

# Small Business Is Big Business

# Japan's SMEs

Small and medium enterprises (SMEs), which together comprise 99.7% of all enterprises in Japan, support Japanese industry with their high technologies and skills. Some SMEs also play a vital role in overseas development, in terms of providing employment and transferring said technologies and skills. The Japanese government and related bodies like JFC in turn support the activities of SMEs.

**J**apan may have rebuilt after World War II, experienced rapid economic growth and established itself as the world's second largest economy, but the front-line of the global economy these days is undeniably made up of small and medium enterprises. Even giants such as Honda, Sony and Panasonic started out as small venture companies. Other companies that supply products all round the world similarly began life as small or medium enterprises and have grown into major global companies representing Japan on an international scale. Major companies may account for a mere 0.3% of the overall total on paper, but they each rely on unique technical capabilities and behind the scenes support from the small to medium subcontractors that supply them with parts.

In fact, there are countless small and medium manufacturers that have honed their skills and technical capabilities by fulfilling orders for major companies. From Okano Kogyo, which makes lithium ion battery casings that have helped reduce the size of mobile phones, to NIPPURA, which designs and makes seamless aquariums, from small ball bearing manufacturer Minebea to the developer of the automated knitting machine Shima Seiki, Japan is home to innumerable companies that, despite their small size, have used their world-class technology and products to secure leading shares in markets in Japan and

all over the world.

As Japan's industrial structure is dependent on exports, however, it is particularly susceptible to overseas economies and exchange rate fluctuations. In the worst-case scenario, the current global financial crisis could potentially spell the end for many of the small and medium enterprises that underpin the Japanese economy. Prime Minister Taro Aso came to power on September 29, just over two weeks after the collapse of Lehman Brothers. One month later, on October 30, he made the following speech, setting out a new economic policy to safeguard people's livelihoods.

"My understanding is that this storm, which should be called a 'financial disaster,' developed in the United States. I hardly need to quote former U.S. Federal Reserve Chairman Alan Greenspan in saying that the financial crisis which originated in the subprime loan problem in the United States is truly a 'once-in-a-century' financial crisis." In addition to acknowledging the financial crisis, he also underlined the need to take action. "We must neither be daunted by the storm nor merely choose to lie low till the typhoon passes."

The prime minister's speech emphasized two key points in terms of measures to help small and medium enterprises. The maximum level of emergency credits allocated in the first supplementary budget was raised from six trillion to twenty trillion yen and

the emergency lending limit of government-affiliated financial institutions, previously set at three trillion yen, was raised to ten trillion yen. The total scale of these measures will thus reach thirty trillion yen.

However, even after these efforts, the economy has been worsening at unexpected speed. On December 12, 2008, Prime Minister Aso therefore announced "emergency measures to defend people's daily lives" totaling 23 trillion yen. On the day, an amendment to the Act on Special Measures for Strengthening Financial Functions was fortunately passed in the Diet. Based on the legislation, countermeasures concerning the lenders—the maximum level of the government's total equity participation (in financial institutions)—will be increased by 10 trillion yen, from the present level of 2 trillion yen, to 12 trillion yen. As a result, it will further foster an environment in which financial institutions can provide finance to regional economies and SMEs so that a credit contraction and forced loan repayments do not occur.

Combined with an increase in the maximum credit guarantee level, which is a countermeasure on the borrowing side, the government intends to make countermeasures for financing micro, small and medium enterprises totally sufficient through countermeasures on the lending side. The Aso Cabinet is thus continuing to step up economic measures.

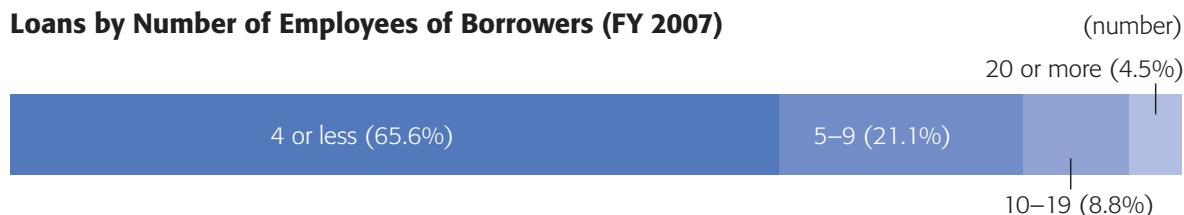
## Role of JFC

Japan Finance Corporation (JFC), inaugurated on October 1, 2008, will be the agency that introduces initiatives aimed at financing the small and medium enterprises identified by the Aso Cabinet. JFC was established through the integration of the National Life Finance Corporation, the Agriculture, Forestry and Fisheries Finance Corpo-

