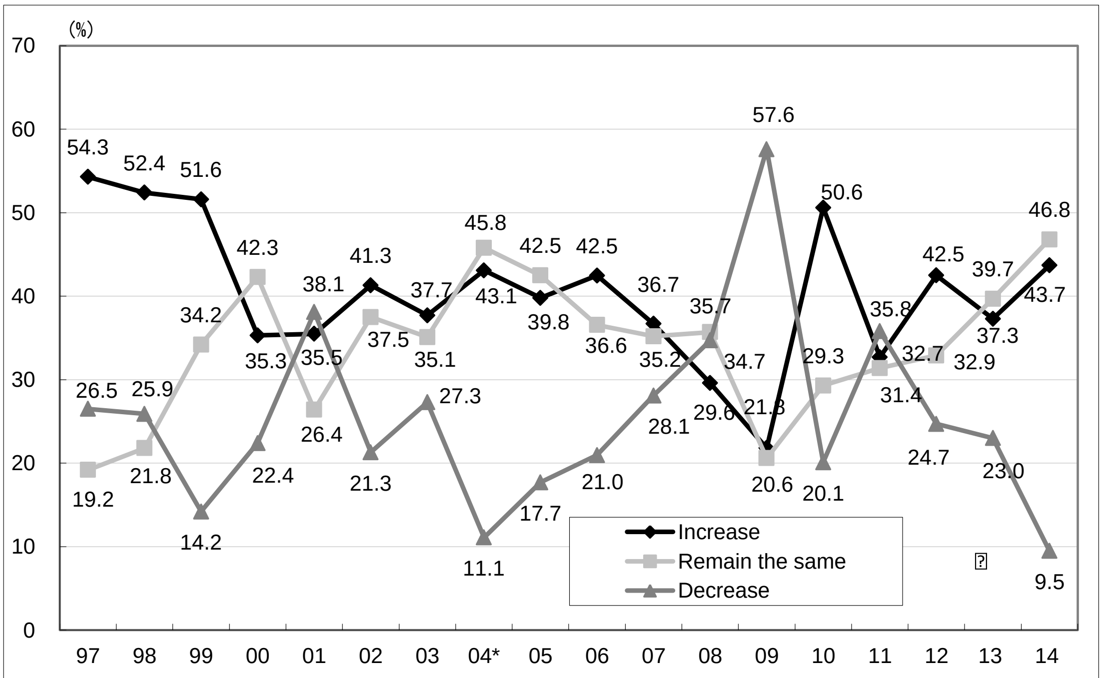
Figure 1: Operating profit diffusion index and changes in Canadian real GDP growth rate



N.B. The DI value for 2013 is the expected value; for 2014 it is a forecast. Real GDP growth rates for 2013 and 2014 are IMF estimates (published on October 8, 2013) *Since no survey was conducted in 2004, the 2004 DI value is the forecast at the time of the 2003 survey.

Number of respondents: 126

Figure 2: Change in operating profit expectations compared to preceding year



* Since no survey was conducted in 2004, the 2004 value is the forecast at the time of the 2003 survey.

Number of respondents: 126

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Figure 3: Reasons for increased operating profits in 2013 compared to 2012 (Multiple responses)

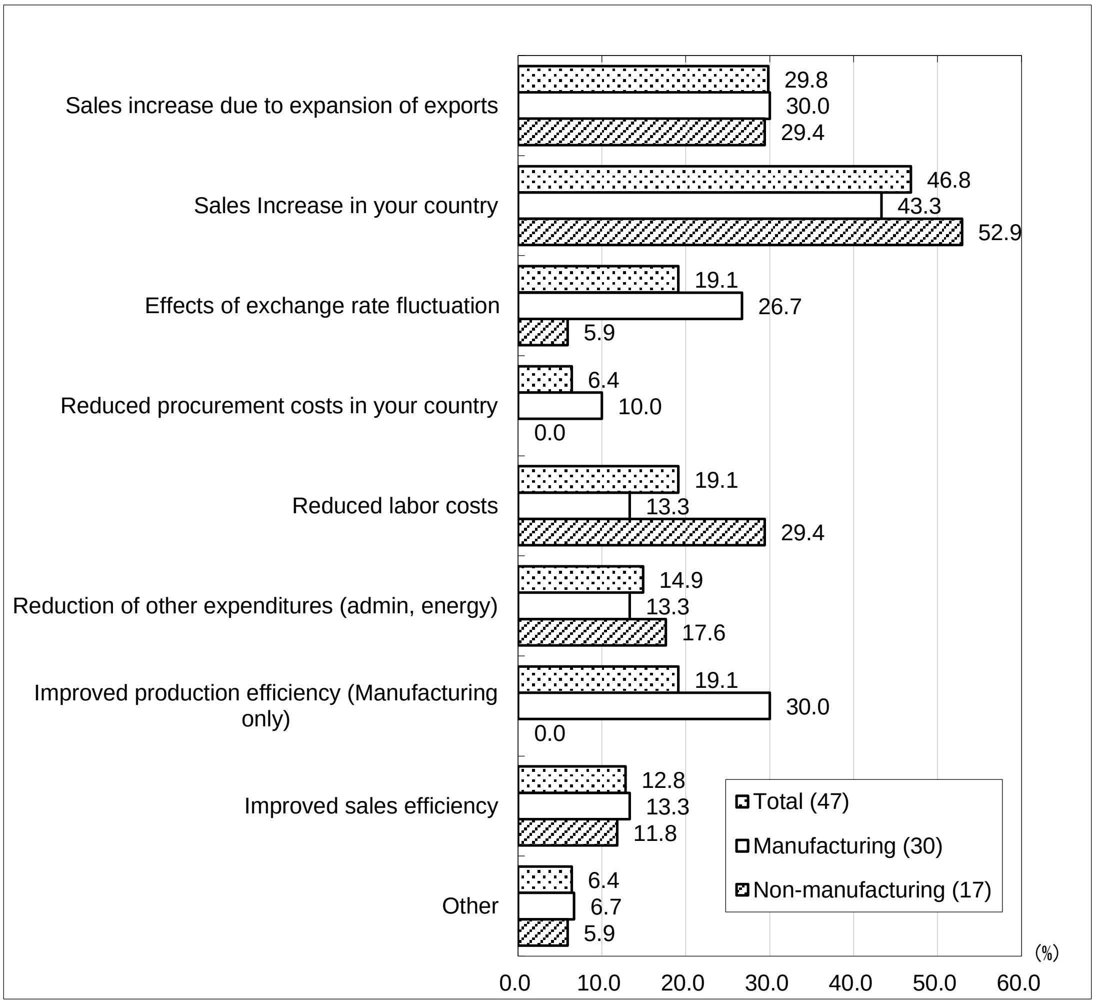

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Figure 4: Reasons for decreased operating profits in 2013 compared to 2012 (Multiple responses)

