

No.

REPORT
ON
INTELLECTUAL SUPPORT FOR SMALL AND MEDIUM
SCALE ENTERPRISES PROMOTION

MAY, 2000

THE COMMITTEE ON FACILITATION OF
INTER-AGENCIES ACTIVITIES
ON SME PROMOTION IN DEVELOPING COUNTRIES
JAPAN INTERNATIONAL COOPERATION AGENCY

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FOREWORDS

COMMITTEE'S OBJECTIVES AND NATURE OF REPORT

The Committee on Facilitation of Inter-Agency Collaboration for SME Promotion in LDCs (referred to as “the Committee” throughout this Report) met 7 times starting in July, 1999. The Committee was chaired by Professor Shujirou Urata of Waseda University, and participated by representatives of the Ministry of International Trade & Industry, the Ministry of Foreign Affairs, the Ministry of Finance and donor agencies concerned as well as persons knowledgeable and experienced in economic cooperation. The Committee's ultimate objective was to answer the following questions: What should we do to carry out more effective cooperation with LDCs for their SME promotion? Specifically, the Committee's deliberations were made from the following two viewpoints:

First, the cooperation must have sustainable impacts. Namely, how can we assure that impacts of the transferred expertise by means of intellectual support be sustained in a recipient country? The intellectual support is defined here the cooperation designed to transfer expertise in policies and systems facilitating SME development in LDCs.

Second, so-to-speak an “All Japan” approach is needed for effective cooperation. How can we generate a synergy effect by enabling a variety of donor agencies to collaborate each other while supporting SME development in LDCs taking advantage of their own strengths?

Described below are the circumstances which triggered initiation of the Committee as well as the issues presented for its discussions.

BACKGROUND

According to the recently shared premise, SME development helps LDCs achieve a range of development goals like upgrading of industrial structures, employment creation, growth of regional economies and promotion of market-oriented economies. Among LDC policy makers, merits of SME development is sometimes emphasized as if it were Aladdin's lamp. Consequently, more LDCs are now willing to learn experiences of Japan.

Japan's mid-term ODA strategy made public in August, 1999 clearly gave a priority to

the intellectual cooperation, namely, cooperation for transfer of expertise and human resources development concerning creation and execution of economic and other schemes. The cooperation in this field aims to create environment facilitating SME development through transfer of expertise in system building and human resources development, and, by definition, requires much intellectual ability on our side. Consequently, an urgent need has been felt to accumulate more expertise among our donor agencies.

The East Asian economic/currency crisis triggered in the summer of 1997 disclosed structural vulnerability of the economies in the Region, making adverse impacts even on the Japanese economy because of Japanese-Asian mutual dependence. In view of such circumstances, the ODA strategy written above stated, "Efforts should be continued, while defining demarcations and closely collaborating with other assistance programs spending public funds, for infrastructure building, technology transfer and promotion of SMEs and supporting industries". The statement confirms the necessity to help promote SME development in LDCs with a view to innovating LDC's economic structures, namely from a perspective wider than that of ODA alone.

In many instances, Japan's conventional technical assistance (intellectual cooperation) for SME promotion introduced promotion policies implemented by the Japanese Government in the past and selectively transferred policies which had not yet been implemented in the recipient country. Because systematic examinations into unique situations of each recipient country or into development strategies have seldom been made, a uniform method has been used and uniform expertise has been transferred in many cases.

Recognizing that SME promotion is an important development objective, the international organizations like the World Bank and donor agencies of other developed countries are actively discussing cooperation strategies and tactics in a variety of forums like the Committee of Donor Agencies. Meanwhile, it has become clearer that there is a noticeable gap between Japan's conventional cooperation strategy and the strategy broadly accepted by the international community led by the World Bank and IMF.

QUESTIONS TO BE ANSWERED

While SME promotion is fashionable in the international community of development assistance, have we not taken for granted many issues? Have we not bypassed such fundamental themes like policy goals, market mechanisms and Government roles, and

been preoccupied with technical details of SME promotion?

Japan's conventional approach has been to introduce mechanisms of individual SME promotion measures. Such an approach, however, has the following drawbacks:

- (a) In the absence in a recipient country of fundamental systems supporting these policies, the transferred measures were neither effective nor sustainable.
- (b) The transferred promotion measures did not necessarily suit the socioeconomic environment of the recipient country.
- (c) Because a cost-benefit analysis was not elaborated, an adequate examination was not made whether the measure to be transferred were superior to others (or to doing nothing) in terms of opportunity costs.

In view of these reflections, should we start with an analysis of more fundamental issues like socioeconomic systems in order to provide sustainable development assistance in a country whose socioeconomic conditions are different from ours?

While, for SME promotion in an LDC, a number of Japanese organizations are involved from their own perspectives in addition to the assistance-providing agency, has the inter-organizational cooperation been adequate? Should we come up with the best practice through inter-organizational collaboration by knowing more about functions of other agencies?

Should we learn more about internationally accepted ways of assistance concerning SME promotion in LDCs including their differences from our ways and factors bringing about such differences? To this end, should we objectively review our experiences in SME promotion and theoretically reflect on justification of transferring the expertise obtained through such experiences?

The Committee was organized recognizing these circumstances and asking ourselves questions described above and met seven times to discuss the subjects written on the following pages. The subject was chosen for each meeting and discussed following presentation by the Committee members or outside speakers. Each meeting was so brief for subjects of complicated and far-reaching implications that discussions were often introductory. The Committee, however, may be judged successful to the extent that it provided an opportunity, which had been rare in the past, for representatives of many agencies concerned to meet to exchange information and to share issues for joint considerations. Furthermore, the information and data presented to the Committee are mostly useful for those who will be engaged in assistance for SME promotion in LDCs.

Collected in a package, such information and data will serve as useful reference materials for planners and implementers of SME promotion assistance projects in LDCs, and facilitate them to reflect on future courses of our assistance from broader perspectives.

With such expectation, the Committee has produced its Report incorporating the outcomes of discussions made during its initially planned sessions. The Report summarizes presentations made by the Committee members and other reporters, discussions and information submitted by the secretariat, taking note of pertinent issues and points to be considered. As main readers of the Report are expected to be implementers and planners of assistance projects including experts and consultants, it will hopefully be used as a reference material and encourage them to reflect further on better ways of making our cooperation more sustainable and assuring a closer linkage among donor agencies concerned.

The Report is mainly structured along the line of the sequence of each session but partly restructured in reflection of the overall context. The salient content of each chapter is briefed below.

Chapter1 Measures Concerning Collaboration for SME Promotion by Japanese and Foreign Donor Agencies

For LDC's SME development, not only ODA but private sector assistance is being actively provided. Under the supervision of the Ministry of International Trade and Industry (the SME Agency), a number of agencies are engaged in SME promotion, providing human resources for cooperation with LDCs. It is therefore necessary to know functions of each agency in order to devise inter-agency collaboration for effective intellectual cooperation. The Report goes on to examine how the international community positions SME promotion in the context of LDC's overall development strategy, and notes that SME development has become a key concept relating to transition to market-oriented economies and development led by private sectors, stimulating active discussions and studies in the international community.

Chapter 2 Basic Issues on Cooperation for SME Promotion

During the day-to-day practices of international cooperation, a recipient country tends to demand a prescription with immediate effects for SME development, while a donor

looks for such prescriptions without carefully reflecting on their limitations and side effects. This chapter deals with fundamental issues which tend to be neglected during day-to-day execution of cooperation projects. Among others, basic discussions are made how a particular SME promotion policy is justified in the light of economic theories based on merits of market mechanisms as well as what the Government role should be for SME development.

Chapter 3 SME Development and Issues (Presentation of Cases)

In consideration of fundamental issues discussed in chapter 2, the cases of Taiwan, Indonesia and Thailand are presented to help identify factors contributing to SME growth. The Taiwanese case suggests some favorable factors leading to SME growth. The Indonesian case reminds us of complicated SME development policy in an LDC where socioeconomic conditions are very different from ours. The Thai case provides useful information concerning the measures taken by the Thai Government and Japan's assistance during the economic crisis.

Chapter 4 Major Issues of Intellectual Cooperation

Following the discussions of chapter 2 and 3, chapter 4 looks for ways and means to provide effective intellectual assistance facilitating SME development in LDCs.

Chapter 5 Support of Formulation of Basic Frameworks Needed for Business Development

While Japan's conventional method has been to facilitate Government's direct intervention in SMEs, this chapter steps back and looks into ways to support development of basic frameworks affecting growth of individual SMEs. Mainly referring to the World Bank strategy, legal systems and other external frameworks affecting business behaviors are identified.

Chapter 6 Support of SME's Fund Raising

Not only in an LDC but in any other country, fund raising is vital to SME development. The Japanese Government has also regarded financing support as a core SME promotion policy, providing a range of support including establishment of public

financing agencies for SMEs. The chapter outlines and characterizes Japan's financing schemes and functions in connection with cooperation with LDCs in order to reflect on issues relating to financial support by looking into some examples of financing for SMEs in LDCs by the International Bank for Cooperation (JBIC).

Chapter 7 Support of Market Penetration

According to an enquete survey among LDC's SMEs, support for market penetration is considered the most demanded Government promotion policy. SMEs are handicapped in comparison with large enterprises in accessing to information on domestic and foreign markets. This chapter reveals outlines and features of policy-making experiences of Japan and other developed countries in order to stimulate thoughts on future courses of support and matters to be taken into account.

Chapter 8 Support of Provision of Managerial and Technological Expertise

Acquiring necessary expertise in management and technology is decisive for SME's growth. In business development services providing such expertise including the SME Management Consultants System, Japan's experiences are rich and her schemes are diverse. Reviewing the cases of assistance provided by the Small Business Corporation, the SME Management Consultants Association and others, this chapter presents lessons relevant to this field of cooperation. Also looked at are the direction of thoughts broadly endorsed by the international community, its difference from Japan's conventional practice, and significance of such difference.

Though the Committee members are personally responsible for the content of the Report, the organizations sending them to the Committee do not assume any responsibility.

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THEMES OF EACH SESSION

<p>1st Meeting July 29, 1999</p>	<ul style="list-style-type: none"> • Objectives and procedures of the Committee • Functions of each donor agency for cooperation for SME promotion • Fundamental issues for facilitating inter-agency collaboration
<p>2nd Meeting September 10,1999</p>	<ul style="list-style-type: none"> • Relation between market mechanisms and Government role for SME promotion • Government role for SME promotion • Fundamental frameworks and systems affecting SME development
<p>3rd Meeting October 15,1999</p>	<ul style="list-style-type: none"> • Process of development of Taiwanese SMEs – cases of shoes making and electronics • Current status and support of Indonesian SMEs • The current status and tasks of Thai SMEs – the cases of manufacturing • Summing up of Japan's cooperation for SME promotion in Indonesia and Thailand
<p>4th Meeting December 10,1999</p>	<ul style="list-style-type: none"> • Japan's SME financing and role of the Small Business Finance Corporation • The issues to be discussed in planning development loan for SME promotion – the case of Thailand • The issues to be discussed in planning investment and financing relating to SME development • Japan's SME financing schemes and cooperation with LDCs
<p>5th Meeting February 4, 2000</p>	<ul style="list-style-type: none"> • Japan's market penetration policies • Support of LDC's market penetration and export promotion – JETRO's schemes • Issues of investment/export promotion, SME promotion and facilitation of inter-agency collaboration in Sri Lanka • Support by international organizations and US/European countries for market penetration • Cooperation strategies by international organizations and US/European donors for SME promotion
<p>6th Meeting March 17,2000</p>	<ul style="list-style-type: none"> • Outlines and characteristics of Japan's business development services • Cooperation with LDCs for training SME management consultants • Current status of business development services in Mexico and Japan's cooperation • Future courses of cooperation for business development services
<p>7th Meeting May 22, 2000</p>	<ul style="list-style-type: none"> • Report of the meeting of the Committee of Donor Agencies for SME Development (Hanoi Meeting) • Final report • Ways to follow-up the Committee meetings

TABLE OF CONTENTS

0. SUMMARY.....	1
1. MEASURES CONCERNING COLLABORATION FOR SME PROMOTION BY JAPANESE AND FOREIGN DONOR AGENCIES.....	13
1.1 MEASURES BY JAPANESE DONOR AGENCIES	13
1.1.1 Functions of Each Donor Agency.....	13
1.1.2 Characteristics and Functions of Each Major Donor Agency.....	15
1.1.3 Significance of Inter-agency Collaboration.....	17
1.1.4 Ways to Facilitate Collaboration.....	18
1.2 TREND OF INTELLECTUAL COOPERATION BY OTHER DONOR COUNTRIES AND THEIR AGENCIES.....	23
1.2.1 Overall Trend.....	23
1.2.2 Actions by Major Donor Countries and Agencies	24
2. BASIC ISSUES ON COOPERATION FOR SME PROMOTION.....	28
2.1 NECESSITY OF DISCUSSION ON BASIC ISSUES	28
2.2 FUTURE ISSUES.....	29
3. SME DEVELOPMENT AND ISSUES (PRESENTATION OF CASES).....	34
3.1 LESSONS DERIVED FROM CASES	34
3.2 GROWING PROCESS OF TAIWANESE SME – SHOE MAKING AND ELECTRONICS	35
3.3 SME AND PROMOTION POLICIES IN INDONESIA	37
3.4 CURRENT STATUS AND ISSUES OF SME IN THAILAND – MANUFACTURING.....	39
4. MAJOR ISSUES ON INTELLECTUAL COOPERATION.....	42
4.1 BARRIERS OF SME GROWTH AND DESIRABLE SUPPORT	42
4.1.1 Japan’s Approach.....	42

