

The International Efforts of Japanese Small Businesses

By Kengo Ishii



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Introduction

The existence of numerous small businesses, which are a major source of the economy's vitality, is one of the salient features of the Japanese economy. In view of the great importance of small and medium enterprises to the nation's economy, the government takes various measures designed to promote their growth and development and to improve the economic and social standing of their employees. These measures are based on the Small and Medium Enterprise Basic Law, which defines small and medium enterprises as (1) companies and individuals with capital of ¥100 million (about \$400,000) or less and a workforce not exceeding 300 engaged in industries other than commerce and service (e.g. manufacturing, mining); (2) companies and individuals with capital of ¥30 million (about \$120,000) or less and a workforce not exceeding 100 engaged in wholesale business; (3) companies and individuals with capital of ¥10 million (about \$40,000) or less and a workforce not exceeding 50 engaged in retail business and services. In 1981, there were 6,230,000 small-business offices and factories meeting these conditions throughout the country, accounting for 99.4% of all business offices and factories. In the same year, 37,210,000 persons were engaged in the activities of small and medium enterprises, representing 81.4% of Japan's total private-sector workforce.

The small business sector is equally important on the production side. In 1983, goods shipped by small and medium manufacturing enterprises were worth ¥122,008 billion (\$488 billion), or 51.8% of the aggregate value of manufacturing-industry shipments. The value added by small and medium manufacturers totaled ¥44,378 billion (\$177.5 billion), accounting for 56.1% of aggregate value-added for manufacturing as a whole. As for distribution, annual sales by small and medium wholesalers reached ¥223,416 billion (\$894 billion) in 1982, a 58.6% share of wholesale industry annual sales. Annual sales by small and medium retailers stood at ¥93,971 billion (\$376 billion), representing 79.9% of the retail industry's entire sales for the same year.

Obviously small and medium enterprises occupy a crucial place in the Japanese economy. But more detailed breakdown reveals that these enterprises are concentrated in certain sectors. In manufacturing, for example, they are particularly conspicuous in light-industry as well as intermediate goods produced by processing and assembly industries. Small and medium manufacturers operate predominantly in sectors marked by small and diversified demand. In the case of retail business, most small and medium enterprises enjoy the distinct advantage of being located near consumers, and can thus maintain good customer relations. Wholesale enterprises, meanwhile, are most active in the final stages of distribution where well-thought-out wholesale activities are a must. And small and medium businesses in the service industry exist in large numbers in fields geared to local demand, such as personal services.

Japan's changing economy and small businesses

In recent years the business environment surrounding small and medium enterprises has changed markedly on both the supply and demand sides. Consumer demand has gained in diversity and sophistication in line with the rapid development of the nation's economy. On the supply side, small and medium enterprises have encountered a wave of technological innovation and information revolution. Such changes may offer new business opportunities to enterprises already active in fields where demand is diverse and small in scale. But the shifting business environment demands hard adjustments of the small entrepreneur to respond effectively to the new needs of consumers and users. In order to profit from such transformations in the business landscape and ensure their own sustained growth, small and medium enterprises will find it increasingly important to make better use of their technological, informational and human resources. These can best be described as "intellectual management resources," as technology, information and talent constitute the intellectual aspect of business administration.

1. Strengthening technological foundations

Technology has a vital role to play in a period of stable, non-inflationary growth for the Japanese economy. Thus far, however, technological innovation in small

business has remained at a low ebb compared with that of big business, because small and medium enterprises have concentrated almost exclusively on applying and improving existing technologies (Fig. 1). The utilization of existing technologies has, in fact, been a convenient and effective way to strengthen the technological foundations of small and medium enterprises lacking in financial, human or informational resources. Recently, however, small businessmen increasingly recognize the need for technological development in light of the growing trend toward product diversification, technological fragmentation and reintegration. From this point of view, linkups with outside research organizations by venture-capital businesses, and autonomous technological development programs using external resources, such as exchanges between enterprises in different industries, offer useful examples of positive business strategies for small and medium enterprises.

In the meantime, there exists in Japan a large number of small subcontractors, who produce and supply parts and other products to order for particular enterprises. There are about 465,000 of these subcontractors accounting for some two-thirds of all smaller enterprises in manufacturing. They form the broad base of the division-of-labor structure of Japan's industrial society, supporting its efficiency.

Subcontractors have traditionally devoted much of their energy to maintaining and improving production processes that are compartmentalized under the division-of-labor system. The technological level of each subcontractor has been raised through assistance, most notably technical guidance, from its parent company. However, orders from parent companies have been undergoing qualitative change under the impact of technological innovation, and to meet such

changes subcontractors are stepping up independent efforts to improve their in-house technologies. The growing need for subcontracting enterprises to make improvements on their own—through technological development activities—has already prompted some to come out with their own products. And their success at product development has in turn triggered further changes in relations with their parent companies.