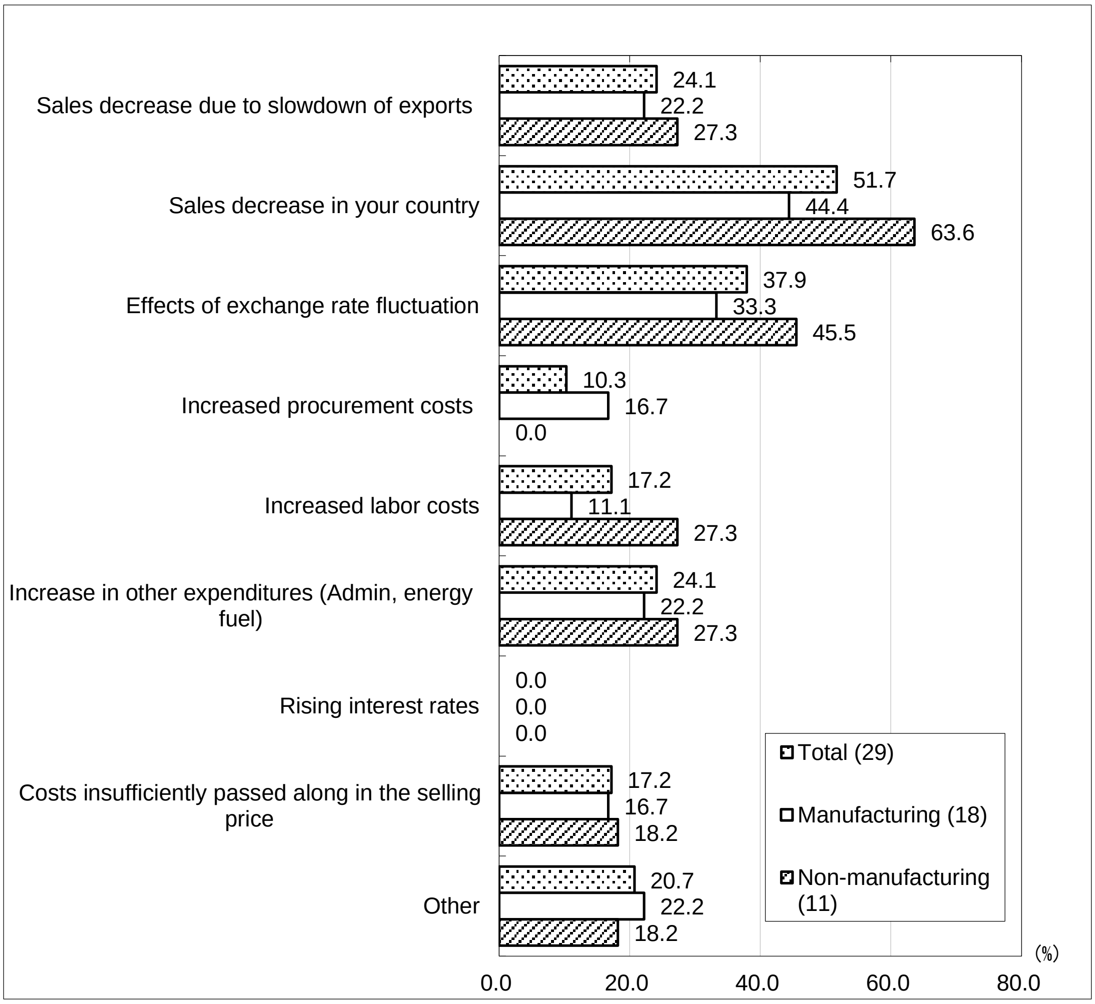

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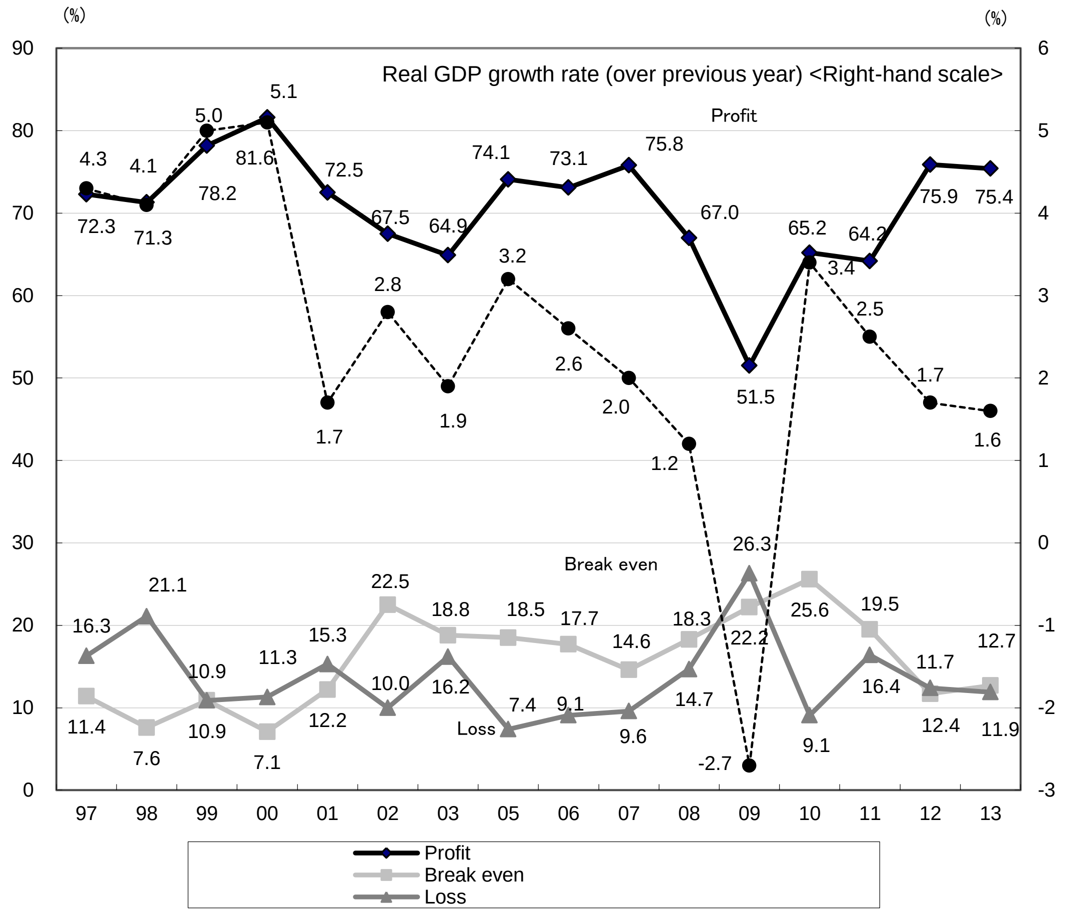
Figure 5: Operating profits (profit, break-even, loss) and changes in Canadian real GDP growth rate



N.B. Real GDP growth rates for 2013 are IMF estimates (published on October 8, 2013). No survey was conducted in 2004.

Number of respondents: 126

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Figure 6: Reasons for increased operating profits forecast for 2014 (Multiple responses)