4.1.2	Other Donor's Approach	42
4.2	AREAS TO BE ADDRESSED BY INTELLECTUAL COOPERATION AND FUTURE ISSUES	43
4.2.1	Areas to Be Addressed	43
4.2.2	Future Issues	44
5.	SUPPORT OF FORMULATION OF BASIC FRAMEWORKS NEEDED FOR BUSINESS DEVELOPMENT	45
5.1	LEGAL SYSTEMS AND OTHER CONDITIONS REQUIRED BY WORLD BANK	45
5.2	BASIC LEGAL FRAMEWORKS AFFECTING SME GROWTH	46
5.3	MATTERS TO BE TAKEN INTO ACCOUNT DURING IMPLEMENTATION OF COOPERATION.....	51
6.	SUPPORT OF SME'S FUND RAISING	63
6.1	JAPAN'S EXPERIENCE AND ITS APPLICATION	63
6.1.1	Evolution and Outline of Japan's Policy Measures	63
6.1.2	Current Status of SME Financing	71
6.1.3	Matters to Be Taken into Account in Application to LDC	72
6.2	SUPPORT BY BANK FOR INTERNATIONAL COOPERATION	75
6.2.1	Credit as Official Development Assistance	75
6.2.2	Foreign Loans and Investment (ODA)	76
6.2.3	Policy Recommendation Based on Special Assistance Facility (SAF), Special Assistance for Development Policy Project (SADEP) and so forth (ODA)	76
6.2.4	Export Credit (Other Official Flow)	77
6.2.5	Import Credit (Other Official Flow)	77
6.2.6	Investment Financing (Other Official Flow)	77
6.2.7	Untied Two-step Loan (Other Official Flow)	77
6.3	ACTIVITIES OF OTHER DONOR COUNTRIES AND AGENCIES	82

6.4	MATTERS TO BE TAKEN INTO ACCOUNT IN DESIGNING FINANCIAL INTELLECTUAL SUPPORT PROGRAMS	83
6.5	COLLABORATION BY DONOR AGENCIES.....	88
7.	SUPPORT OF MARKET PENETRATION	90
7.1	JAPAN'S EXPERIENCE AND ITS APPLICATION	90
7.1.1	Japan's Policy for Market Penetration	90
7.1.2	Matters to Be Taken into Account in Application to LDC	100
7.2	ROLE AND LDC-SUPPORTING FUNCTIONS OF JETRO.....	102
7.3	ACTIVITIES BY OTHER DONOR COUNTRIES AND AGENCIES ...	104
7.3.1	World Bank	104
7.3.2	EU (PHARE and TACIS)	108
7.4	COLLABORATION BY DONOR AGENCIES.....	112
8.	SUPPORT OF PROVISION OF MANAGERIAL AND TECHNOLOGICAL EXPERTISE	115
8.1	JAPAN'S EXPERIENCE AND ITS APPLICATION	115
8.1.1	Japan's SME Business Development Services.....	115
8.1.2	Technical Guidance to SME in Japan by Public R&D Institutions ..	118
8.1.3	Guidance Including Technical Advice by Small Business Corporation	120
8.1.4	SME Management Consulting and Cooperation for Training of Management Consultants in LDC.....	123
8.1.5	Business Development Services through Public Technological Agencies in LDC	125
8.1.6	Matters to Be Taken into Account in Application to LDC	126
8.2	ACTIVITIES OF OTHER DONOR COUNTRIES AND AGENCIES ...	128
8.3	COLLABORATION BY DONOR AGENCIES.....	134

0. SUMMARY

0.1 GENERAL REMARKS (FUTURE COURSE OF DELIBERATION)

- Not only for SME promotion but for any intellectual support, future courses of cooperation should always be reexamined through constant communications with a recipient Government, trade associations, private companies and other stake holders
- Promotion of SMEs in an LDC should be preceded by development of basic socioeconomic institutions of recipient countries assuring efficient industrial activities and free market functions as well as by appropriate administration of such institutions. Such preconditions should be fully kept in mind in making future development efforts.
- Attention should be paid to recognitions and discussions in the international community concerning roles to be played by Government and donors. Regarding a particular method of intellectual support, theoretical explanation should be made for its justification.
- More efforts should be made for well coordinated execution of financial cooperation and non-financial cooperation as well as of that for establishment and improved enforcement of socioeconomic systems mentioned above. Because they are mutually complementary, comprehensive measures should be encouraged by referring to good practices in the past and measures taken by international organizations.
- For a most modest step for facilitating collaboration among donor agencies concerned, inter-agency exchanges of information should be made actively. Consequently, to follow-up the Committee activities, donor agencies concerned are advised to set up a forum for regular exchanges of information on ongoing execution of their programs/projects as well as issues faced by them. Furthermore, an exchange of personnel is expected to be useful between domestic policy-directed financing institutions and donor agencies so that experiences of the former will be effectively used by the latter. At the same time, an exchange of personnel between our donor agencies and foreign comparable agencies should be made more actively.

0.2 COLLABORATION AMONG DONOR AGENCIES

- Abilities and actions of three kinds of organizations contribute to SME growth: first, Government ministries designing promotion policies and economic schemes; second, public agencies implementing such policies and industrial associations; and third, banks and companies performing business activities. For effective execution of cooperation with LDCs, therefore, an overall observation should be made to identify and take into account problems of these organizations in a consistent manner. Meanwhile, because specialties and functions of each agency are diverse and fragmented, any comprehensive approach needs inter-agency collaboration toward a synchronized direction and design.
- On the other hand, since an extensive range of expertise is required for SME promotion in LDCs, it is difficult to predetermine agencies to be involved. A collaborating arrangement should be made for each program/project depending on LDC's needs. For this purpose, Internet's web site may be useful enabling anyone to participate. In any event, concrete case examinations should be repeated, so that practically feasible occasions and manners of collaboration will be identified and shared among potential collaborators.
- For realization of collaboration, characteristics and functions of each donor agency should be known to every party concerned. Each agency is required to enhance transparency of information respecting its missions, functions, available specialties, available cooperation tools, financial abilities, promptness of action, a scale of operations and other pertinent matters. Besides, as such an agency is interested in different areas, it may be useful to prepare and share typical collaboration patterns designed in accordance with specific areas for collaboration as exemplified below.
 - a recipient country (stage of development, importance as a market, etc.)
 - development needs (upgrading industrial structures, poverty reduction, etc.)
 - sectors to be targeted (supporting industries, small/micro firms, etc.)
- Among various ways of inter-agency collaboration, especially effective is a combination of financial assistance and technical assistance, which helps improve both appraisal ability of a lender and managerial/technical ability of a borrower. Past examples of such collaboration include a combination of a two-step yen credit for Thai industrial development and JODC's dispatch of experts to borrowing companies as well as a combination of an untied loan for Tunisian industrial development and JICA-sponsored support to technology development agencies. For

the purpose of enhanced effectiveness of such collaboration, agencies concerned need to share principles of policies and visions concerning SME promotion with the recipient Government and private sectors. In this regard, desirable are sending experts advising policies and conducting a development study in advance so that such cooperation will help formulate a development master plan.

0.3 ACTIVITIES OF OTHER DONOR COUNTRIES AND AGENCIES

- SME promotion is regarded by other donor countries and agencies as an important objective hopefully leading to development led by private sectors. Recently, SME promotion is increasingly looked at from a viewpoint of poverty reduction.
- Although the international community does not define an SME, it appears to target small firms in Japan's definition, and normally does not target a medium sized firm. Such policy stands in contrast with the Japanese cooperation which has considerably emphasized development of supporting industries including a medium sized firm.
- Concerning SME promotion, the role of the Government and donors in relation to market mechanisms is subject to a debate. In many cases of conventional cooperation, the Government or donors directly supported SMEs. According to evaluation of the international community, such a method was not very effective from a viewpoint of both beneficiaries outreach and sustainability. For this reason, such a direct approach is being replaced by a framework/institution-building approach aiming to take advantage of market mechanisms.
- For example, concerning measures to remove SME's financial constraints, a monetary sector reforms is becoming a main tool, enabling a private bank to enter into a business of small firm financing so that SMEs will have easier access to financing. Furthermore, concerning business support aiming to strengthen individual SME's competitive edge, a notable trend is to provide assistance for building the system that will assure supply of such support services through market mechanisms. This trend notably deviates from Japan's conventional approach.

0.4 FUNDAMENTAL DISCUSSIONS ON COOPERATION FOR SME PROMOTION

- A major tool of Japan's conventional intellectual assistance in this field has been to teach our past policies to LDC's policy makers who wished to learn experiences of Japan where SMEs have remarkably grown. Recently, however, more LDCs request us to help make a tailor-made promotion plan.
- Such changing needs are causing some difficulties. First, LDC's socioeconomic systems substantially differ from ours. In such a case, SME promotion cannot be treated as an extension of Japan's experiences. Second, Japan's past policy may not agree with more or less internationally dominant practices, or, at present, practices of the World Bank/IMF. Whenever a system that deviates from the internationally dominant practices is planned to be transferred to an LDC, its justification has to be expressed logically in internationally understandable terms. Moreover, during day-to-day execution of a cooperation program/project, rationale of SME promotion tends to be taken for granted. In other words, development needs and policy objectives underlying SME promotion are not necessarily fully discussed, giving way to more practical subjects relating to day-to-day operations. Between a donor and recipient country, thorough discussions should be made as to the ultimate goal of economic policy and significance of SME promotion, which is a means to achieve the goal, the segment of SMEs to be targeted, and comparative importance of any other necessary policies than SME promotion. Intellectual cooperation would be valueless, failing to achieve the ultimate goal, without going through such fundamental discussions in advance.
- As has been emphasized above, sustainable impacts would not be hoped for without discussions of basic issues. However, those assigned to individual programs/projects are mainly experts in a specific SME promotion measure and preoccupied with day-to-day planning and execution. Because only a few of them are able to deal with both fundamental discussions and specific programs/projects, they would not be able to meet rapidly increasing needs for assistance. In view of such reality, the followings are examples of measures to be taken to activate discussions on basic issues and to upgrade our SME-promoting cooperation:
 - (a) to upgrade a dialogue with recipients on economic development policies
 - (b) to upgrade knowledge in social science of administrators and experts assigned to cooperation programs/projects

(c) to upgrade basic studies

(d) to step up interaction with international organizations

0.5 LESSONS DERIVED FROM CASES (TAIWAN, INDONESIA AND THAILAND)

- The SME-driven economic growth is realized in the process of survival of the most competitive firms, where both start-ups and closures are observed in large numbers.
- Active start-up and closure of SMEs are supported by social values that think highly of a successful entrepreneur who starts from scratch.
- SME's competitiveness is derived from a flexible manufacturing system supported by division of labor and partnership.
- Such a unique form of industrial organization encompassing SMEs is closely related to socioeconomic frameworks of the country.
- Prosperous farm economies greatly contribute to SME development.
- If SME development is made an objective of the economic policy, it is necessary to create environment where not only Government policies but private firm's assistance to SMEs are expected to work.
- Mutual trust between the Government and industries is essential for effectiveness of Government policies.
- In the case like the recent Asian economic crisis where conventional financing intermediaries do not work, public assistance to private venture capital investors can be effective.
- The more interested in SME policies are politicians, the more they resemble social policies and the less economic policies. Especially, Government's support of potentially competitive medium sized enterprises is difficult to be justified.
- Cooperation for SME development should include support of restructuring and transformation of companies suffering a sudden shock like the recent Asian economic crisis.

0.6 MAJOR ISSUES CONCERNING INTELLECTUAL SUPPORT

- Most of Japan's conventional SME-promoting cooperation programs chose to provide public support to alleviate SME's difficulties. The underlying premises have been that SME's handicaps are not removable by means of market mechanisms and that Government support is therefore indispensable. Consequently, the Japanese method has been to treat Japan's promotion schemes and company's capability as benchmarks. On the basis of comparison with the benchmark, managerial/technical capability of SMEs in LDCs were measured, and proposals were made to narrow the gap by means of public assistance.
- The more or less dominant approach in the international community led by the World Bank is different from the Japanese approach. While both approaches aim to strengthen SME's competitive edges, extensiveness and intensity of intervention by the Government and donors significantly differ between the two approaches. The method of the international community is based on the belief that the major Government role is to create schemes enabling the market, which is friendly to SMEs, to work without disturbance. Their highest priority is to help set up proper legal systems and other frameworks and prepare a level playing field.
- For the sake of upgrading our intellectual assistance, our conventional approaches should be modified or strengthened in the following manners in consideration of other donor's activities:
 - study/analysis of basic systems affecting industrial development and identification of impediments of development

A study/analysis of basic systems affecting not only SME development but overall industrial development should be stepped up. Analysis of factors impeding SME development should be made from wide perspectives including legal and other systems. In the process of such a study/analysis, representatives of private sectors of a recipient country should also be invited to join.
 - support for financing

In Japan, policy-directed financing played an important role for SME development. Such valuable experiences should be actively used for intellectual assistance for LDCs. Even in such instances, however, mere copying of our past experiences should be avoided so that sustainable schemes will be proposed and supported in consistency with basic systems and institutions of the recipient country.

- support of market penetration
In the context of changing environment of international trade, effective measures should be chosen among Japan's market penetration policies in the past and expertise in them should be transferred.
- managerial/technical business development services
Concerning business development services through Government agencies, appropriate schemes should be proposed and supported corresponding to supply/demand relations of such services in management and technologies and in consideration of a cost/benefit comparison.