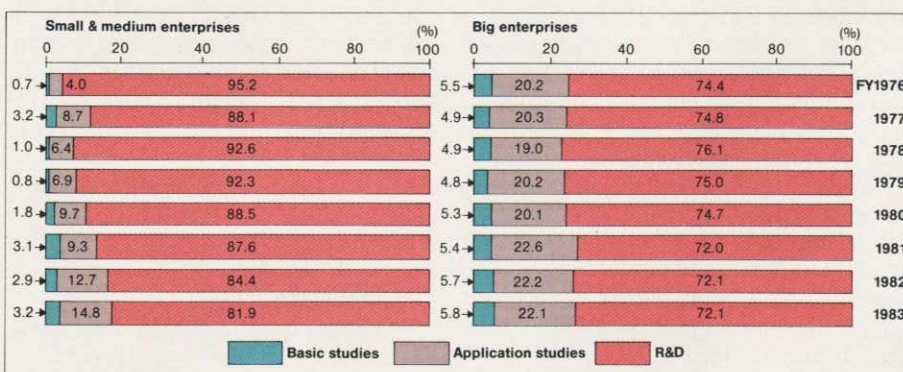
There is a wide disparity in the managerial resources of small and big enterprises, from talent to information and capital. Autonomous technological development of course requires positive efforts by small and medium enterprises themselves. At the same time, however, it is necessary to improve and better utilize measures designed to help them cultivate their capacity for technological development.

2. Information revolution and small business

At a time when rapid change is sweeping the business environment and corporate activities are becoming more sophisticated and complicated than ever before, it is essential to effectively organize and utilize diverse production factors. In this, information plays an important and fundamental role. Advanced business management depends crucially on the collection, sorting and application of information. Advertising is assuming an ever more important role. And once again, small and medium enterprises must adapt themselves to this changing environment.

Many information-related technological innovations are already being made, particularly in electronics. Small and medium enterprises are introducing information devices in their various departments, and progress is expected not only in rationalization and labor saving but in the formulation of advanced business

Fig. 1 R&D Spending by Purpose



Note: Total of percentage figures in each bar graph does not necessarily equal 100 due to rounding up.
Source: Survey on Scientific & Technological Studies, Management & Coordination Agency

Fig. 2 Electronics Equipment Used by Businesses

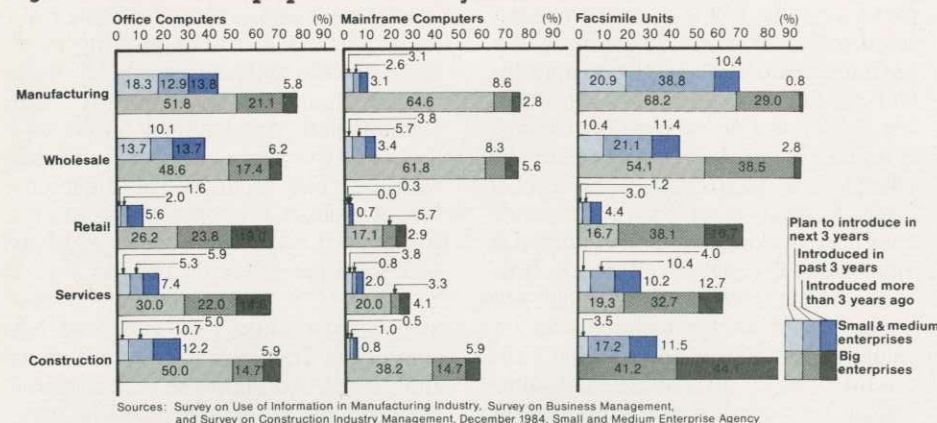
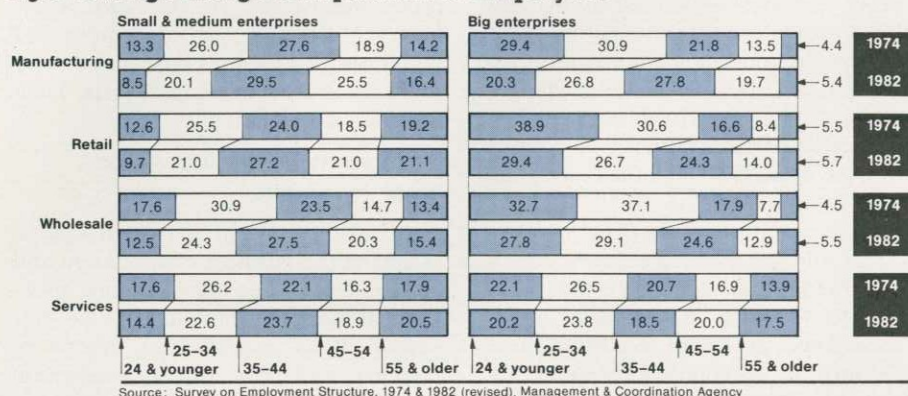