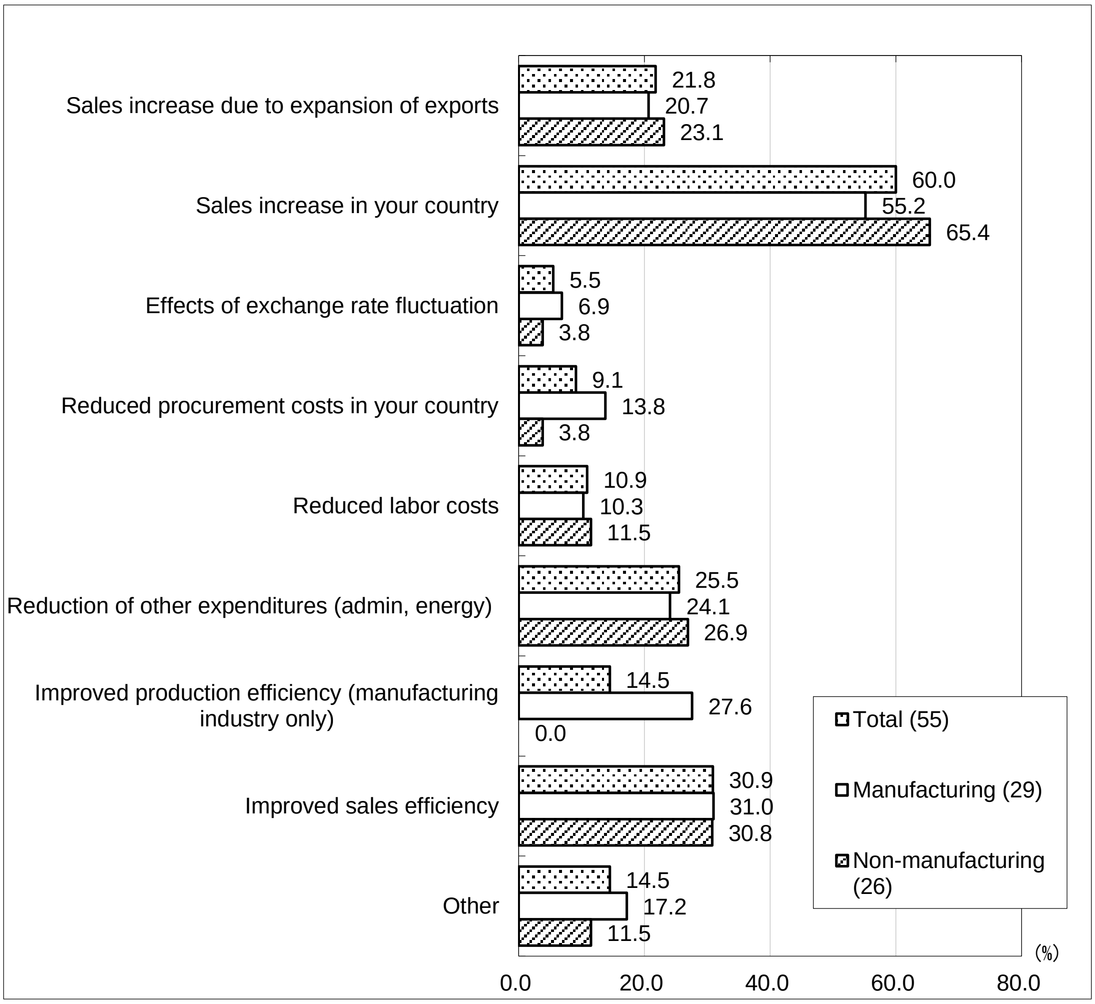

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Figure 7: Reasons for decreased operating profits forecast for 2014 (Multiple responses)

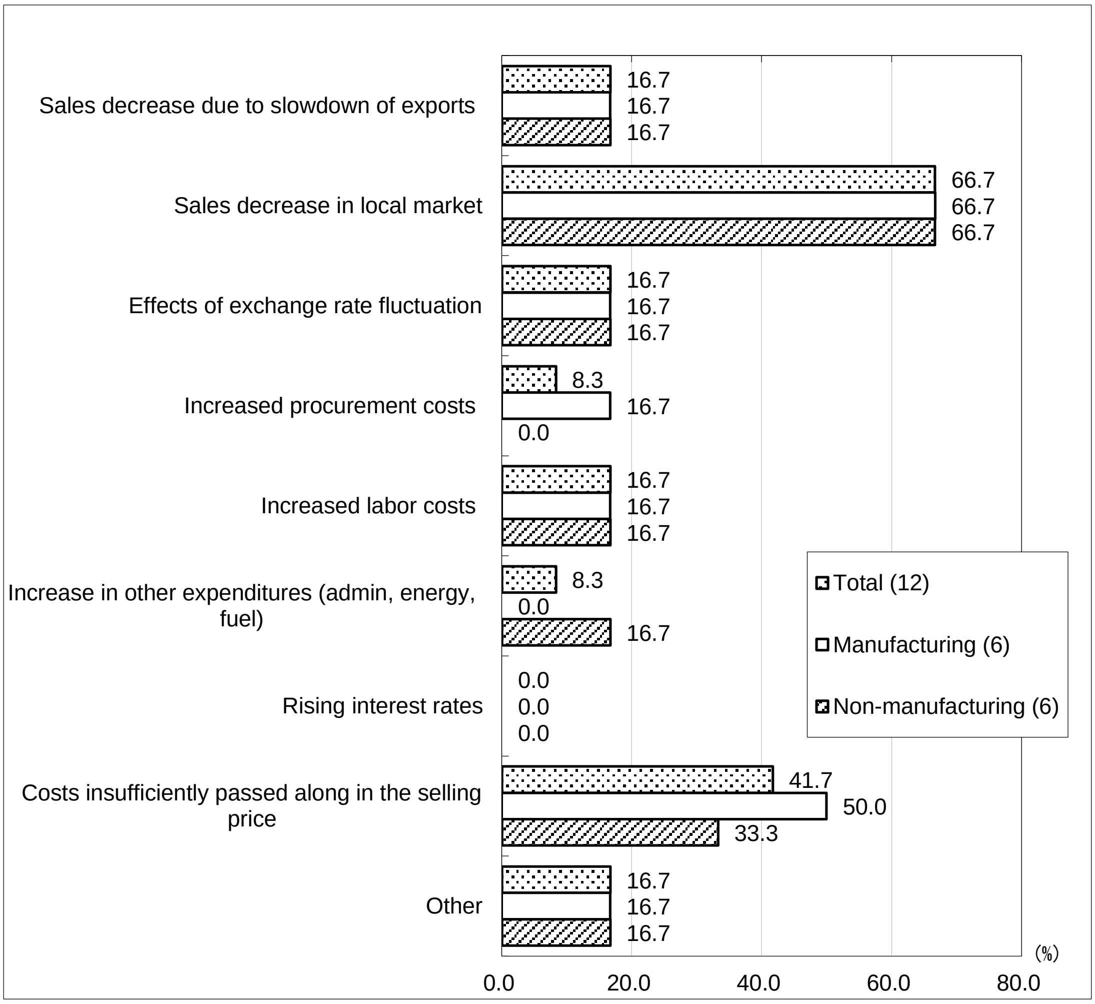
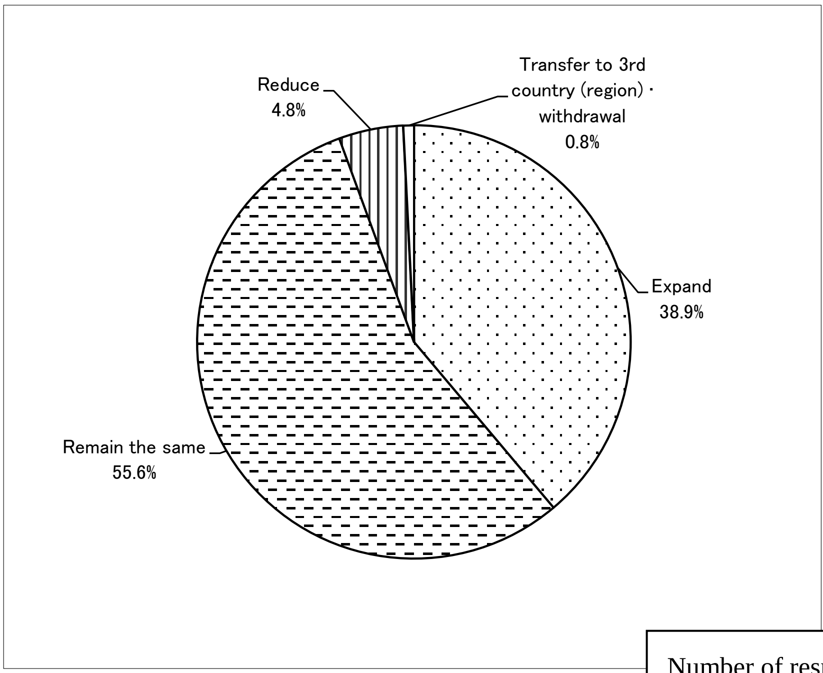


Figure 8: Trends for the business in the next year or two



Number of respondents: 126

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Figure 9: Reasons for business expansion in the next year or two (Multiple responses)