0.7 COOPERATION FOR DEVELOPING FRAMEWORKS REQUIRED FOR SME-PROMOTING POLICIES

- Listed below are basic frameworks which have to be looked at in prescribing policies for SME promotion.
 - (a) basic legal and other systems
 - definition of property rights
 - rules of business transactions
 - rules of entry into and exit from business
 - prohibition of monopoly and unfair business practices
 - development of money/securities markets
 - (b) stabilization of macroeconomy
 - improvement of fiscal balance
 - improvement of the current account in the balance of payments
 - reduction of the inflation rate
 - (c) international trade schemes and domestic business laws
 - international trade schemes
 - domestic business laws
 - (d) intellectual infrastructures supporting industrial activities like quality control
 - standardization

- tests and inspection
- metrological standards
- In the case of collaboration for developing basic frameworks, items to be checked have to be identified, and viewpoints, theory and methodologies be properly chosen. A uniformly-applied method without going through such exercises is risky.
- The basic systems to be checked include not only legal systems but social systems like mutual aid affecting personal saving.
- Design of basic legal and other systems should be thoroughly discussed in a forum attended by Government officials, representatives of private sectors and scholars in consideration of SME's situations and difficulties.
- While our approach to SME promotion is based on wisdom obtained through observation of day-to-day SME business, such a bottom-up approach may be combined with a framework approach of the World Bank into an optimum mix.
- While transferring our SME promotion policies in the past, confirmation should be made as to our basic legal and other systems which supported effectiveness of our policies as well as status of development of such systems in the recipient country.

0.8 FINANCING SUPPORT

- Our SME policy financing has been made for a number of years, accumulating a great deal of expertise. In applying our support schemes in LDCs, situations prevailing when the scheme was introduced should be recalled, and the scheme to be transferred should be carefully examined in consideration of LDC's stage of development.
- In Japan, though a large amount of fiscal funds is being channeled to SMEs, commercial financial intermediaries account for over 90 percent of outstanding loan amounts to SMEs. Many Governmental financial institutions made a lending agent arrangement with commercial banks to lend through their networks. In this sense, a Government institution relies on commercial banks. When establishing an SME financing scheme in an LDC, the first task should be to develop commercial banks and monetary sectors. The role and functions of the public financing scheme should be discussed in relation to facilitation of development of commercial banks.

- Japan's policy-directed financing for SMEs has been effective because of its execution synchronized with other promotion measures such as business development services and tax concessions. Consequently, when our scheme is transferred to an LDC, availability of other complementary schemes should be ascertained.
- Japan's SME financing is being executed through networks formed by local Governments and other public SME support agencies. For example, the 521 Chambers of Commerce & Industry and 2,808 Society of Commerce & Industry throughout the country provide consultation covering SME financing. Availability of a lending facility in borrowing SME's vicinity makes the scheme more effective. Furthermore, an industry division of local Governments executes SME-promoting policies taking advantage of its close contacts with local SMEs. During our cooperation with LDCs, such network building is to be an important task, because it is an essential infrastructure for SME financing.
- For many decades, our Government financing institutions have aimed to support borrowers from long term perspectives by means of their excellent appraising expertise accumulated through their experiences for many years looking deeply into managerial situations of a would-be borrower and of their affluent information stored in databases containing borrowers' information. Companies or projects which passed rigorous appraisal by a Government financing institution usually had easier access to commercial banks. In this sense, a Government financial institution reduced commercial banks' cost for information gathering. When a Government institution is founded in an LDC, efforts should be made for human resource training and institution building, so that it will perform such useful functions.

0.9 SUPPORT OF MARKET PENETRATION

- Japan's past policies for market penetration would not necessarily comply with the current rules of international trade if they were implemented now. Besides, environment surrounding international trade has substantially changed as exemplified by a number of regional free trade arrangements. For these reasons, mere copying of Japan's schemes in an LDC is inappropriate. When designing a recommendation, compliance with the current trade rules and future prospects of success should be fully taken into account so that the recommended scheme will be effective matching the current conditions.

- While a variety of policy measures seems available for information supply services in an LDC, conformation should be made not only on its effectiveness but availability of complementary schemes. Specifically the following questions have to be asked to ourselves before choosing a particular measure for an LDC: (a) how in practice such measures were applied in Japan, (b) how beneficiaries evaluated effectiveness of such measures, and (c) which of them was the most effective.
- As public support for market penetration complement private sector's activities, they would be ineffective without meeting constantly changing needs of beneficiary firms. When transferring our schemes, merely transferring the content of the scheme would not be sufficient but expertise in establishing a proper role of Government and in accommodating needs of beneficiaries should also be transferred.

0.10 SUPPORT OF PROVISION OF MANAGERIAL/TECHNICAL EXPERTISE

- Provision of a business development service for SMEs as well as financing and support for SME's collective action has been for many decades a most important SME-promoting policy of Japan. The expertise and human resources accumulated for many decades through training and experiences of an SME management consultant uniquely match SME's needs in an LDC where even elementary managerial expertise is scarce.
- On the other hand, in Japan, business development services have been effective in the context of complementary relationship with our corporate culture and other SME-supporting measures. The SME Management Consulting System was initiated in prefectural Governments and designed to train prefectural staff guiding SMEs. Subsequently keeping pace with the economic growth, the management consulting business has been taken up by private sectors. Therefore, in LDCs where organizations and personnel of local Governments are in an early stage of development, a comparable scheme initiated on the basis of an analogy from Japanese experiences would not be sustainable. Confirmation should be made before the initiation whether a suitable executing agency exists equipped with well-developed internal organizations and able staff, how a management consultant is to be used, and whether SMEs are prepared to use such services.

- Notably, our business development services have enjoyed synergy effects because of the execution synchronized with other policy measures for encouragement of SME's collective action, financing and others. For example, financing and business development services for SME's Structural Upgrading were successful in a number of cases because of provision of a package of support ranging from financing and guidance to tax concessions. The Scheme makes concessional credits for SME's grouped or joint operations and requires the applying SME to go through management consultation.

- Combining financing and business development/consulting services complements appraising ability of financial intermediaries, and is considered useful in LDCs as well. Because a financial intermediary in an LDC, however, tends to avoid making a lending decision under the influence of outsiders, such combination may not be practicable. A dialogue between a donor Government and recipient Government should confirm that, without a firm commitment and comprehensive measures by the recipient Government, any synergy effect would not be hoped for. In combining financing and business development services, caution is needed to avoid business development services becoming preoccupied with techniques for borrowing.

- Training by the Institute for Small Business Management and Technologies for managers and technicians of SMEs is designed on the assumption that a company trains its employees at its expense. This assumption is not necessarily applicable in a country where a long-term employment practice of a Japanese style is not customary.

- In a country where markets of private consulting business are developed, especially where US/European consultants have entered into business actively, business development services through Government agencies may compete with them. In such a country, private consultants may be used, a role and coverage of public services should be carefully identified, and the necessity of such public services should be theoretically justified.

- While the Japanese Government has spent a considerable amount of fiscal funds on dissemination of business development services, an LDC suffering financial

difficulties is not able to allocate substantial resources continuously. Therefore, for the sake of financial viability of the public service, at least a part of the cost has to be recovered. For this purpose, it is necessary to earn a profit by servicing large firms and to continue low-cost or free services for SMEs which are not able to pay the full cost. In order to satisfy large firms, public service suppliers need to have unique expertise. Specialization and networking may be a means to be considered for acquisition of such expertise.

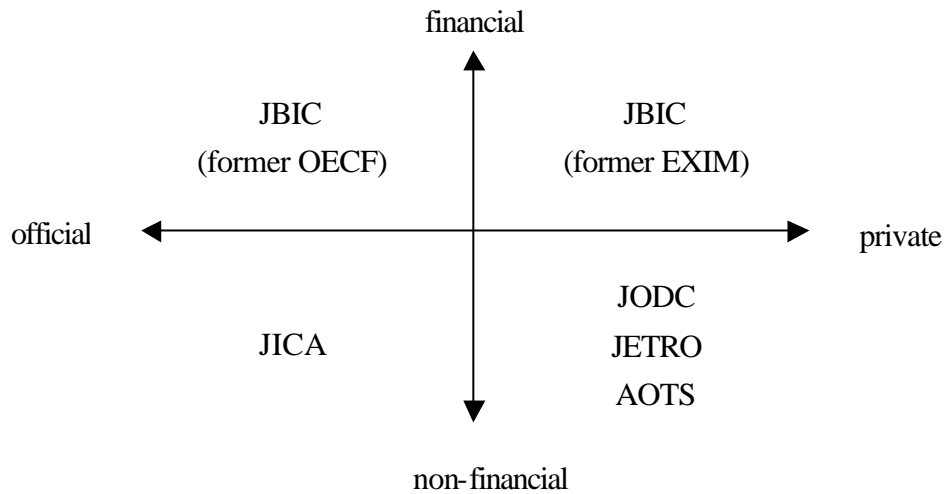
- In the context of the worldwide trend toward a free market and small Government, the position of Governmental suppliers of business development services is subject to discussions. In Japan as well, as a result of progressive industrialization, private companies like subcontract-awarding large firms and business partners became more important channels of technology transfer, limiting the role of Governmental services agencies. Corresponding to a stage of development and beneficiary sectors, it is necessary to make optimum combination of direct service supply by a Government agency and creation of environment deriving vitality of private sectors.

1. MEASURES CONCERNING COLLABORATION FOR SME PROMOTION BY JAPANESE AND FOREIGN DONOR AGENCIES

1.1 MEASURES BY JAPANESE DONOR AGENCIES

1.1.1 Functions of Each Donor Agency

- While numerous donor agencies in Japan are engaged in SME promotion in developing countries, to describe all of them is beyond the purpose of this Report. The reasons are:
 - (a) In connection with cooperation with developing countries, the concept of “SME promotion” is flexible, because each developing country has her own needs for development underlying SME promotion, targeting different firm sizes and sectors.
 - (b) Because not only conventional donor agencies but private firms, universities and NGOs are contributing to SME promotion in developing countries, delineation of the whole picture is not practicable.
- Since this Committee has focused on ways for closer collaboration among Governmental/semi-Governmental agencies closely connected with SME promotion mainly in manufacturing sectors in developing countries, its members have been chosen accordingly. Meanwhile, during its discussions, the common recognition has been made that a number of organizations other than those explicitly dealt with in this Report should be invited for collaboration for the purpose of more effective cooperation. Particularly important among such organizations are private companies, universities and research institutes.
- In considering ways for collaboration, a distinction should be made between the following two groups:
 - (a) economic cooperation agencies
 - (b) agencies supplying knowledge, know-how and human resources
- The economic cooperation agencies consist of financial agencies and non-financial agencies. From another viewpoint, they may be classified into: (a) ODA implementing agencies, (b) agencies supporting private sector’s development assistance, and (c) agencies supporting other private economic cooperation such as trade and investment. From the viewpoints combining the above, the major donor agencies participating in the Committee (JBIC, JETRO, JICA, JODC and AOTS) are positioned in the diagram below.



➤ Among agencies supplying knowledge, know-how and human resources needed for cooperation for SME promotion, the following three organizations have been represented in the Committee. All of them are public entities implementing policies designed by the Small and Medium Enterprises Agency.

- (a) Small Business Corporation
- (b) Small Business Finance Corporation
- (c) Small & Medium Enterprise Management Consultants Association

Meanwhile, remarks were made pointing out relevance of collaboration with the following organizations supplying knowledge, know-how and human resources:

- (a) People's Finance Corporation (expertise in financing small firms)
- (b) Shoko Chukin Bank (expertise in organizing SMEs from a viewpoint of financing)
- (c) Japan Chamber of Commerce and Industry; and Central Federation of Societies of Commerce & Industry (expertise in business development services for small firms)
- (d) National Association for Subcontracting Enterprises Promotion (expertise in promoting inter-firm linkages including promotion of supporting industries)
- (e) Small Business Research Institute (collection of knowledge in Japanese and foreign policies for SME development)

- (f) National Federation of Small Business Credit Associations (expertise in establishment and operation of small business credit guarantee agencies)
- (g) Trade and Investment Insurance Organization (expertise in trade/investment insurance)

A view was also expressed reconfirming importance of contribution by academicians and researchers knowledgeable in SME situations, socioeconomic systems in developing countries, development economics and business laws. Such knowledge is needed for creating environment conducive to growth of SMEs in developing countries whose socioeconomic systems differ from those in Japan.

- The Committee has discussed ways to promote inter-agency collaboration among a limited number of representatives mainly for the sake of convenience of meeting procedures. A list of collaborating organizations, however, should not be limited in advance, because SME promotion in developing countries needs a wide range of knowledge and know-how. A system, therefore, is needed enabling a wide range of related donor organizations to collaborate in accordance with requirements of each developing country. For this purpose, a good way may be to provide a virtual forum by means of an internet web site enabling any organization/individual to join as long as they are interested in SME promotion in developing countries.

1.1.2 Characteristics and Functions of Each Major Donor Agency

- The characteristics and functions of each major donor agency represented in the Committee are summarized in the table below.