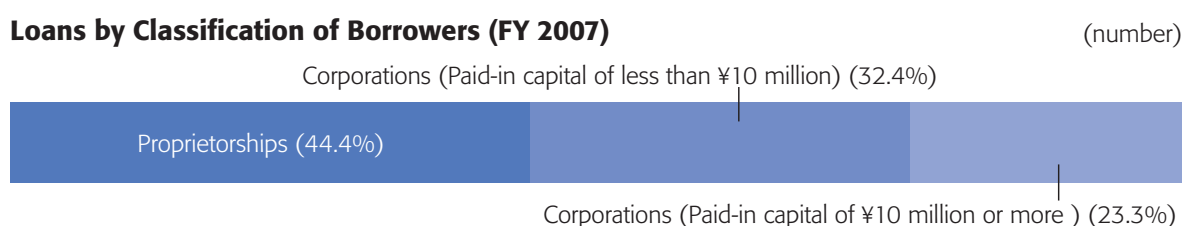
## Small-scale loans

The majority of JFC-Micro's customers are enterprises with less than 10 employees, accounting for 86.7% of the total number of business loans extended by JFC-Micro in fiscal year 2007. Proprietorships account for 44.4% and corporations for 55.6% of this total. Loans for up to ¥5 million make up 59.7% of the total, with the average loan amounting to ¥5.68 million.

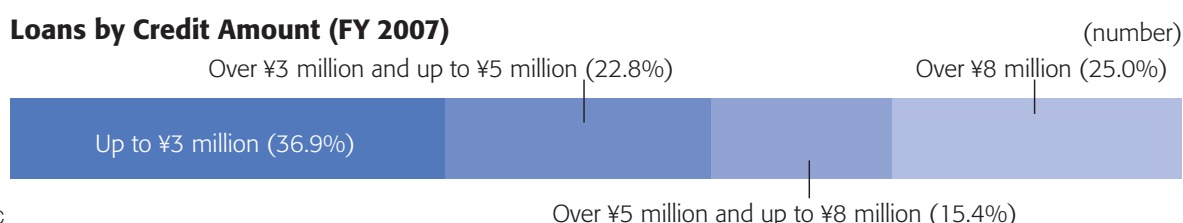
### Loans by Number of Employees of Borrowers (FY 2007)



### Loans by Classification of Borrowers (FY 2007)



### Loans by Credit Amount (FY 2007)



Source: JFC

ration, the Japan Finance Corporation for Small Business and international financing and related operations of the Japan Bank for International Cooperation. The Corporation is wholly owned by the Japanese government. Its role is to implement government policies and measures.

The operations that JFC has taken over from the four previous institutions are as follows. The Micro Business and Individual Unit of JFC handles operations, including petty business loans, support for business inauguration, management consulting, the provision of information, and a broad range of lending that is closely associated with people's lives, such as educational loans and loans secured by governmental pensions and mutual aid pensions. The Small and Medium Enterprise Unit of the Corporation assists in the growth and development of small and medium enterprises through its operations based on the central government's policies concerning such enterprises, including long-term lending to the enterprises, support for private financial institutions' initiatives, the use of securitization tech-

niques, and the underwriting of debt guarantees in connection with loans that credit guarantee corporations extend to such enterprises. In addition, JFC supports agriculture, forestry, fisheries and food business, and helps to maintain and improve international competitiveness through the Japan Bank for International Cooperation. JFC's role is to support the vitalization of Japan's local economies, the growth and development of micro, small and medium enterprises, and, by extension, the achievement of synergy, including operational globalization.

JFC has the role of extending credits within certain limits to specified financial institutions when losses are incurred through financial upheaval in Japan and abroad, or other events occur, such as large-scale disasters. This is a scheme that is a central feature of JFC. As is evident in the emergency measures of the central government, mentioned above, this scheme's functions have gotten a lot of attention under the current financial crisis. Prior to their integration, the institutions that merged to form JFC had engaged in activities that had a strong basis in

local areas, provided policy-based finance functions, and contributed to the vitalization of local areas through achievements that include maintaining and cultivating employment. JFC has undertaken a variety of operations, including the latest emergency measures to help small and medium enterprises.