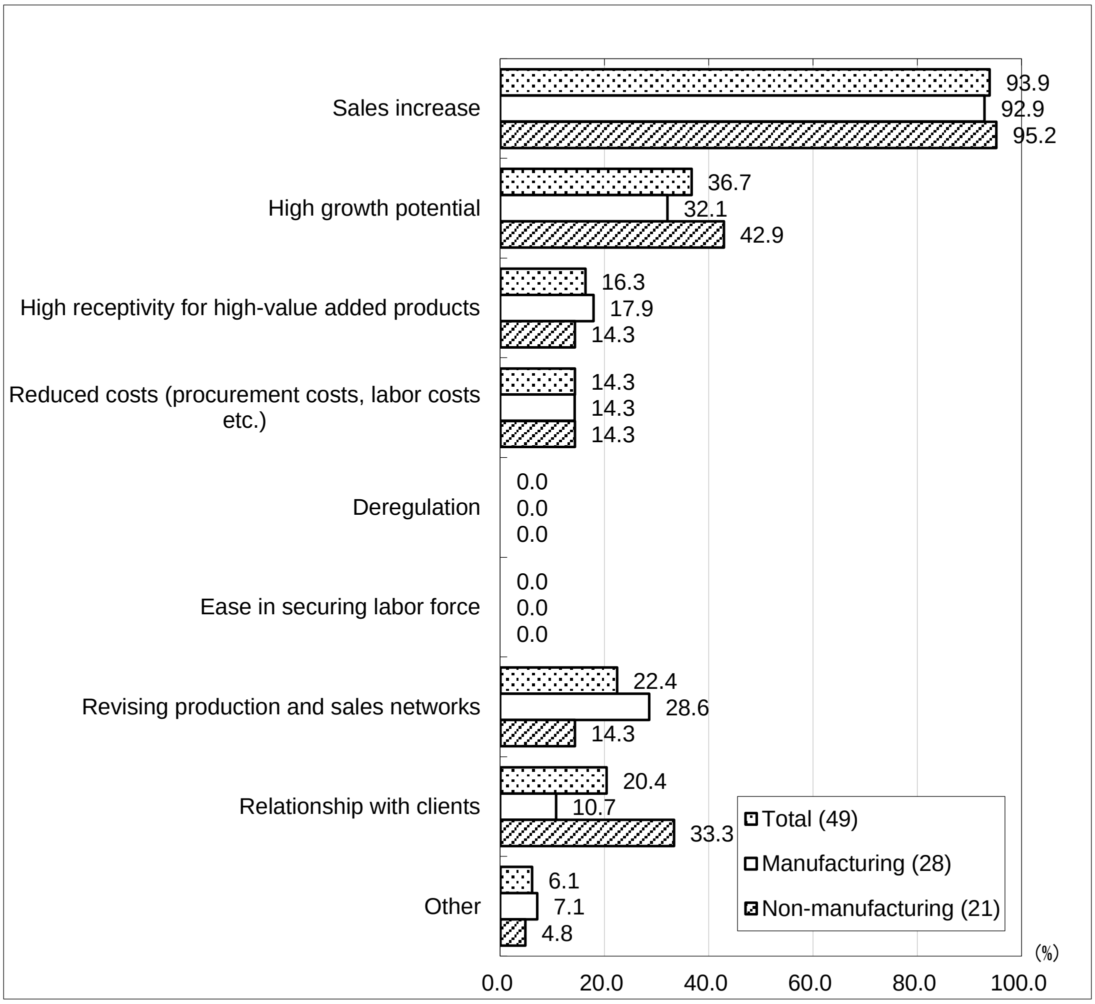

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Figure 10: Expanding functions in case of business expansion in the next year or two (Multiple responses)

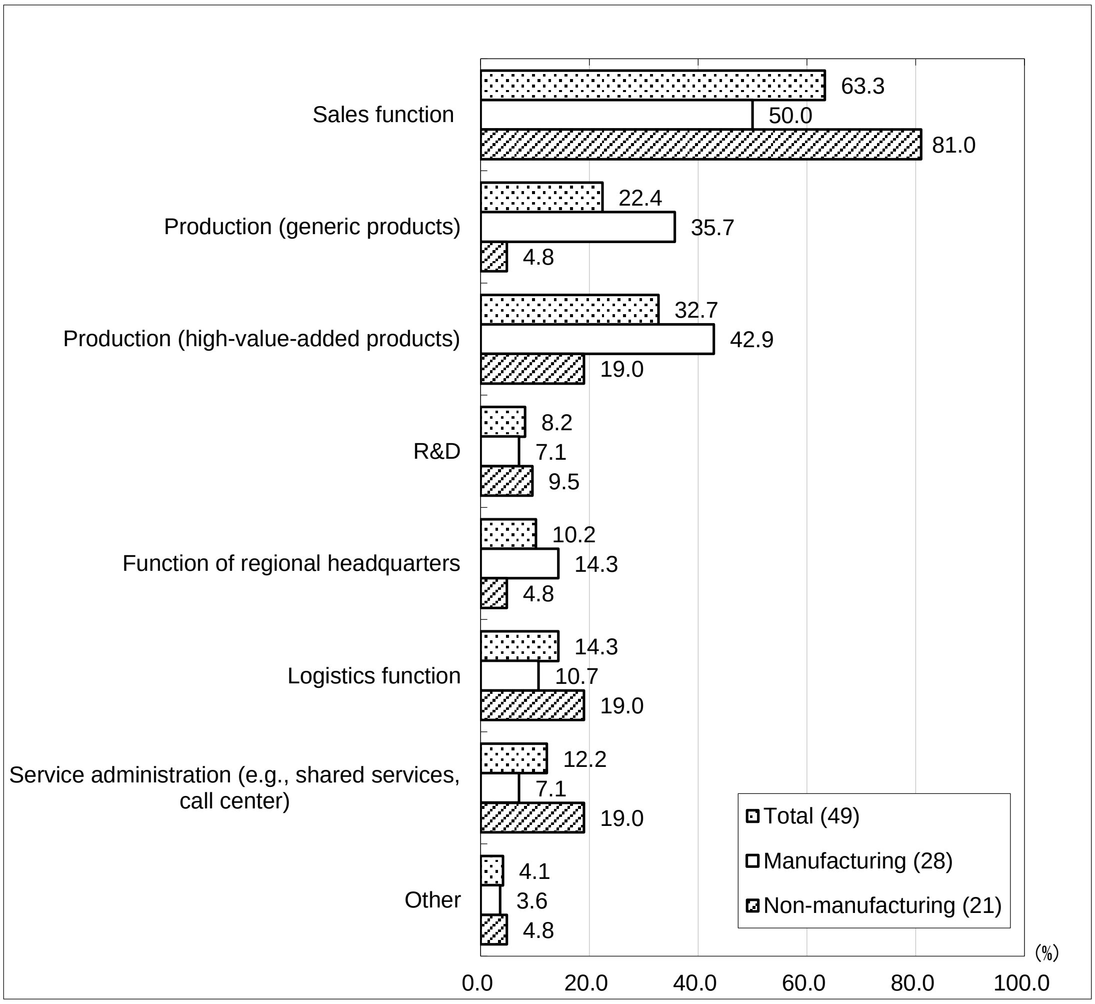

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Figure 11: Measures to carry out management localization (Multiple responses)