	Category	Measures	Tools
International Cooperation Agency	<ul style="list-style-type: none"> • ODA 	<ul style="list-style-type: none"> • formulation of a master plan for SME promotion • organization building of public SME promotion agencies • training of Government personnel executing SME promotion policies • fostering and 	<ul style="list-style-type: none"> • sending a mission studying development projects/programs • sending an expert • hosting a trainee • senior volunteer

	Category	Measures	Tools
		training SME's human resources	
Bank for International Cooperation (former OECF)	<ul style="list-style-type: none"> • ODA 	<ul style="list-style-type: none"> • supporting promotion of SME forming a basis of economic growth in LDC 	<ul style="list-style-type: none"> • development loan • overseas direct investment and loan • policy recommendation based on SAF and SADEP
(former EXIM)	<ul style="list-style-type: none"> • promotion of economic exchange in private sectors 	<ul style="list-style-type: none"> • SME promotion in LDC through supporting activities of Japanese firms • development of economic infrastructures 	<ul style="list-style-type: none"> • export credit • import credit • investment credit • untied loan • investment seminar
JETRO	<ul style="list-style-type: none"> • promotion of trade & investment 	<ul style="list-style-type: none"> • promotion of supporting industries and support of Japan-affiliated firms in LDC • support of structural improvement of economies and industries of LDC 	<ul style="list-style-type: none"> • sending an expert • trade fair for purchase of LDC goods • sponsoring a forum for exchange of business executives • services for promotion of LDC's export to Japan
Association for Overseas Technical Scholarship (AOTS)	<ul style="list-style-type: none"> • promotion of private economic cooperation 	<ul style="list-style-type: none"> • training of technical personnel of LDC • support of structural improvement of industries of LDC 	<ul style="list-style-type: none"> • hosting LDC's trainees
JODC	same with the above	same with the above	<ul style="list-style-type: none"> • sending an expert

Small Business Corporation	<ul style="list-style-type: none"> • supplying expertise and human resources for cooperation concerning SME policies 	<ul style="list-style-type: none"> • promotion of SME in LDC through support of international activities of Japanese firms • training of LDC personnel executing SME promotion policies 	NA
Small Business Finance Corporation	same with the above	<ul style="list-style-type: none"> • training of LDC personnel executing SME promotion policies 	NA
Small & Medium Enterprise Management Consultants Association	same with the above	<ul style="list-style-type: none"> • promotion of SME management consulting systems and training of SME management consultants in LDC • OJT training of human resources in management techniques 	NA

1.1.3 Significance of Inter-agency Collaboration

In the light of the discussions of the Committee, inter-donor collaboration (or so-called “All Japan” measures) has the following merits:

- First, the collaboration meets requirements for comprehensive measures. For SME development, expertise and activities of the three kinds of organizations are required: (i) the Government designing economic systems and promotional policies, (ii) public entities and industry associations implementing policies, and (iii) financial intermediaries and enterprises performing businesses. Consequently, for effective cooperation for SME development in LDCs, issues faced by these organizations need to be understood and taken into account consistently. On the other hand, because our donor agencies operate on the basis of specialized responsibilities, inter-agency collaboration based on an overall design is essential so that each agency will take its respective measures with clear orientation aiming at a comprehensive approach.

- Second, the collaboration leads to efficient use of domestic resources for cooperation. There are not many organizations and human resources capable of supplying expertise in SME development. The resources are even more scarce for cooperation with LDCs. The collaboration helps avoid inefficient duplication of cooperation measures or competition among agencies looking for such scarce resources.
- Third, the collaboration enables donor agencies to share experience and knowledge. Since there are numerous LDCs and situations of private sectors are changing constantly, accumulation of experience and collection of information by each donor agency are ineffective. Shared experience and information are expected to reduce costs and upgrade quality of cooperation.
- Forth, the collaboration helps make such donor's operations more transparent. During the process of collaboration, more information will be disclosed as to what can be done by each donor. Such enhanced transparency is expected to enable the Japanese people to understand merits of economic cooperation more favorably and LDCs to gain more benefits.

1.1.4 Ways to Facilitate Collaboration

- As paragraph 1.1.2 describes, each donor agency executes measures for SME promotion from its own perspective in accordance with its mission. Given such a diversified mission of each agency, inter-agency collaboration would not be practicable without realistic means, even if its merit is understood theoretically. For its facilitation, concrete case-by-case consideration should be made and shared by agencies concerned as to under what circumstances and how collaboration is feasible.
- For the purpose of case-by-case considerations, characteristics and functions of each agency have to be known to all related entities. Each agency needs to provide information openly concerning its mission, functions, expertise to be made available, tools of cooperation, cost-bearing ability, promptness of action, scales of operations and the like. Moreover, since each agency is interested in different areas of cooperation, collaboration cases may desirably be looked at from such viewpoints as listed below so that they will be understood and shared by agencies concerned.

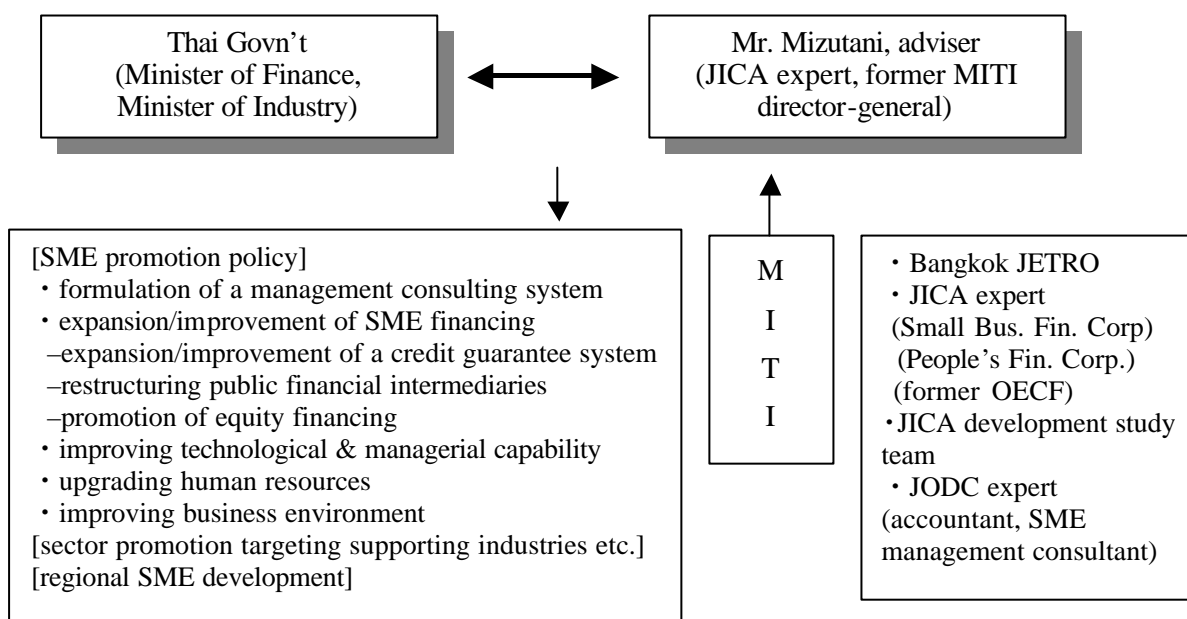
- (a) assistance-receiving countries
 - development stages, importance as a market etc.
 - (b) development requirements
 - upgrading industrial structures, alleviation of poverty, etc.
 - (c) sectors or segments to be promoted
 - supporting industries, micro firms, etc.
- For accumulation of concrete collaboration cases, a mechanism should desirably be established for reporting, feed-back and coordination. From this viewpoint, the Committee considers it useful to continue to organize such a forum facilitating inter-agency collaboration.
 - Among the cases presented to the Committee, those illustrated below may be use for future consideration.

Case 1 Comprehensive Cooperation Measures Implemented in Thailand Following Advice of Japanese Experts (Mizutani Project)

Objective: to facilitate industrial structural reforms through development of supporting industries

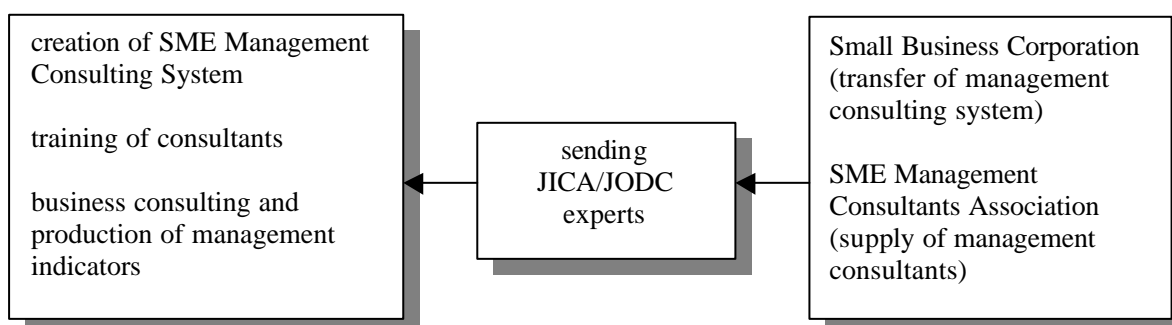
Structure of Cooperation

Contribution to formulation of a framework of SME promotion policy

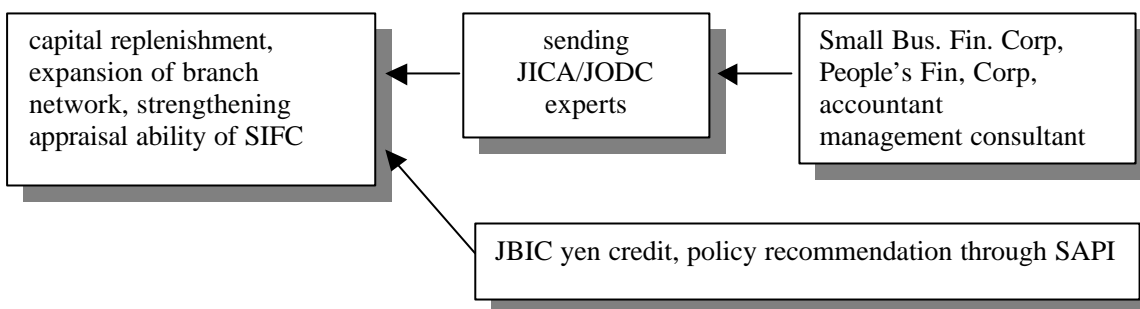


Contribution to design and implementation of individual policy measures
(examples)

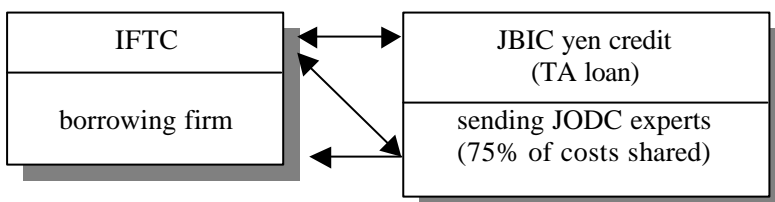
- creation of a management consulting system and training of management consultants



- strengthening Small Industries Finance Corporation (SIFC)



- yen credit (industrial upgrading plan)



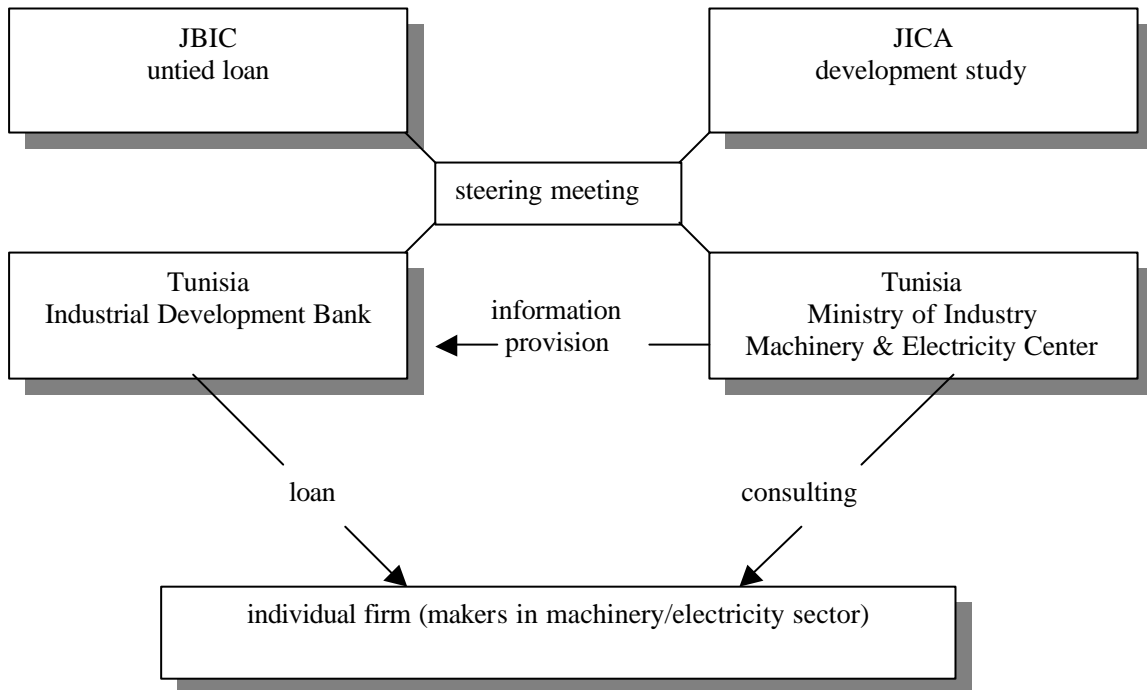
Notable Features

- economic crisis and necessity for structural reform (objective of cooperation readily understandable)
- MITI's role as an overall designer and coordinator
- incorporation of existing related cooperation measures

Case 2 EXIM Loan and JICA Technical Cooperation in Tunisia

Objective: to enhance industrial competitiveness and step up economic cooperation with private sectors of Japan against the background of coming into force of the Association Agreement with EU

Structure of Cooperation



Notable Features

- JICA's development study identified potentially capable firms which are likely to contribute to strengthening industrial competitiveness. JBIC's untied loan was provided to the identified firms.
- Because of provision of JBIC's untied loan, economic cooperation between firms of both countries was made closer.
- Because of JICA-JBIC collaboration, an opportunity for dialogues was created between the Ministry of Industry and Development Bank respecting industrial promotion.