Shosaku Yasui, who has been appointed to the post of governor of the Japan Finance Corporation for Small Business from a private company and was appointed as governor of JFC upon its establishment through the organizational integration, plays the lead role in implementing the government's economic measures. Yasui is confident that the measures implemented on this occasion will function adequately (see [pages 8-10](#)).

## Characteristics of Small Enterprises

To start with, JFC Micro Business and Individual Unit (JFC-Micro) has a long lending history for small enterprises and extensive experience. As a financial institution standing next to its customers in each region, JFC-Micro

places top priority on customer services and promotes small-lot loans and business start-up support in the fields where private financial institutions find it difficult to provide such services.

JFC-Micro's predecessor, the National Life Finance Corporation (established in 1949) initially provided support for businesses starting out, for example, for people who had repatriated from Japan's former colonies, in the postwar years of recovery. As a specialist in small enterprise, JFC-Micro is continuing its small-scale lending to small borrowers in need of funds for starting and operating their businesses. Although they are called small enterprises, approximately half of these borrowers are individuals who have yet to incorporate their operations. Ninety percent of corporate borrowers in this category operate with nine or fewer employees. In that sense, JFC-Micro's lending operations resemble the objectives of microfinance. Unlike mid and large-sized enterprises, most of these borrowers have limited financial resources and no assets. These small enterprises are in a situation where borrowing from private financial institutions is difficult due to their lack of financial standing.

Speaking on this point, Taro Morita, chief of the International Cooperation Office under the Micro Business and Individual Unit of JFC, offers the following explanation: "Even if the financial background of a lender is unavailable, our staff members gather the necessary information on their own. JFC-Micro prepares the basis for judgment by collecting various types of information through such visits and interviews. JFC-Micro distinguishes itself by making lending decisions in consideration of the ability of managers, their personality and business relationships, in addition to the financial and numerical aspects. Another feature of our loans is that the loan amounts are small so that we can diversify risks."

These so-called grassroots financing activities have supported the activities of small and medium enterprises in Japan, not only in this case of emergency lending, but also in ordinary times. By extension, JFC-Micro

has contributed to the development of Japanese industry.

For example, there is a company in Fukuoka called Unitics. This company is supplying systems for integrated, single-computer management of machinery, including machine tools and assembling machines, and systems for management of heat sources, including electricity, to small and medium enterprises. Unitics is a company of just ten or so employees working under its president, Akira Ikeda. Ikeda is one of the individuals who obtained a loan from JFC-Micro and placed his business on the right track. At his previous job at a major measuring instrument manufacturer, Ikeda was in charge of developing systems for automating large companies' factories. Believing that small and medium enterprises experiencing intensifying competition with their overseas rivals need factory automation more desperately, Ikeda left the manufacturer, accumulated experience, and started his own business in 2005. His company moved forward with research and development, relying on subsidies from local governments and other funds, but more funds were needed to continue with the research.

"The recovery of invested capital takes a long time in system development projects. This pattern leads us to a tight cash flow situation which prevents us from investing in research and development," says Ikeda.

Ikeda was introduced to JFC-Micro by a business incubation manager with whom he had consulted for financing. Loans from JFC-Micro gave him operational capital to spare. They enabled Ikeda to move ahead with research and development, the core operation for his company, and his business started to run smoothly.

### JFC-Micro Policy

Recently emerging nations and developing countries are showing strong interest in JFC-Micro's loan operations for small enterprises. For their economic development, they are hoping to develop small and medium enterprises so as to increase the number of homegrown industries and thereby accumulate and enhance knowledge

and skills. On the other hand, they have not built up a system like Japan's JFC-Micro, and thus call on Japan to cooperate with assistance in providing a stable financing system for small and medium enterprises. In response to requests, organizations have been calling for the JFC-Micro's cooperation to participate in seminars and dispatch instructors.

Introducing its system overseas can provide support for developing small and medium enterprises in emerging nations and developing countries. This meets with JFC-Micro's policy and supports Japanese SMEs operating overseas and those considering setting up operations overseas.

"We are sending instructors to ODA (official development assistance) and corresponding projects that are undertaken by organizations centering on the Japan International Cooperation Agency (JICA). For example, many trainees visit Japan from developing and other nations under JICA's training programs. An increasing number of these people visit Japan with "the promotion of small and medium enterprises" as their training theme or objective. JFC-Micro dispatches instructors and takes other actions in response to them because their training includes finance. JFC-Micro has about thirty such cases a year now," says Morita.

At the point where exchanges were launched, JFC-Micro was concerned about whether or not systems that were peculiar to Japan would work in other countries. The Corporation had such concerns because financing for small enterprises differs, depending on the social customs, laws and accounting systems of each country.