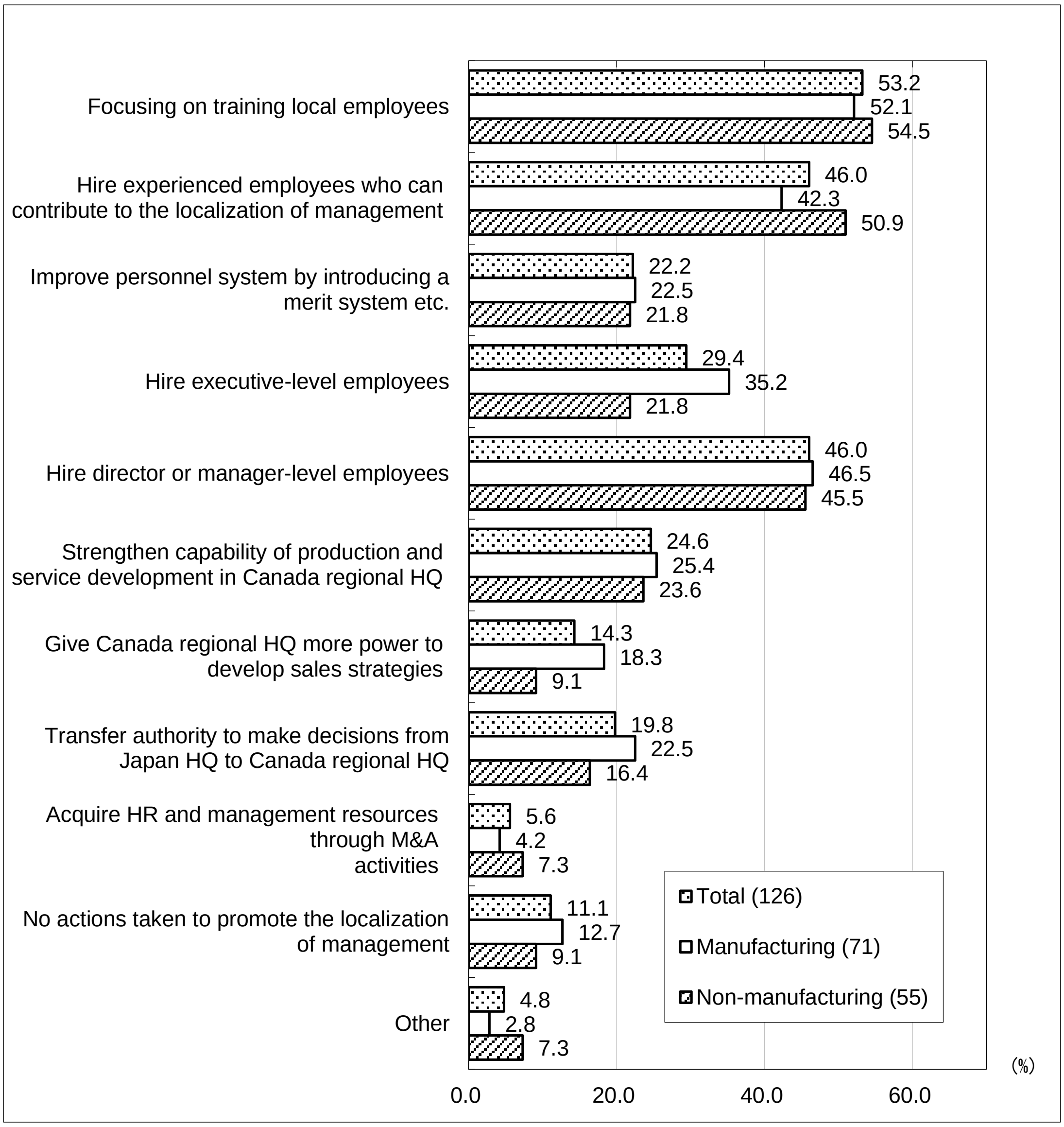

Figure 12: Problems when carrying out management localization (Multiple responses)