1.2 TREND OF INTELLECTUAL COOPERATION BY OTHER DONOR COUNTRIES AND THEIR AGENCIES

1.2.1 Overall Trend

- Other donor countries and their agencies as well as Japan treat SME promotion as a prioritized objective of economic development led by private sectors. Meanwhile, SME promotion has been increasingly looked at from a perspective of poverty alleviation.
- In the community of international cooperation, an SME is not clearly defined. A main target of assistance is firms belonging to a size bracket comparable to small firms in the Japanese standard. Medium-sized firms, therefore, are normally not targeted by other donor countries.
- Concerning a method of SME promotion, a way of market intervention by the Government is controversial. In the case of many conventional assistance projects, LDC Governments or donors directly supported SMEs. A recent trend, however, is toward more use of institutional approaches based on market mechanisms, because the conventional direct intervention has allegedly been ineffective due to limited coverage of beneficiaries and sustainability.
- For example, regarding financing, whose limitation often constitutes a bottleneck of SME growth, improving SME's access by means of support of financial reforms has become a dominant method. An example of such reforms is to build an institutional framework that enables a commercial bank to start small firm financing. For business support aiming to strengthen competitiveness, assistance for building a market-oriented system that will facilitate such services is becoming more fashionable. Notably, such a trend deviates from Japan's conventional approach.
- Regarding a method of cooperation for SME promotion, active discussions are taking place in the international community, among which the following forums are worth noting:

(a) **Committee of Donor Agencies for Small Enterprise Development**

Administered by the World Bank, the Committee is attended by most of major donor countries including Japan. The Committee has met more than 20 times since 1979, discussing and studying best practices and other topics to set standards of financing and business development services. This forum is playing a leading role in advocating institutional approaches.

(b) **DAC**

The Working Party on Financial Aspects of Development Assistance of DAC has been actively discussing cooperation for SME promotion in connection with poverty. In January 2000, the Party organized a workshop co-sponsored by the World Bank.

(c) **Forum on Entrepreneurship and Enterprise Development**

The Forum was organized with the initiative of OECD and UNIDO, mainly focusing on methods of cooperation for SME promotion in countries transforming themselves into market economies.

1.2.2 Actions by Major Donor Countries and Agencies

➤ World Bank

Setting up a Small Firms Unit in the Private Sector Department in 1997, the World Bank helps promote SMEs including micro firms.

In the views of the Small Firms Unit, major constraints of SME growth are:

- (a) external constraint: underdeveloped infrastructures, excessive Government regulations and restrictions, and the like
- (b) limited access: limited access to information, markets, raw materials, intermediate goods and services
- (c) internal constraint: inadequate ability in technology, production control and management

With the above recognition, the World Bank deems it important to reform financial systems and to develop private sectors providing business-related services, helping small firms grow with maximum use of market mechanisms. The Bank no longer provides low interest credits, because, according to their opinion, such credits distort normal market functions.

➤ USAID

The USAID mainly helps micro firms employing 10 persons or less, as such assistance provides a social safety net.

The USAID emphasizes consideration of political/diplomatic policies of the US Government. For example, its assistance in Eastern Europe and CIS attempts to promote and sustain political reforms based on democracy. In their mindset, policy consideration appears to outweigh economic cooperation.

Micro financing is provided through private foundations and NGOs. Besides financial assistance, business development is given priority. For business development services, firms providing such services are being financed.

The highest priority is given to formulation of a framework for fostering micro firms and of policy designs, which include legal/regulatory reforms, selection of strategic sectors to be targeted, forming or reforming consumer financing systems through small banks.

In the area of financial support, micro firms are financed through NGOs. Measures for legal/regulatory reforms include preparation/amendment of anti-monopoly laws and elimination of corruption.

➤ EU

In 1996, the EU Council adopted the Programme for Community Policy for SMEs, which has guided Central/East European countries desiring to join EU. Based on the policy planning principles of this Programme, EU has assisted the Central/East European countries through the PHARE Programme as well as the CIS through the TACIS programme. The objective is to enable SMEs in expanded EU to compete fairly on a level playing field.

The Community Policy Programme mainly consists of the following measures:

- (a) simplifying and improving administrative and regulatory procedures relating to business management
- (b) making continued efforts to improve financial systems, to improve access to financing of risk capital, to prevent delayed payments, and to promote development of money markets conducive to rapidly growing SMEs.
- (c) supporting SME's European/international strategy and business links through provision of services of good quality
- (d) encouraging entrepreneurship
- (e) improving SME policy tools

The PHARE/TACIS Programmes support:

- (a) establishment and operations of an SME promotion agency on a nationwide basis and design of SME promotion policies
- (b) a regional/local SME promotion agency and business consulting center
- (c) a variety of financing schemes
- (d) SME promotion measures conducted by industry associations
- (e) an agency attracting incoming foreign direct investment

Extract of Committee Discussions

- High-grade intellectual support for SME promotion – summary of a back-to-office report of the trip to the US and Europe (5th meeting)
(by Prof. M. Kondo, Kochi Univ. of Technology)

(1) Operations of international development banks

The World Bank is executing its program on the basis of well-thought principles and strategies based on economic theory and reality of SMEs. To overcome inadequacy of SME's technology and information, the Bank chooses to build and improve mechanisms of market where SME-supporting services are expected to work properly. In addition, the Bank organizes a number of donors' meetings.

The Inter-American Development Bank applies a method of attribution from empirical observation, while the European Bank for Reconstruction and Development has made an empirical model incorporating EU's directives and related laws of the members and uses the model in accordance with situations of each country. Like other development banks, the European Development Bank is required to earn income. The Bank, therefore, helps recipient countries improve legal systems so that they will provide environment favorable to its investment and loan.

(2) Strategy of Japan

Until today, Japan may have been thanked for her economic cooperation. She, however, should be respected in the future by theorizing, evaluating and analyzing rationale and effectiveness of her policy. It would be inadequate just to declare what was done and how well each measure was done. Theoretical explanation needs to be made why individual measures work and whether their costs/benefits ratios are higher than their alternatives. Theoretical dialogues on policy justification need to be conducted by top executives of the Government and donor agencies. Moreover, conventional technical support, intellectual support and others need to be combined for the sake of synergy effects.

(3) Future action

- (a) Theorization and evaluation of policies have to be stepped up. Donor agencies concerned are recommended to support and implement necessary measures for this

purpose.

(b) The best practice in Japan and that in LDCs should be compared so that their differences will be explained.

(c) Japan's presence in international forums need to be enhanced.

(d) Intellectual support measures should be implemented systematically with the best use of Japan's strengths in policy planning. For Central/East European countries, although Japan does not seem to be in a vantage position to advise on formulation of legal systems, feasibility of cooperation respecting implementation of such systems may be worth considering. For Asian countries, where legal systems are relatively underdeveloped, cooperation in both formulation and implementation of legal systems may be feasible, while for other countries whose legal systems are relatively well developed, cooperation in implementation of such systems in the light of Japan's experience may well be provided.

- DAC (5th meeting of Workshop on Enterprise Development for Private Sector-Led Economic Growth in Less Advanced Developing Countries) – summary of a back-to-office report by Mr. Ueshima, JICA

Co-sponsored by the DAC and World Bank, the Workshop was attended by representatives of both developed countries and LDCs. The World Bank was of the view that conventional assistance had not been very effective, urging to apply new methods. Also emphasized were needs to theorize ways and means to combine alleviation of poverty and private sector development. The general consensus was that direct Government intervention should be minimized and that institutional approaches should be applied taking advantage of market mechanisms.

From a viewpoint of a technical cooperation agency, the most impressive was the opinion that cooperation through a public entity was ineffective and should be phased out. According to this opinion, cooperation for development of markets contributing to development of service-providing private firms should be stepped up instead of helping develop a public agency. Concrete measures for such market-oriented cooperation are due to be discussed in the process of future donor's meetings

The Japanese donor agencies should keep an eye on the progress of such discussions in international forums so that their policies will remain consistent with the worldwide trend.

2. BASIC ISSUES ON COOPERATION FOR SME PROMOTION

2.1 NECESSITY OF DISCUSSION ON BASIC ISSUES

- Japan's conventional intellectual cooperation for SME promotion has mainly been to teach contents of policies implemented by Japan to policy makers in LDCs, who wish to learn policy practices of Japan, where SME development has been outstanding. For this purpose, LDC's personnel was invited to Japan and educated through lectures and field trips. Recently, however, more requests are being made to formulate a tailor-made promotion plan taking into account situations of individual countries.
- Such requests are causing the following difficulties. First, in cases where LDC's socioeconomic systems are different from ours, SME promotion is not an extension of our experience. Legal frameworks forming a foundation of Japan's SME policy may not exist and consequently policy expertise to be transferred may not work effectively. Under these circumstances, more basic system building must precede transfer of expertise in individual policies.
- Second, it has become more important to comply with international standards that are set by the World Bank and IMF and dominantly supported in the international community. Whenever any donor deviates from such standards, such a donor is required to justify the deviation in logical terms acceptable to the international community. Without economic theoretical explanation, such a proposal may not be accepted. In this sense, cooperation for SME promotion cannot do without basic discussions, because SME promotion is closely connected with the issue of Government's role.
- Moreover, in actual practices of cooperation for LDCs, SME promotion per se tends to be considered an objective. Following such a practice, a donor agency is apt to be solely interested in discussions of implementation of individual measures like an SME policy-directed financing scheme. Such discussions, however, should be preceded by deliberation with a recipient LDC of such basic issues as:
 - (a) a relationship between overall policy goals and SME promotion, which is a means to attain the goal; (b) the segment of SMEs to be targeted; and (c) necessity of any policy other than SME promotion.
- Without thorough discussions of such issues, intellectual cooperation would not be of high value.

2.2 FUTURE ISSUES

As has been pointed out, consideration of fundamental issues is indispensable in designing an intellectual cooperation program with a lasting effect on a recipient LDC. Though such an approach may sound roundabout, avoiding fundamental discussions is likely to cause a substantial damage in future. However, most experts assigned to a cooperation project experienced in Japan's SME policy are preoccupied with details of the specific policy design in executing their duty. Worse yet, only a few experts are able to discuss and examine a wide range of issues covering both the fundamental matters and details of an individual policy. Due to such limitations, they are unable to meet increasing development requirements. In consideration of such reality, the following proposals exemplify measures to be taken with a view to upgrading quality of cooperation for SME promotion.

➤ Upgrading dialogue on economic development policy

Though a policy dialogue between a donor and an LDC is being made more frequently than it used to be, in-depth discussions are rare. Recent dialogues tend to be superfluous without inviting scholars and researchers, and is too short to be in-depth. For example, even if SME promotion is understood to be important for a variety of reasons, mostly skipped are such theoretical discussions as its justification in the context of an overall socioeconomic policy framework of a particular LDC, its relationship with other policies, and roles to be played by the Government and the donor. Burden of such basic discussions is usually shifted to those executing individual projects. In the light of limited availability of human resources, however, discussions on basic issues in relation to individual projects would be inefficient and unrealistic. Upgrading quality of across-the-board discussions is most desirable. To this end, a standing forum should be set up inviting scholars and researchers, and specializing in economic development policy, enabling individual project personnel to use its outcome.

➤ Educating cooperation personnel in social science

The majority of Japanese personnel assigned to cooperation projects has educational background in natural science, equipped with advanced knowledge and know-how in manufacturing. Consequently, our cooperation is appreciated by LDCs due to its direct contribution to increased competitiveness of manufacturers. On the other hand, in making proposals with wider implications like promotional policy

frameworks, these experts are not good at theorizing their proposals due to lack of knowledge in social science. As a result, even if the proposals are useful, they may be judged immature from a viewpoint of international standards and neglected by a recipient LDC. So that Japan's cooperation will be appreciated in the international community, Japanese experts should regard expertise in social science including economic theory as international common language and attempt to learn more about it.

➤ Stepping up research in development theory

Inadequate research in development theory concerning SME growth and Government's role stands in the way of discussions of basic issues. Regarding Japan's SME policy as well, few studies have attempted to demonstrate persuasive theoretical justification or made empirical case studies of Japan's cooperation projects. Evidences proving rationale of Japan's cooperation projects are scarce, while, LDC's socioeconomic systems are not adequately understood. In straightforward words, Japan's intellectual cooperation tends to rely on intuition merely supported by Japan's successful experience. For the purpose of upgrading intellectual cooperation, the following themes need to be studied eagerly through concerted efforts by donor agencies:

- (a) Government's role in the light of effectiveness of Japan's individual promotional policies (an empirical study)
- (b) comparison between successful cases and unsuccessful cases of cooperation projects in the past as well as reasons for the success/failure
- (c) prerequisites for SME growth

Extract of Committee Discussions

- Outline of market mechanisms and Government's role for SME promotion (2nd meeting)

(Mr. Kimura)

(1) Theoretical justification of SME promotion policy

In designing cooperation for SME promotion in LDCs, each policy needs to be justified in logical and internationally understandable terms. Particularly the following points need to be clarified:

- (a) policy objectives of SME promotion (To what extent should social policy consideration be taken into account?)
- (b) Government's role (To what extent and how should the Government intervene)

in markets?)

- (c) rationale of Japan's cooperation (should Japan cooperate for basic human needs, or for complementation of microeconomic policy?)

(2) Theoretical justification of SME promotion policy

In designing a microeconomic policy, incidences of market failures are to be identified on the basis of a laissez-faire benchmark, and policies to overcome such failures are to be designed. Justifiable policies consist of: (a) a first-best policy, which eliminates market distortions arising from market failures, and (b) a second-best policy, which creates new distortions but eliminates existing distortions. As for SME promotion, market failures such as undeveloped capital or labor markets, incomplete flow of information, and liquidity preference of banks (SME's difficulty in raising capital due to inadequate collateral values, etc.) may be identified. For elimination of market distortions arising from such market failures, either a first-best policy or second-best policy is to be proposed.

(3) WTO compliance

In recent years, it has become more relevant for LDC's SME promotion policy to comply with the WTO Agreement. Though some transitional periods and exceptional treatments are allowed for LDCs, such basic principles as the Most Favored Nation Treatment, National Treatment and prohibition of export subsidy need to be observed. In addition, LDC's trade-related investment measures as well are to comply with the WTO Agreement.