However, there is no difference as far as the assessment of enterprises is concerned. At JFC-Micro, the department for credit analysis compiles manuals and formats for screening to lending.

The JFC-Micro counterpart in Vietnam is the Vietnam Bank for Social Policies (VBSP). Like JFC, the Bank is a policy-based financial institution wholly owned by the Vietnamese government. The VBSP offers small loans that cannot be provided by private financial institutions.

## Globalization and SMEs

As demand for the development of SMEs in emerging nations and developing countries has risen in developing countries, so has the demand for the development of the appropriate human resources. Support for this will contribute both to local industries and to the Japanese SMEs operating overseas, helping to make their operations run more smoothly and fruitfully. The Japanese government has helped to meet this demand, from the perspective of enhancing the international competitiveness of SMEs. JICA, for example, accepts foreign trainees in the field.

A prime example of this may be found in Thailand. One of the most successfully industrialized nations in Asia, Thailand is host to around 9,000–10,000 Japanese companies. It has such a thriving auto industry that it is sometimes referred to as the Asian Detroit, with a considerable number of auto manufacturers from Japan also locating operations there. To move into other countries, Japanese companies require a second, third and even fourth tier of subcontractors. To begin with, however, Thailand didn't have the high quality small to medium enterprises it needed to cater to this demand. Although having such companies in place would have made it possible to supply parts locally, which in turn would have broadened local skills and technology and increased employment, Thailand was found it difficult to create such a positive cycle at that time.

"Ultimately, it's all a question of developing human resources," explains Takeshi Takano, deputy director general of JICA's Industrial Development Department. "Public and private sector organizations in both Japan and Thailand are now working to develop human resources in supporting industries. The key is to train people in Thailand so that they can take on the role of trainer and train local Thai workers themselves."

Japan is helping to improve business environments in a broader sense in other countries as well as Thailand, harnessing ODA to make institutional and other improvements. In addition

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—Taro Morita, JFC-Micro

to the respective countries and Japan itself, this actually benefits all investors and companies locating operations in the relevant areas, resulting in high levels of interest in small and medium enterprises in each country, as pointed out previously by JFC's Taro Morita.

Another point mentioned by Morita is that JICA runs training schemes for government workers and other trainees from the likes of business and economic organizations around the world. "The number of people coming to Japan to undertake training based on the theme of how best to nurture small and medium enterprises is on the increase. There are often cases however in which people tend to think that small and medium enterprises are lacking in skills and technology."

Efforts are therefore underway to broaden the range of companies targeted by representatives from investment promotion institutions coming to Japan. Although they tend to be interested in major companies to begin with, investment promotion institutions start to look to other companies once they have been reminded that even the likes of Honda and Sony were small companies once and acquainted with the facts, including being shown around small or medium enterprises that, despite their size, have sufficiently advanced technology to supply components to NASA for instance or manufacture parts for the bullet train. According to Takano, the developing countries searching for advanced skills and technology should focus more on small Japanese companies as investors and gradually build from there.

"It's a three-way win-win situation in that it ensures that Japanese ODA fulfills its objectives, makes it easier for small and medium Japanese

enterprises to move into other countries and enables local people to reap the benefits."

As the international wing of JFC, Japan Bank for International Cooperation (JBIC) is supporting small and medium enterprises which are setting up operations overseas by collaborating with private financial institutions. The three pillars of JBIC's comprehensive support for small and medium enterprises are financing, overseas information services and consultation, and issuing solutions by working with the partner country. Specifically, JBIC's support includes (1) preferential treatment on loan terms for applied interest rates, loan ratio etc., (2) consultation on procedures for trading, overseas investment and way of raising funds for long-term financing, (3) business and investment related information services on emerging nations and development countries such as China, Vietnam, India etc., and (4) handling overseas political risk guarantees, which is difficult for private financial institutions to manage alone.

Thus, JBIC's multidisciplinary and comprehensive support is also supporting the global approaches of Japanese small and medium enterprises.

During an economic policy speech on October 30, Prime Minister Taro Aso underlined the aims of Japan's economic measures as follows. "I stress that the purpose of the present set of economic countermeasures is not merely to create ephemeral demand. We must rather make them generate steady economic growth through the self-sustaining expansion of domestic demand. Their purpose is to transform the nature of the economy so as to enable the latent potential of the Japanese economy to be fulfilled."

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Hitoshi Chiba, The Japan Journal