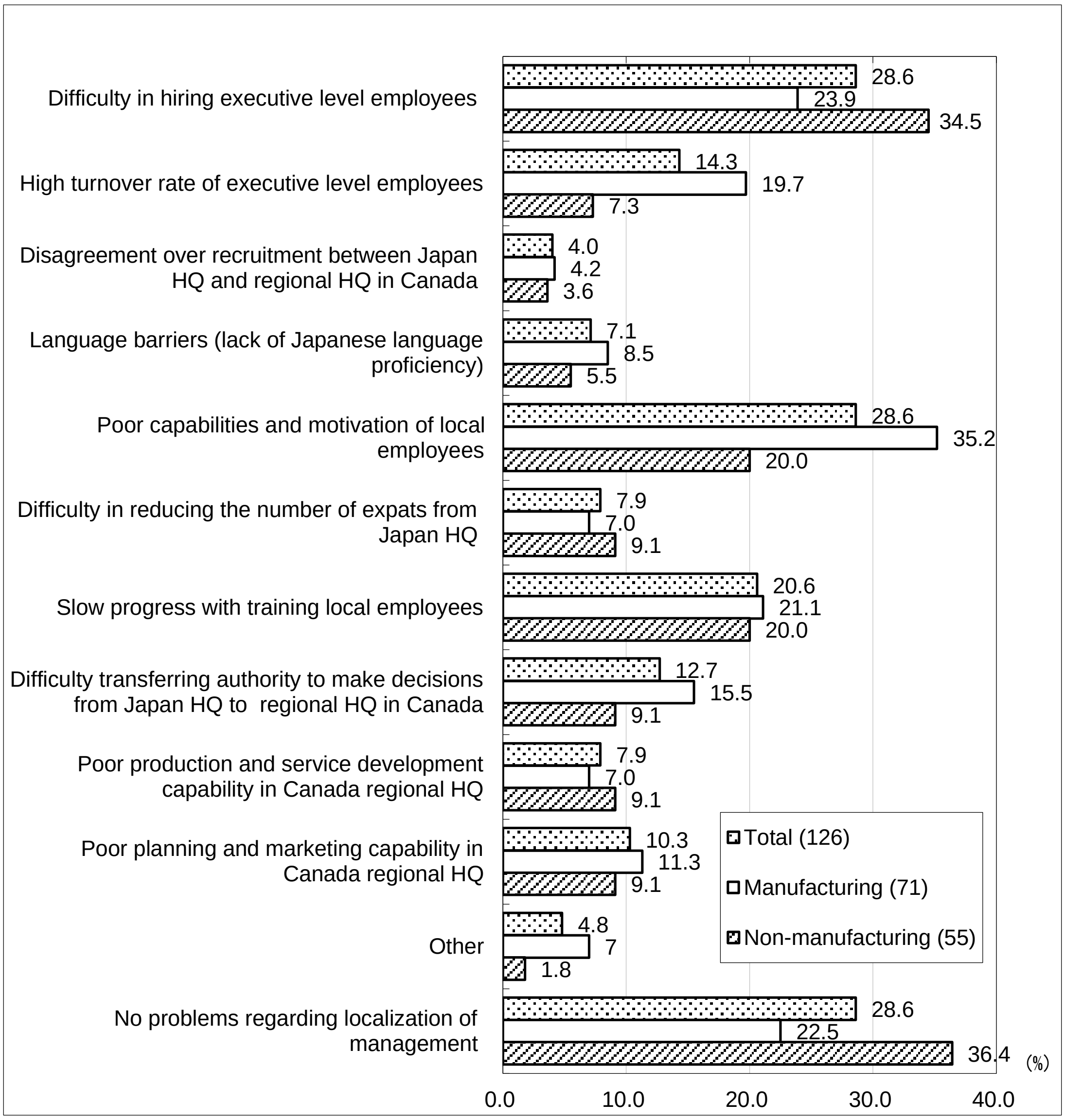

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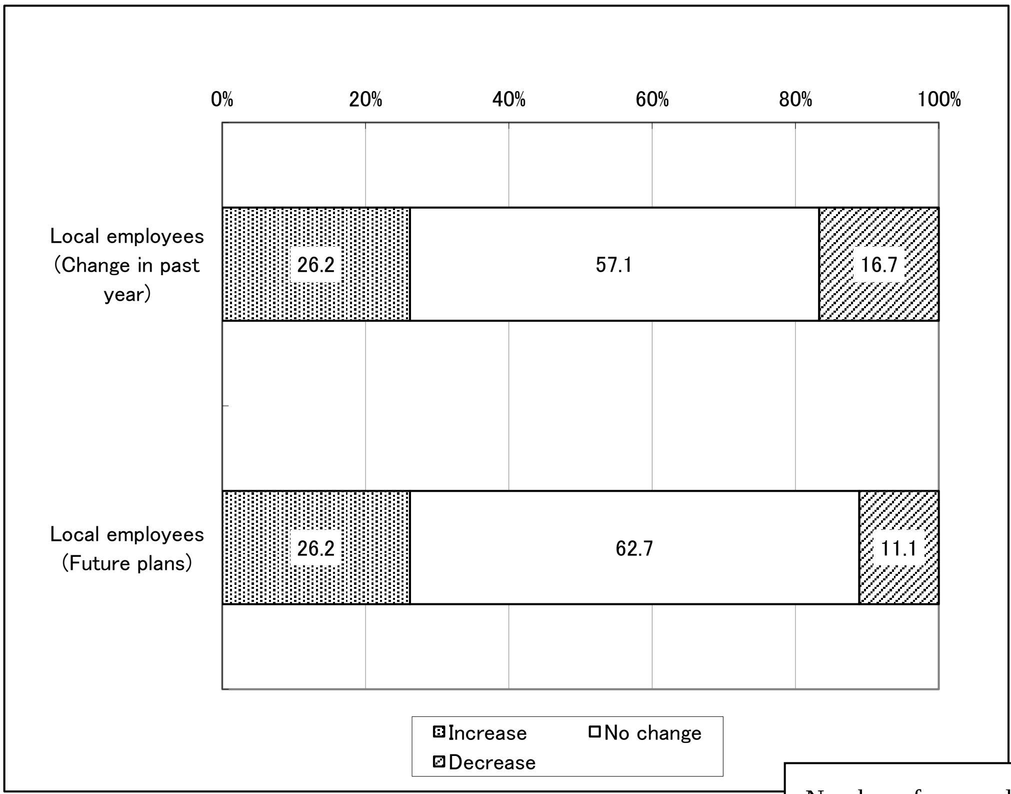
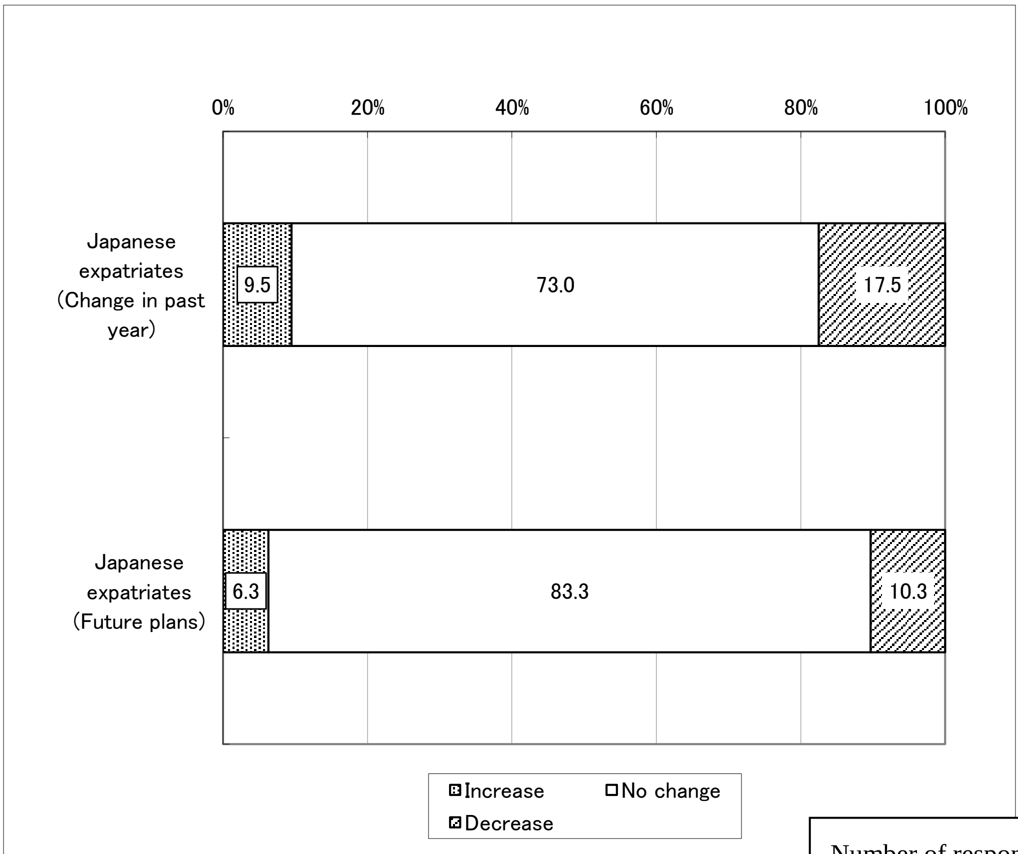
Figure 13: Number of local employees in the past year and the future



Number of respondents: 126

Figure 14: Number of Japanese expatriate employees in the past year and the future



Number of respondents: 126

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Figure 15: Management challenges - Factors for cost increase (Multiple responses)

Rank	Item	#	Ratio (%)
1	Increase in labor costs (including salaries and bonuses)	76	60.3
2	Rise in the value of the Canadian dollar (against the US dollar)	39	31.0
3	Increase in raw material, natural resources and commodity prices	38	30.2
4	Increase in transportation costs (including gasoline)	33	26.2
5	Rise in the value of the yen (against the Canadian dollar)	19	15.1
6	Increase in health care costs	19	15.1
7	Increase in financing costs	15	11.9
8	Tightened regulations on distribution	11	8.7
9	Visa issues	8	6.3
10	Labor management (labor disputes/litigation)	7	5.6
11	Legal issues (cost of compliance with regulations on cartels, etc.)	6	4.8
12	Increase in tax	4	3.2
	Other	18	14.3

Number of respondents: 126

Figure 16: Management challenges - Factors for weak sales (Multiple responses)

Rank	Item	#	Ratio (%)
1	Severity of price competition	100	79.4
2	Difficulties in distinguishing our products or ourselves from competitors	55	43.7
3	Popular products from competitors	50	39.7
4	Difficulties in expanding sales channels	41	32.5
5	Low awareness of company's products and technologies	16	12.7
6	Rise in Canadian dollar increases prices of products exported to US	16	12.7
7	Pirated or counterfeit products from competitors	7	5.6
8	Approval and authorization system for product sales in Canada	7	5.6
9	Approval and authorization system for product sales in the US	3	2.4
10	Decrease in sales and disruption of sales channels due to natural disasters	3	2.4
11	Tightened border control including quarantine	2	1.6
	Other	10	7.9