(4) Other considerations

Besides the above, points to be considered include: the segment of SMEs to be targeted (small firms, supporting industries, etc.), econo-political implications of the proposed policy, and relationship with foreign-affiliated companies (especially Japan-affiliated companies).

(5) Reexamination of each mode of cooperation

Such technical advisory cooperation as expert dispatching and trainee hosting could be implemented at the expense of a beneficiary as long as such private sector cooperation is demanded. Only when such cost-chargeable cooperation is infeasible, support either by a recipient Government or donor Government is needed. From this viewpoint, justification and effectiveness should be demonstrated responding to an issue whether the cost should be charged to a beneficiary or borne by a donor.

In an attempt to form a core platform of technical support, Government's support is often effective, though a general practice should be to let private sectors play a major role. Also important in LDCs is Government's initiative in activating industry associations, in marketing and in forming a company-to-company linkage.

Since other developed countries provide financial SME assistance with systems and logics different from Japan's, a proposed cooperation should be justified in theoretical terms. To this end, failures of financial markets should be carefully examined.

(6) Questions and answers

It may be practically difficult to identify in each case what is justified on the basis of market failures/distortions. During day-to-day execution, recommendations promoting industries must be made promptly. What is required, however, is to justify and theoretically explain any proposal to those who have different background. Other issues that should also be addressed include opportunity costs of a cooperation project, its effectiveness, and justification of Government's involvement in comparison with private sector's free execution.

Extract of Committee Discussions

- SME growth and Government's role (2nd meeting)
(Prof. Urata, chairman)

(1) Government's support of SMEs and evaluation of effectiveness

The above theme focusing effective evaluation of Government's support was taken up by the World Bank. Case studies were made in Japan, Korea, Indonesia and Columbia, where SMEs were visited and interviewed and their evaluation of Government support was heard.

(2) Study outcome

The study in Japan confirms the following observations, which are to be taken into account in planning Government support for SMEs:

- (a) Support by contract-awarding large firms and by firms belonging to the same sector are highly valued, demonstrating significant contribution of private firms.
- (b) Government support are appreciated by firms belonging to such sectors that are rarely supported by private sectors or are in an early stage of development. Government support, therefore, should match the stage of development and industrial organization.
- (c) For promoting R&D, policy measures should encourage competition among companies as well as among producing communities.
- (d) Even if Government support is considered useful, its form and a cost-benefit comparison are important.

Comparison of study outcomes of the four countries reveals that each country has her own supply-demand relations respecting Government support. Demand for Government support is low in such a country as Japan where private company networks are extensive and company's technological standards are high. Conversely in countries like Indonesia where private networks are not extensive, demand for Government support is high. The Government's support-supplying capacity is large in countries like Japan and small in those like Indonesia.

In the light of the above study, the supply-demand relations need to be taken into account in designing a Government support program. Though the role of private sectors is recognized important, Government intervention is required when a market fails.

(3) Examples of quantitative studies into SME promotion

Currently, the World Bank is conducting a quantitative study into sources of SME's dynamism. The study attempts to estimate the Total Factor Productivity and other indicators measuring efficiency, determining contribution of various explanatory factors leading to productivity increase. Should, for example, subcontracting or an industrial organization be proved a positive factor, policies leading to closer inter-firm links would be justified on this account. Generally speaking, however, such studies are still in an early stage.

(4) Questions and answers

How do the empirical studies by the World Bank and economic theory meet practical requirements of actual SME policy planning? These studies are being made by researchers and will eventually produce outcomes that are applicable to actual policy making.

3. SME DEVELOPMENT AND ISSUES (PRESENTATION OF CASES)

3.1 LESSONS DERIVED FROM CASES

This chapter presents cases showing SME growth patterns in LDCs. First, the case of Taiwan will be presented, representing countries where SME growth is remarkable, so that factors contributing to her success will be revealed. Then, the cases of Thailand and Indonesia will be presented, representing countries where SME promotion has become more urgent due to the recent economic crisis. From observation of issues relating to SME promotion, the following lessons have been derived.

- The SME-driven economic growth is realized in the process of survival of most competitive firms, where both start-ups and closures are observed in large numbers.
- Active start-up and closure of SMEs are supported by social values that think highly of a successful entrepreneur who starts from scratch.
- SME's competitiveness is derived from a flexible manufacturing system supported by division of labor and partnership. Such a unique industrial organization encompassing SMEs is closely related to socioeconomic frameworks of the country.
- Prosperous farm economies greatly contribute to SME development.
- If SME development is made an objective of the economic policy, it is necessary to create environment where not only Government policies but private firm's assistance to SMEs are expected to work.
- Mutual trust between Government and industries is essential for effectiveness of Government policies.
- In the case like the recent Asian economic crisis where conventional financing intermediaries do not work, public assistance to private venture capital investors can be effective.
- The more interested in SME policies are politicians, the more they resemble social policies and the less economic policies. Especially, Government's support of potentially competitive medium sized enterprises is difficult to be justified.
- Cooperation for SME development should include support of restructuring and transformation of companies suffering a sudden shock like the recent Asian economic crisis.

3.2 GROWING PROCESS OF TAIWANESE SME – SHOE MAKING AND ELECTRONICS

Extract of Committee Discussions

- Growing process of Taiwanese SMEs – cases of shoe making and electronics sectors (3rd meeting)

(Mr. Kawakami, Institute of Developing Economies, JETRO)

(1) SME's role in Taiwanese economic growth

The Taiwanese economy has grown by means of the strategy focusing on export-oriented industrialization. Especially notable is its growth since the 1960's when labor-intensive SME sectors like shoe making and apparel started their businesses using flexible production processes, strengthening their competitive edges and driving the rapid economic growth. Such an important role of SMEs stands in sharp contrast to Korea where large firms' roles have been decisive.

Since the mid-1980's, when Taiwanese SMEs came to a crossroad due to drastic currency appreciation and higher wages, Taiwanese industries have moved their manufacturing bases overseas. Furthermore, in place of conventional light industries, SMEs making personal computers have become the engine of economic growth. In such many ways, SMEs have greatly contributed to the Taiwanese economic growth.

(2) Characteristics of Taiwanese SME

- (a) active start-up forming a partnership and specialization
- (b) low-cost and flexible manufacturing networks based on well-organized division of labor
- (c) active foreign business through foreign direct investment

Taiwanese SMEs have established businesses with a variety of capitalization structures based on entrepreneurs' local connections and family connections, which characterize a Chinese pattern of a society. A number of firms are started by former poor workers, specializing in a narrow range of products or processes. Taking advantage of such comparative advantages in a limited area, Taiwanese SMEs expand their business step by step, forming a flexible manufacturing network based on well-organized division of labor. Since the early 1990's, SME's foreign direct investments have increased mainly in China, activating international businesses.

(3) Shoe making

In the shoe making sector, a variety of partnerships were formed by local wealthy investors and technological partners, specializing in cutting, sewing, designing and other processes, leading to concentrated development of shoe makers in the middle region of the country. In this way, an extensive network of division of labor for shoe making was formed, enabling SMEs to meet demand flexibly at low costs. At present, many shoe makers have moved their production bases to China, where numerous

businesses are being founded in the form of a partnership.

(4) Electronics

The growth of the Taiwanese electronics industry was triggered by Japanese/US makers who built factories in Taiwan taking advantage of cheap and affluent local labor. In early days, such foreign affiliates made final products buying components from local makers. Since the 1980's, the Taiwanese spinning out of foreign affiliates have founded local makers. Though large makers' shares began to expand and SME's shares diminished in the 1990's, SMEs continue to support the entire manufacturing network at the bottom by means of process-by-process division of labor. As has been described above, active start-up and flexibly organized networks of division of labor have enabled electronics makers to acquire strong competitive ability. Such networks in turn have encouraged active start-up, forming a virtuous circle.

(5) SME growth and role of Government

Because of rapid growth, Taiwanese SMEs undoubtedly present a typical success story. However, the growth has been led by private sectors and not been attributable to Government intervention. Though SME promotion policies have been implemented even in Taiwan, they had not been notable until SME's contribution to export was made visible. Consequently, the growth of Taiwanese SMEs is mainly attributable to the socioeconomic structure of the country.

(6) Questions and answers

(a) comparison between Taiwan and Japan (Ohta Ward in Tokyo, and others) respecting networks of division of labor and specialization

In Japan, advanced technology forms the core of the manufacturing process as well as a basis of industrial development and transformation. On the other hand, Taiwan's strengths are flexibility and low costs. In the event of external drastic changes, Taiwanese SMEs are flexible enough to rebuild an entirely new network of manufacturing division of labor. Such difference appears to arise because Taiwan's industry is younger than ours as well as because, in Taiwan, manufacturing technology has not yet formed a core of industries as hard as in Japan.

(b) impact of SME policy in Taiwan

According to general understanding, export inspections were initiated by the Government, followed by active efforts in quality improvement by trade associations of bicycles, canned foods and so forth. In fact, however, the Government initiative was made only because companies sharing the same concern cooperated. In the electronics industries, the private companies have driven the growth, while even trade associations have not been active. On the other hand, the semiconductor sector has been exceptional, because Government agencies including the Industrial Technology Research Agency have played important roles.

(c) contribution of basic infrastructures

Already in the era of the Qing Dynasty, the Taiwanese commerce and monetary economies developed. Subsequently, during Japan's colonial days, basic infrastructures were built facilitating SME's activities in rural areas. Furthermore, according to an

observation shared by many economists, high agricultural productivity and affluent farm economies have led to SME's creative activities.

3.3 SME AND PROMOTION POLICIES IN INDONESIA

Extract of Committee Discussions

- SME and promotion policy in Indonesia (3rd meeting)
(Mr. Sato, Institute of Developing Economies, JETRO)

(1) Definition of SME

In Indonesia, each agency defines an SME in its own way. Researchers mainly use the following definition of the Central Bureau of Statistics on the basis of the number of employees:

cottage firm	: 4 or less
small firm	: 5 - 19
medium firm	: 20 - 99
large firm	: 100 or more

The comparison between Japan's Manufacturers' Census and the Indonesian statistics reveals that the numbers of establishments and employees of Indonesian small firms are roughly equal to those of Japan's SMEs. In terms of value added, Japan's SMEs are about 20 times as large as Indonesia's small firms. A generally shared image of Japan's SME may be comparable to Indonesian firms employing 100 persons or less. In Indonesian local regions, however, some of large firms in their definition should be regarded as SMEs from a viewpoint of real status.

(2) Structure of SME's business transactions

As described below, the structure of SME's business transactions may be characterized as a dual structure consisting of modern subcontracting and pre-modern merchant's subcontracting.

(a) Jakarta metropolitan area

In the case of motor bicycle assembly, all primary subcontractors are Japanese affiliates, while secondary and other subcontractors are mostly local firms. For exported products, requirements for delivery dates and quality are so rigorous that local firms often have to discontinue subcontracting. Therefore, the subcontracting structure does not necessarily form a solid pyramid.

(b) local regions

In local regions, both large firms in the Jakarta metropolitan area and those in the local areas subcontract with medium and small local firms. In some cases, subcontracting terms like a delivery date and quality are rigorous, while in other cases, particularly subcontracting through merchants, they are lenient. Merchants make down-payments to subcontractors to let them buy materials and equipments. This is a kind of merchant's subcontracting arrangement with mediating and financing functions, which was widely used in the 1930's.

(3) Support of SME

The Indonesian SME support can be divided into those inherent in business transactions and those provided by outside organizations.

(a) support inherent in business transactions

(i) modern subcontracting: mainly technical support provided by contract-awarding large firms

(ii) merchant's subcontracting: mainly financial support (down-payments) and provision of market information (mediation); technical support is rare.

(b) support provided by outside organizations

(i) financial support

Low-interest credits have been criticized because they tend to cause moral hazards, and for this reason a credit line for SMEs have been considered more important. In practice, however, banks have been reluctant to lend to SMEs. Recognizing that SME's lack of access to financing is a market failure, the World Bank has commended lending by a common people's bank with branches in rural areas. In any case, an effective financing system has yet to be established.

(ii) Foster Parent Scheme (Bapak-Angkat System)

Under this scheme introduced in the 1980's, a large company provided a package of support to an SME consisting of technical guidance, managerial guidance, financing and purchase of products, as if the large company were a foster father of the SME. The scheme had some significance as a social policy and income distribution policy but was not an effective industrial promotion policy. In later years, Astra Group provided SMEs with technical, managerial and financial support and offered to buy such companies that would turn out to be successful after going through competition. This support was effective because of incentives given to SMEs.

(4) Assessment of promotion policies by SME

(a) Generally speaking, technical support, especially if provided by private large firms, are highly assessed.

(b) Financial support is not highly assessed, provided that business partner's assistance like down-payments is appreciated.

(c) To summarize, business partner's support is appreciated, while that by the Government, foreign companies or foreign agencies is not.

(5) Summary

SME policies in Indonesia are categorized more as social policies. Only few of them have been effective as economic policies. While private sector's support inherent in business transactions has worked, Government's support has not. In addition to a belief in market mechanisms following the Neo-classical economic theory, power politics and excessive intervention of the Soehart Administration made Indonesians skeptical of the Government. Consequently, a careful dialogue is needed to convince them of effectiveness of policy proposals. Inadequate capability of the Department of Industry

and Trade should also be taken into account. Also, as Indonesian SME policies tend to mix an element of protection of indigenous Indonesians, discussion of their economic justification should not be confused by social considerations.