Fig. 3 Change in Age Composition of Employees



strategies (Fig. 2). However, the introduction of information devices presents new problems in equipment maintenance and software development. Small businesses must make adequate preparations, taking into full account the type of industry to which they belong, if they are to ensure the effective introduction and utilization of this new equipment.

Meanwhile, the fusion of information processing and communications technologies is expanding the range of computer-based information distribution from intra-company systems to inter-company networks. Inter-business on-line networks are already being formed, particularly among large enterprises. These computer networks are designed to rationalize and save labor in administration, speed up data transmission among enterprises and improve accuracy in transmission. So far, most companies using these networks seem well satisfied with what they have achieved. But such developments are likely to affect inter-business relations in many ways, and it will be necessary for small and medium enterprises to respond effectively, taking into account a combination of factors such as the type of industry and business they are engaged in, their size, and where their customers are located. Enterprises lacking in managerial resources also

face problems with respect to know-how about network operation, software development, manpower and capital. For this reason, small businesses are expected to have greater difficulty than large enterprises in introducing on-line systems. One effective way to overcome these handicaps would be to set up inter-business on-line networks on a joint, integrated basis.

The information revolution and rapid progress in data processing and communications technologies has accelerated the development of a variety of information-related equipment. At the same time, numerous information-related services have sprung into being. In these fields, too, small and medium enterprises capable of executing well-thought-out responses to user needs have great and growing opportunities for business expansion. Equally promising for resourceful small and medium enterprises has been the notable development in recent years of so-called "new media" providing entirely new types of service.

3. The manpower factor in small businesses

The importance of human resources to successful business activity is recognized more keenly today than ever before as the business environment is transformed

by diversifying demand, technological innovation and information revolution. Small and medium enterprises are no exception. They now urgently need to secure talented people.

The supply and demand structure of Japan's labor force has changed significantly. On the supply side, the number of middle-aged and older persons has increased (Fig. 3), as has the number of working women. These shifts have been paralleled by changes in worker consciousness, as shown by the rising number of people willing and eager to change jobs. On the demand side, meanwhile, the need for knowledge intensive labor is growing as never before.

These changes have profoundly affected supply and demand in labor markets categorized by sex, age and educational background, for example. They could soon have a significant impact on employment and wage practices, such as the seniority-based wage system.

In general, supply has begun outstripping demand in the labor market, and the quantitative labor shortage facing small and medium enterprises is fading. But at the same time it is becoming more difficult than before to secure sufficient numbers of technicians, engineers, researchers and university graduates. In other words, small business is now facing a qualitative labor shortage. Companies must improve their recruiting and create more attractive working environments. At the same time, in order to make up for their intrinsic disadvantages in recruitment, they should expand and strengthen hiring activities both through better organization of their ongoing efforts and by using third-party organizations.

For the development of human resources it is essential that methods best suited to individual enterprises be adopted, including better on-the-job training (OJT), the use of national and regional public training institutes, and utilization of training programs sponsored by business associations and co-operatives and other bodies. Of course, small-business employers themselves have a large role to play in recruitment. It is important that they, too, make multifaceted efforts for self-improvement.

Upgrading managerial abilities is also essential if "smaller enterprises" are to survive and prosper in this new business environment. Smaller entrepreneurs are, in fact, already trying to improve themselves through participation in study sessions and other training programs. About 60% of such small business owners are said to want their children or relatives to

succeed them at the helm of the company. Their successors will need to be skilled at external negotiations and many other managerial techniques, and growing weight is being attached to developing such skills through outside training. OJT is still the main method of training the employees of smaller enterprises, but in future it will be necessary to expand the scope of human resources development to include outside training and education.

The internationalization of small businesses

The interdependence between the Japanese economy and the world economy is growing through international exchange in trade and capital and a wide range of other fields. There is a growing need for Japanese small and medium enterprises to respond to such changes in the international economic environment.

1. Small businesses and trade trends

Exports of "small and medium enterprise products" increased in 1984 over the year before, although the rate of growth remained lower than that of "large enterprise products."** Most growth centered on manufactured exports by heavy industry.

