Japan

Opportunities and barriers to inbound construction

G20 rankings & data

<table>
<thead>
<tr>
<th>G20 heatmap rankings</th>
<th>Construction industry health</th>
<th>3</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Construction industry value</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>Construction industry, real growth</td>
<td>7</td>
</tr>
<tr>
<td></td>
<td>Announced spend on construction in next 3 years</td>
<td>13</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Country financial health</th>
<th>Budget balance</th>
<th>16</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Overall announced fiscal stimulus</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>GDP/Head</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Credit ratings rank</td>
<td>3</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Ease of doing business</th>
<th>Doing business overall rank</th>
<th>4</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Dealing with construction permits rank</td>
<td>6</td>
</tr>
<tr>
<td></td>
<td>Business transparency rank</td>
<td>5</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Tax regime</th>
<th>BDO overall tax rank</th>
<th>12=</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>World bank – paying taxes rank</td>
<td>11</td>
</tr>
</tbody>
</table>

Financial metrics

- Total fiscal stimulus announced: £163bn
- Announced spend on construction in the next 3 years including fiscal stimulus to construction: £16bn
- Construction industry value – 2009: £232bn
- Main corporate tax rate: 30%

Construction sector metrics

<table>
<thead>
<tr>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>£bn</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>241</td>
<td>234</td>
<td>232</td>
<td>240</td>
<td>254</td>
<td>269</td>
<td>288</td>
</tr>
<tr>
<td>0.8</td>
<td>-3.8</td>
<td>-2.0</td>
<td>3.0</td>
<td>4.7</td>
<td>5.1</td>
<td>7.1</td>
</tr>
<tr>
<td>6.2</td>
<td>6.0</td>
<td>5.9</td>
<td>6.0</td>
<td>6.2</td>
<td>6.5</td>
<td>6.8</td>
</tr>
</tbody>
</table>

BDO review of tax

- Tax rates are all around the G20 average position
- Thin capitalisation rules are broadly comparable to several other G20 nations
- A comprehensive system of tax depreciation is available
- Tax incentives are less wide-ranging than some other G20 countries

Overall scoring

5/10

12= out of the G20

BDO ease of doing business

There are many significant barriers and inbound construction activity will find it hard to do business

1 Very easy
2 Quite easy
3 Average
4 Quite difficult
5 Very difficult

Top construction firms

- Kajima Corporation
- Taisei Corporation
- Daiwa House Industry Company Ltd
- Obayashi Corporation
- Shimizu Corporation

This dominance does not create a significant barrier to entry for foreign-owned firms.

Richard Kelly
Partner
Head of Construction
t +44 (0)170 725 5825
e richard.kelly@bdo.co.uk

Stephen Herring
Tax Partner
Real Estate and Construction
t +44 (0)207 893 2437
e stephen.herring@bdo.co.uk
Opportunities and barriers

Ranked 5th overall in our G20 heatmap, Japan has significant barriers to foreign-owned firms entering the market. If these obstacles are overcome, there are opportunities for construction companies in the public sector; with some recent announcements of infrastructure developments.

Japan’s construction market is the third-largest globally after the US and recently China. In 2008, Japan’s construction market size was around £234bn. The reliance of the Japanese government on the construction industry (as per cent of GDP) has decreased from 18 per cent throughout the 1990s, to around 6 per cent in 2008. Japan has a highly developed infrastructure. High material and land costs, increased red tape and stringent regulations are generally considered to be eroding Japan’s construction sector. According to the Japanese Research Institute of Construction and Economy, non-residential construction investment in Japan is expected to drop 10 per cent year on year to £53bn in the fiscal year 2009.

In April 2009, Japan confirmed a further stimulus programme of £1.05bn (approximately 3 per cent of GDP) to help lift the economy out of recession – this is on top of two initial packages in the past year (in total an estimated £163bn). Although the packages don’t include explicit infrastructure support measures, tax incentives aimed at energy efficiency retrofits and better energy conservation will indirectly boost spending on infrastructure.

However, for most Japanese companies, the clear trend for growth in Japan’s infrastructure sector is abroad. Most of the contracts Japanese construction companies announced in 2008 were for infrastructure projects abroad, largely in Eastern Europe and the Middle East and public works projects in China and India.

Japan’s deteriorating macroeconomic outlook has caused foreign investors to increasingly shun the country. Moreover, Japan has a highly developed infrastructure. There are 145 airports with paved runways, 23,500km of railways and 949,000km of roadways. There are major ports at Chiba, Kawasaki, Kobe, Maizushima, Moji, Nagoya, Osaka, Tokyo, Tomakomai and Yokohama.

Reasons Japan is attractive for inbound construction companies

- There has been political pressure, eg from the US to open their markets more to foreign companies. This may give foreign companies opportunities to enter the market, but when this will happen is unknown.
- The construction market is predicted to grow at 4.9 per cent CAGR to 2013.
- The budget put forward in December 2008 does contain modest new infrastructure measures including:
  - Reinforcement of school buildings against earthquakes ¥78bn (£50m).
  - Protection against flooding ¥38bn (£24m).

Barriers/challenges to construction activity

- The majority of construction orders are from public projects. The company bidding for a public project has to have certain qualifications, which are difficult for foreign companies to gain.
- Orders for public constructions are decided by auction, but there are allegations of bid collusion in the Japanese construction market. This collusion is a difficult barrier for a new entrant to the Japanese market to overcome.
- Cultural issues: The construction industry is highly ‘Japanese’, and all communication with regulators and authorities is in the Japanese manner. It may be difficult for foreign companies to adapt to these cultural differences.

BDO viewpoint and advice

Pitfalls to avoid when doing business in Japan

- Construction companies have to understand Japanese tradition and practice to develop a construction business in Japan. This is the major barrier for foreign-owned companies.

Practical advice for inbound construction activity

- Focus on the private sector – although this is very small compared to the public sector.
- It is essential to get advice from advisers who understand Japanese business.
- Joint ventures or strategic partnerships with local companies is also key to establishing the credentials and local knowledge necessary to win work.

Useful tax and other incentives for inbound construction activity

Main depreciation rates:

- Tax depreciation is calculated on either a straight line method or a declining balance method.
- The applicable rates must be in accordance with statutory useful lives for each class of assets published by the Ministry of Finance.

Other incentives:

- Individuals acquiring their own homes using a loan benefit from a tax credit in order to incentivise the residential sector.
- To cover part of the rising costs in raw materials, the government has agreed to renegotiate public work contracts with some of Japan’s leading public work contractors, which according to a 2008 report, was close to £69m. Construction companies that will reportedly seek compensation are Kajima, Taisei, Shimizu, Obayashi and Takenaka.