(6) Questions and answers

(a) entrepreneurs and their fund raising

Many Indonesian entrepreneurs become business owners by inheriting family businesses, or by converting cottage businesses into corporate-run businesses. There are some entrepreneurs who started a business after quitting a large company but not as many as in Taiwan. SMEs have access to a bank loan in some cases. In cities, SMEs may have a chance to borrow from State banks or other large banks at a low interest rate. Also, wholesalers and other merchants often provide start-up financing.

(b) relationship with ethnic Chinese businessmen

As far as business transactions are concerned, discrimination between the indigenous (Peribumi) and the ethnic Chinese is rare. In public sentiment, however, antagonism against ethnic Chinese business owners is strong, supporting pro-Peribumi policies.

(c) support of venture capital investors

Astra Foundation has spent on SME support its funds set aside from profits (2 percent) made by the Group firms. Because the Group business has recently slowed down, the support has been less active. A number of SMEs has failed to obtain bank financing partly because of inadequate appraisal ability. Though transparency is especially important because of the private nature, Government financing of such venture capitalists appears conducive to SME development. Some venture capitalists are prepared to finance SMEs on flexible conditions in response to changing situations.

3.4 CURRENT STATUS AND ISSUES OF SME IN THAILAND – MANUFACTURING

Extract of Committee Discussions

- Current status and issues of SME in Thailand – Manufacturing (3rd meeting)
(Mr. Inakazu, Unico International)

(1) Situation and characteristics of Thai SME

An SME is defined to be a company employing 200 persons or less, accounting for 98 percent in the number of establishments and 49 percent in employees in the manufacturing sector. In terms of shares in GDP and exports, major manufacturing subsectors are textiles, garments, food/beverage, components, footwear/leather products and rubber/plastic products.

(2) Impact of economic crisis

Among component-making industries, exporting subsectors have gained larger shares,

while SMEs failing to satisfy exporting standards have lost competitiveness since the outbreak of the crisis. Local contents of most of car assemblers have become smaller. As domestic demand for electric/electronic products has been stagnant and more products have been targeted at foreign markets, component makers belonging to local supporting industries have become less competitive and been suffering.

Textile/garment industries are now less competitive in markets of lower grade products because of the Chinese export drive. Performance of footwear/leather products and rubber/plastic products has been generally worse, because these industries have failed to take advantage of the depreciated currency value. Only food/beverage makers are expanding both outputs and exports.

The impact of the crisis may be characterized as outstanding reduction in domestic sales, profits, employment and production.

(3) Desired SME policy

According to an enquette survey conducted among SMEs, they want the following SME supporting policies:

- (a) Urgent tasks following the crisis are:
human resource development, market development, purchase of equipments, financing
- (b) Important measures to be taken preventing adverse effects of the crisis are:
cost reduction, export expansion, expansion of domestic sales, product diversification
- (c) Request for Government support:
support of market development, tax concessions and subsidy, better access to financing, more consistent SME policy

The Thai SMEs disclosed their weak competitiveness during the crisis. Without strengthening the competitiveness, they would suffer the same hardship again in future. While financial assistance is urgently needed, more essential is long term development of technologies, managerial abilities, human resources and markets, as is suggested by the enquette survey.

(4) Government's actions for SME support

Since the crisis, every political party has become interested in SME policies, claiming own authorship of policy proposals. The SME Basic Law is expected to be enacted, covering, among others, manufacturing, retailers and service suppliers. The pros and cons of the following policies are being actively debated:

- (a) an institute for SME development: Eight universities have already started to educate entrepreneurs and business starters.
- (b) management consulting: Japanese consultants have arrived to help establish the scheme.
- (c) financing: Establishment of an SME bank, venture-financing funds and a credit guarantee system is being considered.

(5) Discussions about justification of Government support of SME

An SME is considered significant as a main player of business, active innovator, creator of employment opportunities, foreign exchange earner and contributor to socioeconomic development in local areas. Incurring national costs for such national benefits is claimed justifiable. In the meantime, debates as to the significance of SME policies go on in Thai policy making circles: whether SME policies should be economic policies or social policies, whether the Government should intervene or should not, and how promotion policies differ from protective policies.

Without regard to such debates, SME policy implementation appears of immediate needs in view of disclosed vulnerability of SMEs. Under such circumstances, the JICA-sponsored SME-promoting draft master plan has proposed strategies and tactics in concrete terms.

(6) Current status and future course of Thai SME promotion
(Mr. Uemura, senior planning officer, MITI)

The preparation of Thai SME promotion is going ahead. Main notable points are:

- (a) Small firms should get more support than other firms, partly because of political consideration.
- (b) Concept of clustering
By strengthening weak industrial subsectors, the entire sector will hopefully be upgraded. While SME's joint or cooperative operations may be feasible, initiation of SME-organizing policies appears premature.
- (c) Promotion of non-manufacturing SME
Promotion of entire SMEs including service and commerce sectors is being considered.
- (d) The draft master plan has been sent to the Cabinet. The SME Promotion Law is expected to be enacted.
- (e) Definition of SME
The existing criteria in terms of values of fixed assets are proposed to be replaced by those in terms of the number of employees, because the monetary criteria are subject to fluctuation in real terms. Besides, as agriculture is a main industry, a distinction should be established between SMEs and agriculture production units.
- (f) Is the Thai case applicable to other countries?
The cooperation strategy in Thailand may be applicable to other countries. Copying Japan's policies, however, would cause indigestion. Situations in each recipient country should be fully taken into account. Situations in Japan of half a century ago when post-War Japan's SME policies were initiated, however, do resemble those of some LDCs and may be relevant in designing their SME policies.

4. MAJOR ISSUES ON INTELLECTUAL COOPERATION

4.1 BARRIERS OF SME GROWTH AND DESIRABLE SUPPORT

4.1.1 Japan's Approach

- Barriers of SME growth consist of those inherent in SMEs such as shortages of funds, technology and human resources and those of external business environment such as unfavorable macroeconomic situations, inadequate legal systems related to economic/business functions and lack of a level playing field.
- Conventional cooperation of Japan has focused on support of solution of SME's internal problems. Such cooperation has been based on an assumption that market mechanisms fail to eliminate internal problems needing Government intervention. Consequently, a dominant method has been to propose assistance to fill the gap between what the Japanese Government has done for our SMEs and what the LDC Government is doing, as well as the gap between technical and managerial capability of our SMEs and that of LDCs. In both cases, Japanese situations have been taken as a benchmark.
- Such cooperation has been useful for solution of difficulties immediately faced by SMEs, especially when Japanese technical/managerial experts experienced in operational aspects have been assigned to the job. On the other hand, direct support of SMEs by a public entity has not necessarily had a sustainable impact, because due to a tight budget constraint, the recipient LDC Government is not able to allocate operational expenses needed for continued services after termination of Japan's assistance.
- Most cases of Japan's conventional cooperation, therefore, have helped remove SME's difficulties assuming business environment surrounding SME is given.

4.1.2 Other Donor's Approach

- The currently dominant approaches by other donors including the World Bank are different from Japan's. Both approaches are alike in that they attempt to strengthen SME's competitive edges, but a way and intensity of Government/donor intervention are different. Other donors' premise is that Government's major role is to create systems and institutions that enable market mechanisms to work. Consequently, they are mainly interested in creation of SME-friendly business

environment. To them, the most important task is to cooperate in forming a legal system and a level playing field.

- Following such belief, foreign donors choose to remedy SME's handicaps by means of market forces in contrast to Japan's approach, which focuses on direct Government intervention in management/operations of SMEs.

4.2 AREAS TO BE ADDRESSED BY INTELLECTUAL COOPERATION AND FUTURE ISSUES

4.2.1 Areas to Be Addressed

For upgraded intellectual cooperation, needs for cooperation on each of the following dimensions should be identified in consideration of international standards.

support addressed to entire economy and society

- support to facilitate proper macroeconomic management
- support to lay down the following rules forming a framework of the market economy
 - (a) securing property rights
 - (b) rules of economic transactions
 - (c) rules of entry into and exit out of business
 - (d) rules of competition
- support in the area of international trade policy
- improvement of administrative procedures

support addressed to industrial sector or SME

- support to formulate the following systems, which will remedy SME's handicaps and activate their business
 - (a) encouragement of Government-industry dialogues
 - (b) improvement of access to medium/long term financing
 - (c) improvement of access to managerial/technological and market information
 - (d) intellectual infrastructures supporting industrial activities like quality control
 - standardization
 - inspections and testing
 - metrological standards

support addressed to individual companies

- cooperation for upgrading managerial resources aiming to strengthen competitiveness of individual firms

4.2.2 Future Issues

For the purpose of upgrading intellectual cooperation, the conventional approaches need to be improved in the following ways:

➤ **study and analysis into basic systems/institutions related to business development and identification of impediments (chapter 5)**

A study and analysis should be stepped up concerning a variety of systems/institutions affecting growth of not only SMEs but large enterprises. Such studies need to be made from a wide perspective covering legal systems among other things. In the process of the studies, representatives of private sectors of a recipient LDC should participate.

➤ **support of SME's fund raising (chapter 6)**

In Japan, policy financing has made great contribution to SME development. Such valuable experiences should be reflected in future intellectual cooperation. In such an instance, however, the support should not merely copy Japan's promotional policy, but should facilitate design and implementation of sustainable systems keeping consistency with basic systems of a recipient LDC.

➤ **support of market penetration (chapter 7)**

Among market penetration policies that Japan has conducted, those which are judged successful are to be transferred in reflection of changing environment of international trade.

➤ **support of managerial/technical business development (chapter 8)**

Concerning public support, appropriate support systems should be designed and executed in the light of supply-demand situations of managerial/technical services in a recipient LDC and cost-benefit comparison.

5. SUPPORT OF FORMULATION OF BASIC FRAMEWORKS NEEDED FOR BUSINESS DEVELOPMENT

5.1 LEGAL SYSTEMS AND OTHER CONDITIONS REQUIRED BY WORLD BANK

In connection with credits or loans made by the World Bank in the past, the Bank required borrowers to create or improve the following three kinds of legal systems and other conditions depending on the status of borrowers.

➤ **countries needing to stabilize macroeconomy**

- (a) to improve fiscal balance
- (b) to improve international current account
- (c) to reduce inflation
- (d) to reform monetary/fiscal systems

➤ **countries being transformed to market economy**

- (a) laws defining property rights
- (b) laws setting forth rules of economic transactions
- (c) laws setting forth rules of entry into and exit out of business
- (d) laws prohibiting monopoly and unfair business practices
- (e) effective enforcement of above laws

➤ **LLDC**

- (a) amendment of laws impeding business activities
- (b) clear definition of rights and duties including those of use of real estates
- (c) reconsideration of laws unfairly protecting vested interests or specific groups
- (d) uniform and efficient enforcement and information disclosure concerning legal/regulatory systems
- (e) consistency of laws with international standards
- (f) strengthened implementation of a judicial system

For the purpose of the above system building and satisfaction of preconditions, the World Bank sometimes covers necessary expenses in its credit/loan provisions, or

sometimes asks borrowers for assurances in loan agreements. Generally speaking, while the Bank obligates borrowers to assure removal of impediments of market mechanisms, it does not necessarily emphasize establishment of such industry-specific legal systems as those for industrial standardizations or energy saving. As for SME promotion, the Bank is not interested in elimination of SME's handicaps but concentrate on creation of environment where not only large firms but SMEs enjoy merits of market mechanisms.

Extract of Committee Discussions

- Comparison of methods of SME promotion between the World Bank and Japan (2nd meeting) (discussions by the whole Committee)

Though the World Bank often requires establishment and reform of basic legal systems, it does not necessarily emphasize industry-specific systems for SME promotion. Such stance may be based on an argument that, because Government intervention may fail, a market-oriented approach is more likely to lead to a satisfactory outcome. Even within the World Bank's theoretical framework, however, more logical debate may prove that SME policy with a Japanese style makes up for a market failure.

On the other hand, some of Japan's SME policies are designed to protect the weak and to bridge a gap in productivity/income between a large firm and SME, and, therefore, are sometimes incompatible with the free competition principle. In this respect, Japanese policies may deviate from the World Bank standards. However, SME policies widely differ from country to country, and there is no way of determining which is right. Broadly speaking, Japan's SME policies consist of protective measures and promotional measures. Though the former may have been economically ineffective, the latter has often been effective. In any event, an impact on SME growth of Japan's individual policy intervention should be objectively analyzed so that donors will be able to advise SMEs in LDCs in the light of the analysis.

5.2 BASIC LEGAL FRAMEWORKS AFFECTING SME GROWTH

With reference to the World Bank practices, the table below shows basic legal systems that should be examined in connection with SME promotion.