Export trends affect the production activities of small and medium enterprises, through domestic transactions and other business relations, not only when their products are exported directly but also when parts they produce are used in export goods. The latter case presents indirect effects of export on the production, while the former does direct effects. For small and medium enterprises, the indirect effects are greater because

of the large number of subcontractors among them whereas the direct effects outweigh the indirect in case of large enterprises. In addition, exports of small and medium enterprise products are largely centered in light industry, though those in heavy industry are nonetheless greatly affected by export trends.

2. Changing trade structure and small businesses

A review of shifts in the sectoral composition of the exports of small and medium enterprise products after 1973 shows that the share of the processing and assembly sectors continued to expand until around 1978, and has since remained almost unchanged. The share of fibers and textiles shrank until around 1980 before leveling off in subsequent years. As for imports, the weight of heavy-industry products has expanded, while that of light-industry products, and particularly fibers and textiles, has declined.

The ratio of export over import ($[\text{exports} - \text{imports}] / [\text{exports} + \text{imports}]$) for small and medium enterprise products changed noticeably between 1969-83 (Fig. 4). In the case of light-industry products, the ratio dropped markedly for fibers, apparel, and other textile products in 1969-73. Thereafter it rose moderately, but overall during the 1969 to 1983 period fell, dragging down with it the ratio for light industrial products as a whole. In the case of the materials sectors of the heavy industry, the ratio increased slightly, but remained lower than the industry's average. In heavy-industry processing sectors, exports exceeded imports by a wide margin, with the result that the already high ratio rose even further. The overall ratio for small and medium enterprise products dropped markedly in 1969-73 and climbed moderately thereafter. By 1983, however, it still remained at a lower

level than that of industrial products as a whole.

3. Overseas investment by small businesses

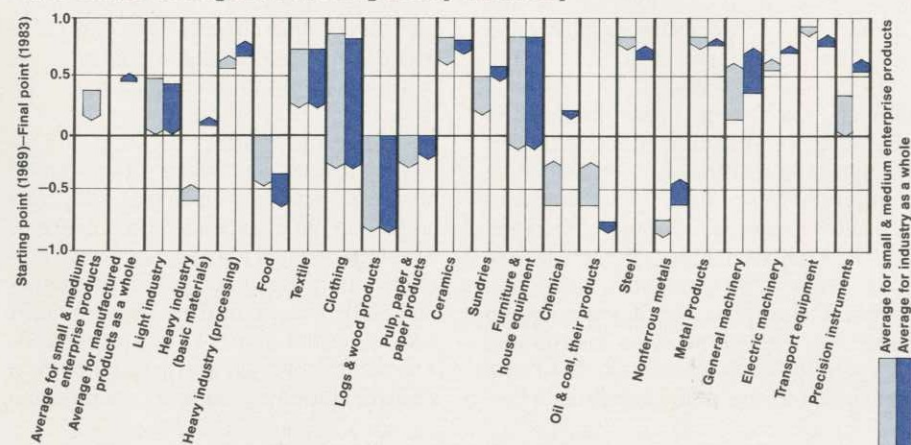
Overseas investment by Japanese small and medium enterprises leveled off after 1980, reflecting economic stagnation at home and abroad. However, investments began to pick up again after 1983 under the impetus of the economic recovery. A sectoral breakdown of manufacturing investments shows that machinery continues to hold the major share, but a declining one in recent years. By region, the proportion of investments in North America and developed countries increased, while the percentage of investments in Asia, including the newly industrializing countries (NICs), sagged.

The primary objective of initial overseas investments by Japanese small businesses is to sell the products of the parent company, according to a recent survey by the Small and Medium Enterprise Agency. Another important objective is to import locally produced goods to Japan. The survey also found that 30% of small businesses with overseas operations are considering additional investment, while 63% plan to maintain their current levels. As these findings clearly show, overseas expansion is an integral part of the steady business development of Japan's small and medium enterprises.

4. Technology trade by small businesses

In recent years, technology exports by small and medium enterprises have expanded rapidly in number, while imports have remained more or less unchanged. A regional breakdown shows that Southeast Asia accounts for the highest proportion of exports from Japan, while North America and Europe dominate imports. On an industry basis, the large export share of technology related to general machinery has expanded even further in recent years while in import, the proportion of textile-related technology has been steadily rising.

Fig. 4 Ratio of Export over Import by Industry



**"Smaller enterprises" are defined as those with employees not more than 20 in manufacturing and mining, and 5 in commerce and service by Small and Medium Enterprise Basic Law.

***"Small and medium enterprise (large enterprises) products" are those products in which small and medium enterprises (large enterprises) contribute over 70% of the total shipment value at the fiscal 1981 level in Japan Standard Industry Classification.