Number of respondents: 126

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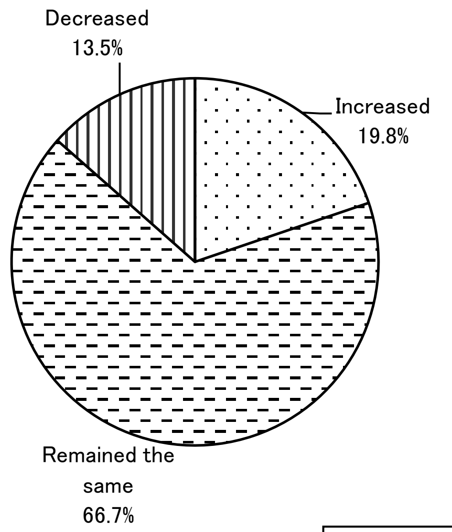
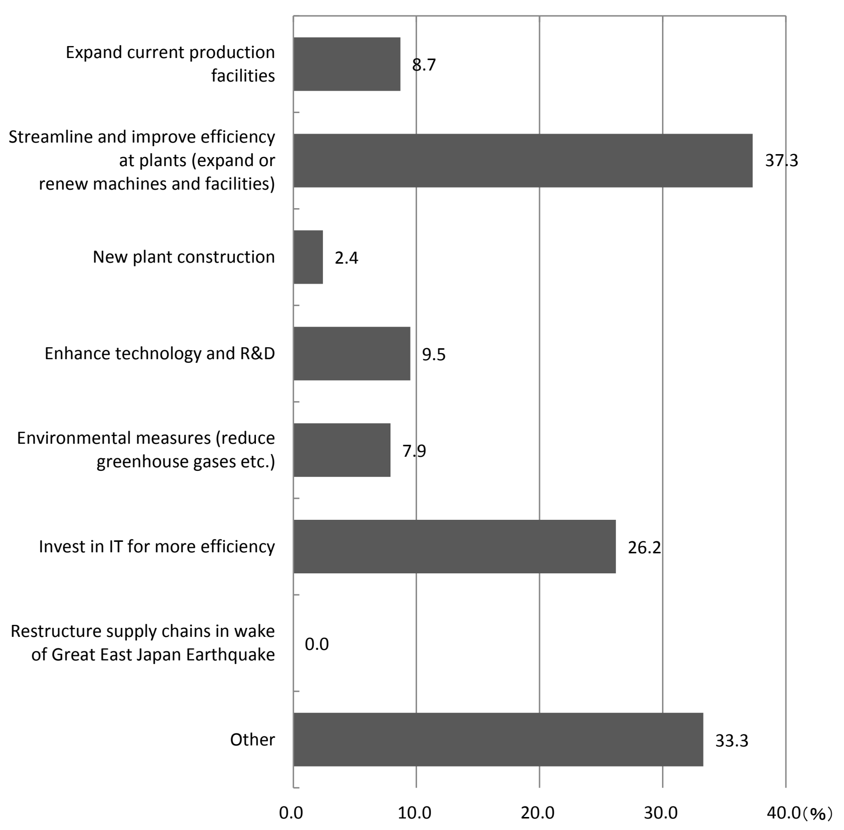
Figure 17: Changes in 2013 capital investment compared to 2012



Number of respondents: 126

Figure 18: Purpose of capital investment in 2013



Number of respondents: 126

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Figure 19: Experience of moving Canadian manufacturing to another country

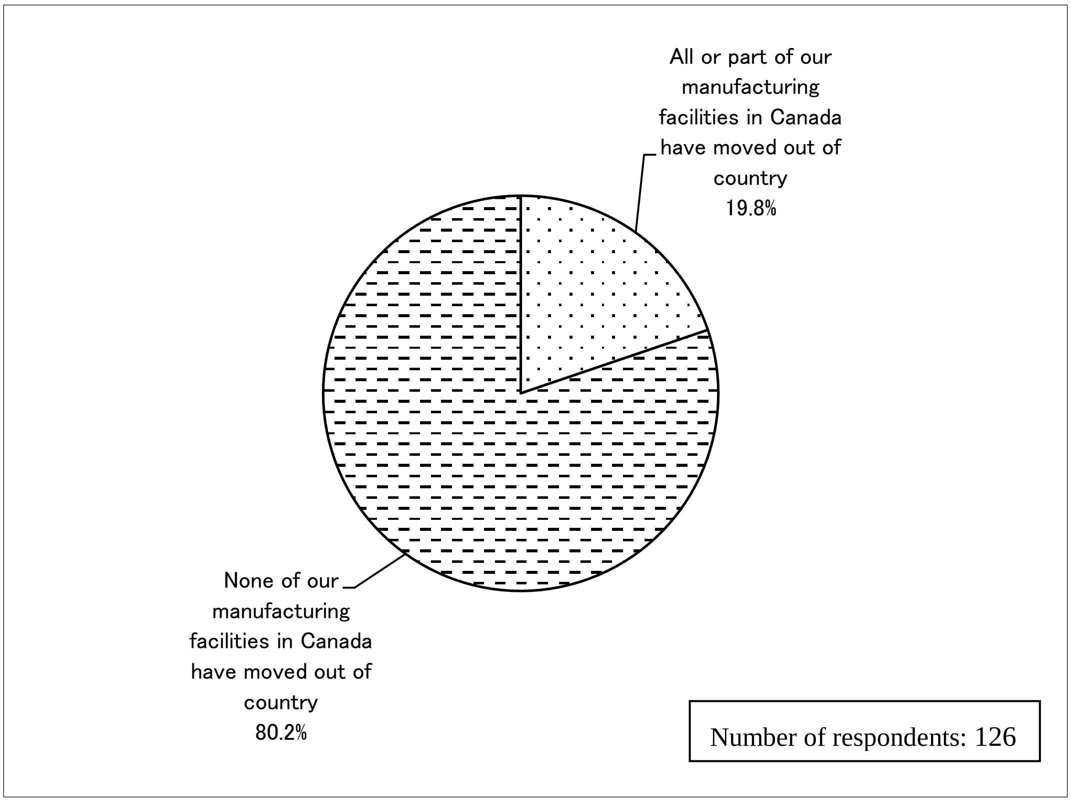

Figure 20: Experience of moving manufacturing back to Canada

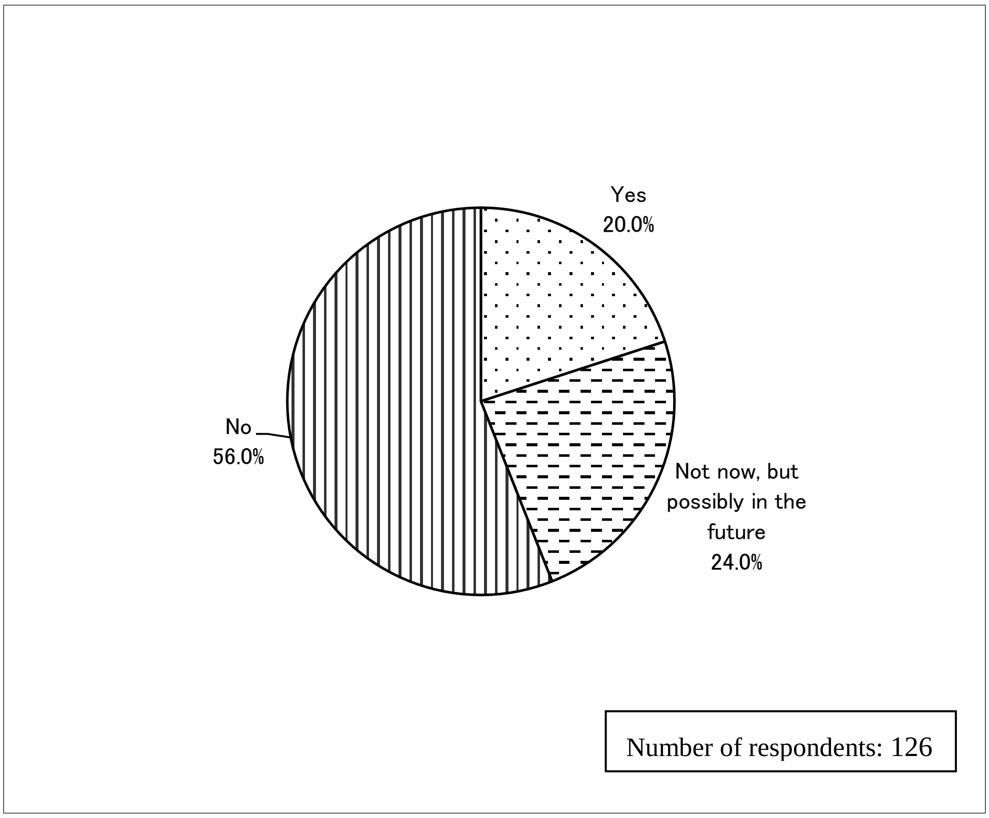

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Figure 21: Fields where the market is most likely to grow in the next few years (top three)

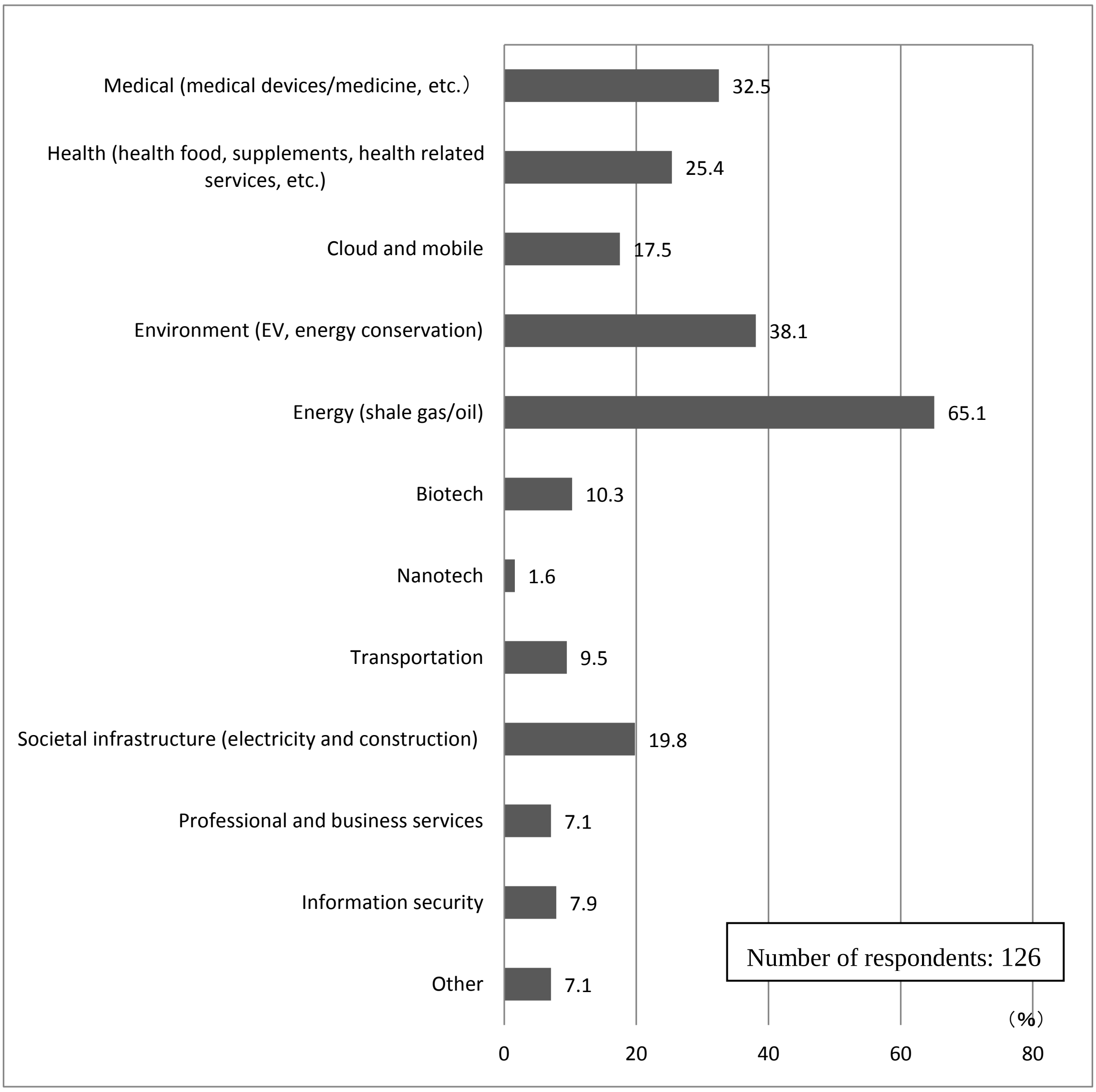

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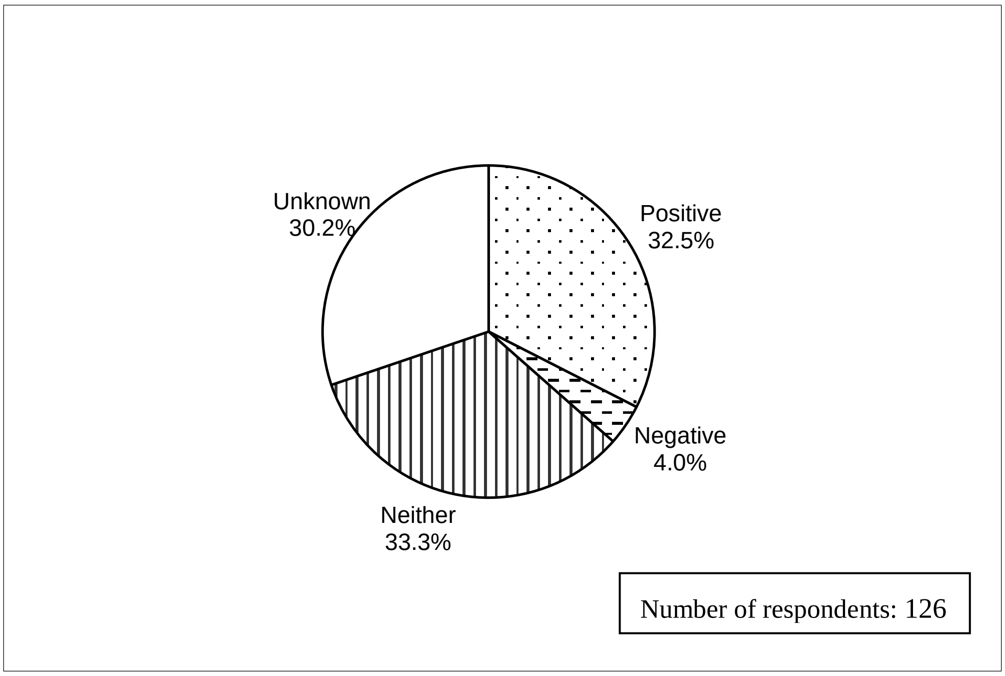
Figure 22: Utilization of bilateral or multilateral FTAs/EPAs

	Utilization/or considering utilization of preferential tax rates provided by FTAs in exports				Utilization/or considering utilization of preferential tax rates provided by FTAs in imports			
	Valid responses	Utilizing	Considering utilization	Not utilizing (No plan to utilize)	Valid responses	Utilizing	Considering utilization	Not utilizing (No plan to utilize)
United States	52 100%	26 50.0%	4 7.7%	22 42.3%	57 100%	30 52.6%	2 3.5%	25 43.9%
Mexico	17 100%	9 52.9%	2 11.8%	6 35.3%	14 100%	9 64.3%	1 7.1%	4 28.6%
Chile	7 100%	3 42.9%	1 14.3%	3 42.9%	2 100%	1 50.0%	- -	1 50.0%
Costa Rica	2 100%	- -	- -	2 100%	1 100%	- -	- -	1 100%
Peru	5 100%	1 20.0%	- -	4 80.0%	3 100%	2 66.7%	- -	1 33.3%
Colombia	6 100%	3 50.0%	1 16.7%	2 33.3%	3 100%	2 66.70%	-	1 33.3%
EFTA	3 100%	- -	- -	3 100%	2 100%	1 50.0%	- -	1 50.0%
Panama	4 100%	1 25.0%	- -	3 75.0%	1 100%	- -	- -	1 100%
Israel	3 100%	- -	- -	3 100%	1 100%	- -	- -	1 100%

* The United States and Mexico are members of the North American Free Trade Agreement (NAFTA).

* The European Free Trade Association refers to Iceland, Norway, Switzerland, and Lichtenstein.

Figure 23: Impact of the shale revolution in North America



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