Legal systems to be examined	World Bank measures	Relation with SME policy
<p>1 Basic institutional framework</p> <p>1.1 definition of property rights</p> <p>1.1.1 definition of contents of property rights</p> <p>1.1.2 establishment of a property registration system and company registration system</p> <p>1.1.3 proper restriction of property rights</p> <p>1.1.4 protection of intellectual property rights</p> <p>1.1.5 corporate governance</p> <p>1.1.6 accounting and auditing standards</p> <p>1.1.7 rules of incoming foreign direct investment</p> <p>1.2 rules of business transactions</p> <p>1.2.1 rules of contract</p>	<ul style="list-style-type: none"> • civil/commercial code • registration system • building code • land expropriation law • patent law • design law • trade mark law • copyright law • company law • international standards • foreign investment law • contract law streamlining administrative approval 	<ul style="list-style-type: none"> • collateral value of real properties or pledging them for borrowing • registration of properties for borrowing, or of a company for business start-up • protection aiming to encourage entrepreneurship and high-tech business • fact finding whether proper stipulations exist as to corporate governance including a company structure, and separation of ownership from management; and whether Government is entitled to intervene. • Examinations of compliance with international standards, information disclosure, and appropriateness of financial statements • Examinations of sectors where foreign investment is allowed, regulation of foreigner's share holding, restriction of foreigner's land ownership, and consistency with incentives for foreign direct investment • laws of claim/debt, drafts and checks

<p>1.2.2 fulfilling a contract</p>	<p>procedures</p> <ul style="list-style-type: none"> • compulsory execution law • civil suit law • arbitration • strengthening judicial administrative ability 	<ul style="list-style-type: none"> • clarified procedures of a civil suit to secure contract fulfilling and of determining debt amounts, prevention of delayed payment to a subcontractor
<p>1.2.3 labor law</p>	<ul style="list-style-type: none"> • appropriate minimum wages • unrestricted hiring and firing • appropriate social security cost 	
<p>1.2.4 development and reform of financial/securities markets</p>	<ul style="list-style-type: none"> • restructuring of financial intermediaries • bank's capital adequacy and reserve funds • rules of lending • safety net for depositors • information disclosure • development of securities market • deregulation of incoming foreign investment 	<ul style="list-style-type: none"> • company's information disclosure and more transparent and appropriate securities-listing standards, taking into account needs for support of venture capital investors
<p>1.3 rules of entry into and retirement out of business</p>		
<p>1.3.1 laws on bankruptcy, settlement and transfer of business</p>	<ul style="list-style-type: none"> • bankruptcy law, etc. 	<ul style="list-style-type: none"> • claim recovery, continued life of a company, uninterrupted flow of capital from financial sectors to industry • relationship with credit guarantee
<p>1.3.2 establishment of a company and laws on approval of business</p>	<ul style="list-style-type: none"> • company law • appropriate approval system of business start-up 	<ul style="list-style-type: none"> • Do company-establishing procedures and business approval conditions assure fair competition in market, especially in connection with encouragement of start-up?
<p>1.4 prohibition of monopoly and unfair business practices</p>	<ul style="list-style-type: none"> • anti-monopoly law 	<ul style="list-style-type: none"> • relationship with business practices for encouragement of fair competition • examination of behaviors of monopolistic firms (conglomerate and family-owned business) and

<p>2 Stabilization of macroeconomy</p> <p>2.1 reduction of fiscal deficits</p> <p>2.1.1 tax reform</p> <p>2.1.2 reduction of subsidy</p> <p>2.1.3 reduction of other Government expenditures</p> <p>2.2 improvement in international current account balance</p> <p>2.2.1 realistic exchange rate</p> <p>2.2.2 raising interest rate</p> <p>2.3 reduction of inflation</p> <p>2.3.2 reduced lending ceiling</p>	<ul style="list-style-type: none"> • setting a target • expanded tax base • abolishing unequitable taxes • increased tax collection • consistency and transparency of tax-collecting administration • reduction of corporate income tax • reduction of subsidy to state/public enterprises • reduction of subsidy to people's living expenses • reduced public works and operational expenditures • setting a target • flexible exchange rate • deregulation of foreign exchange transactions • deregulation of interest rate • raising central bank's official rate • raising central bank's official rate • restricted bank lending 	<p>rationale of promotion of targeted industry</p> <ul style="list-style-type: none"> • Stabilized macroeconomy creates favorable environment for industrial growth. • Immediate objective is to reduce subsidy and Government expenditures following tight money policy. • tax incentives for activation of financial markets, particularly for venture capital • tax incentives • privatization of public technology support agencies and planning for their financial self-sufficiency • administration of export incentives • impact of reduced subsidy to state enterprises • strengthened international competitiveness
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2.3.3 reduced Government expenditures	<ul style="list-style-type: none"> • reduced public works and operational expenditures 	
3 Regulation of international business and domestic business		
3.1 international business		
3.1.1 deregulation of import	<ul style="list-style-type: none"> • abolishing quantitative import restriction • simplified import procedures 	<ul style="list-style-type: none"> • quality improvement and strengthened price competitiveness
3.1.2 reduction of import duties	<ul style="list-style-type: none"> • reduced tariff rates • simplified tariff classification • simplified tariff collecting administration 	<ul style="list-style-type: none"> • consideration of regional integration (products, quantitative targets and year of effectiveness)
3.1.3 deregulation of export	<ul style="list-style-type: none"> • abolishing export restrictions • abolishing export tax • simplified export procedures • tax refund for export 	<ul style="list-style-type: none"> • improvement of export credit and export insurance systems
3.1.4 deregulation of incoming foreign direct investment	<ul style="list-style-type: none"> • laws on foreign investment • elimination of restriction of foreign exchange remittance 	<ul style="list-style-type: none"> • sectors where foreign investment is allowed, regulation of foreigner's share holding, restriction of foreigner's land ownership, consistency with incentives for foreign direct investment
3.2 domestic business	<ul style="list-style-type: none"> • deregulation • explicit provision of undocumented rules • improved enforcement 	
3.2.1 deregulation of prices	<ul style="list-style-type: none"> • raising utility tariff • deregulation of prices reducing people's living expenses 	
3.2.2 deregulation of labor relations	<ul style="list-style-type: none"> • review of minimum wages • deregulation of hiring and firing 	
3.2.3 review of customary privileges and legal systems inherited from the colonial era	<ul style="list-style-type: none"> • amendment and explicit provision of civil/commercial laws 	<ul style="list-style-type: none"> • Please refer to item 1 of this column.
3.2.4 improving ability of judicial administrators	<ul style="list-style-type: none"> • training • setting up operational 	<ul style="list-style-type: none"> • speedy execution of judicial procedures especially, needs to

	standards • dissemination of contents of laws • improved capability of judicial executing organizations	improve ability of administrators executing claims recovery and company restructuring
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5.3 MATTERS TO BE TAKEN INTO ACCOUNT DURING IMPLEMENTATION OF COOPERATION

The above check list has been produced by extracting and rearranging conditions and assurances that the World Bank requested borrowers for the purpose of private sector development as described in the Bank’s appraisal reports. Consequently, details differ from case to case.

In planning reforms on establishment of above-listed systems, not only contents to be checked but their viewpoints and methods of implementation are relevant. Consequently, it is undesirable to use the above list as if it were an operational manual.

Not only legal systems but social systems like customary mutual aid affecting personal saving should be examined.

Deliberation of legal systems should be based on thorough understanding of status and issues of SMEs and be carefully made in a Government-private dialogue forum participated by, among others, representatives of private sectors and scholars of a recipient LDC.

While Japan’s approach may be labeled a “bottom-up” approach, which fully takes into account situations and practical problems faced by individual SMEs, the World Bank approach addresses SME’s business environment and legal frameworks. These two contrasting ways may be combined to arrive at an effective policy mix.

When Japan’s approach is taken and her specific promotional measures are transferred to LDCs, socioeconomic systems which supported such measures in Japan have to be taken into consideration and confirmation should be made whether such supporting systems are working in a recipient LDC.

(Reference) SME Related Legal Systems in Selected LDC
Extract from JICA’s Project Identification Studies
(December, 1999 through March, 2000)

Country	Poland	Bulgaria	Indonesia	Malaysia	Philippines
national plan	unknown	National Economic Development Plan 2000-2006	None. The Guideline of the State Policy Looking to the Future of the Indonesian Economy, however, was tentatively made.	Seventh Malaysia Plan 1996-2000	The Philippine National Development Plan: Directions for the 21 st Century, Medium-Term Philippine Development Plan, 1999-2004
SME promotion plan	Government Policy Guideline for Small and Medium-Sized Enterprises until 2002	National Strategy for Stimulating Development of Small and Medium-Sized Enterprises	None	None. The 2nd Industrial Master Plan, 1996-2005, however, covers industrial promotion including SME.	The Philippine SME Development Strategy: forging a truly dynamic and competitive SME
SME policy organization	Department of Craft, Small and Medium-Sized Enterprises, Ministry of Economy	Agency for Small and Medium-Sized Enterprises	Ministry of Industry and Trade, Ministry of Cooperatives, Small and Medium Enterprises. MOIT is engaged in industrial development and MCSME is in small firm development. (may be subject to change)	Ministry of International Trade and Industry, Small and Medium Industries Dev. Corp., Ministry of Entrepreneur Development. SMIDEC is engaged in SME promotion, and MED is in small firm promotion.	Small and Medium Enterprise Development Council, Bureau of Small and Medium Business Development, Department of Trade and Industry
civil code	Civil Code 1964	already enacted	Civil Code of 1987	Contracts Act 1950, Contracts (Amendment) Act 1976	Defamation Act. Civil Code 1949, Common Carriage Law, Insurance Code, Negotiable Instruments Law, Code of Commerce
commercial law	Commercial Code 1934, Protection of Business Dealings Act 1994, Commerciali-	Commercial Law,	Commercial Code of 1847 52		

company law			Law No.1/1995 concerning Incorporated, promulgated on March 7, 1995	Companies Act 1965. Partnership Act 1961.	Corporation Code 1980, Law on Partnership
labor law	Labor Code 1974	Labour Code 1951, Law for Healthy and Safe Labour Conditions, Law for Vocational Education and Training	Act No.1/1951, Act No.2/1951, Act No.21/1954 (Collective Labor Agreement), Act No.18/1956, Act No.22/1957 (Settlement of Labor Dispute), Act No.12/1964 (Termination of Employment), Act No.14/1969, Act No.1/1970 (Safety), Act No.1/1975.	Industrial Relations Act 1967. Employment Act 1955. Trade Unions Act 1959.	Labor Code
bankruptcy law	Bankruptcy Act 1934	already enacted	There used to be Bankruptcy Law of 1906 under influence of a Dutch law. The amended Bankruptcy Law was promulgated on April 22, 1998 and made effective on August 23, 1998.	Bankruptcy Act 1967 stipulates bankruptcy of individuals. Companies Act 1965 stipulates corporate bankruptcy. Besides above, Companies (Winding-up) Rules 1972.	Insolvency Law
social security law	substantively amended in 1999	Law for Health Assurance,	Law No.3/1992, Act on	already enacted	Social Security Act of 1997

		Law for Additional Voluntary Pension Insurance	Employees' Social Security		
intellectual property law	Copyright and Neighboring Rights Act 1994	Law for Copyright and Related Rights, Law for Patent, Law for Industrial Design, Law for Protection of New Sorts of Plants and Animal Breed	Patent Law 1989, Revised Trademark Law 1993, Revised Copyright Law 1987	Trade Mark Act 1976. Patents Act 1995, Copyright Act 1987.	Patent Law, Trademark Law, Copyright Law
anti-monopoly law	Counteracting Monopolistic Practices Act 1990, Suppression of Unfair Competition Act 1993	Law for Protection of Consumers and for Trade Rules	Promulgated on March 5, 1999 and made effective on March 5, 2000. Draft Competition Law suggested by USAID was not adopted. The current law is of a German style. The enactment was a condition of IMF support.	Not yet enacted. Enactment under consideration.	already enacted
registration law	already enacted	Law for Civil Registration	Land Office files land registration and Register's Office files commercial registration.	National Land Code. Land office files land registration. Based on Registration of Business Act, Ministry of Domestic Trade and Consumer Affairs files commercial registration.	Land Registration Law. Public Land Law. Land Rights Law. Bureau of Land files land registration.
law on solution of business			Arbitration and ADR Law		

disputes					
SME law	None. SME is defined by Econ. Activity Law. In the absence of an SME law, policies can be implemented with existing laws and tools.	Small and Medium-Sized Enterprise Act	Law of the Republic of Indonesia Number 9 of 1995 concerning Small Business. President Instruction Number 10, 1999 #9 and 1995 include provisions of small firm promotion. The President Instruction (#10, 1999) includes provisions of medium firms.	None. The Government assumes that SME promotion can be done with a combination of various policy tools. In fact, a variety of tools is available.	Magna Carta for Small Enterprises (R. A. 6977), January 24,1991
accounting system	accounting standards already provided.	The same with the left column.	The same with the left column.	The same with the left column.	The same with the left column.
corporate income tax	Standard rate at 32% planned to be reduced	Standard rate at 27% (20% for small firms)	progressive rate at:10, 15 and 30%	standard rate at 28% (25% for JV with foreign investors)	standard rate at 32%
personal income tax	progressive rate	progressive rate	progressive rate	progressive rate	progressive rate
tariff	associated with EU	associated with EU	imposed	imposed	imposed
VAT	harmonized with EU at 22%	harmonized with EU at 20%	10%	sales tax, service tax, commodity tax	10%
comment	Harmonization with EU is the general rule, because participation in EU is the top priority.	The same with the left column.	A variety of reforms is being planned or put into force, leading to confusion. Jurisdictions of ministries/ agencies are subject to	Under strong Government leadership, legal systems and policies are firmly laid down. Executions are stable. SME policies are steadily bearing fruits.	Though legal systems are clear and advanced, they are not effective because of weak leadership of central Government

			change. SME policies have not yet been made clear.		and inconsistent enforcement.
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Country	Thailand	Cambodia	Laos	Vietnam	Bangladesh
national plan	The Economic Stimulus Package, 1999	First Five Year Socio-economic Development Plan 1996-2000	Vision of 20 Years National Socioeconomic Development Plan 1996-2000.	5 Year Social/Economic Development Plan, 1996-2000	The Fifth Five Year Plan 1997-2002
SME promotion plan	Master Plan of Small and Medium Enterprises Development, 1999	Industrial Plan and Actions, 1998-2003, covers SME promotion.	None. Department of Industry, Ministry of Industry and Handicraft is studying SME promotion policy.	No official plan. JICA proposed "SME Promotion Plan", and UNIDO proposed a separate plan to Vietnamese Government.	None
SME policy organization	Bureau of Industrial Promotion Policy and Planning, Ministry of Industry. However, when SME Law has been enacted, SME Agency may be established as an independent organization.	Small Scale Industry and Handicraft Section, Ministry of Industry, Mines and Energy	Department of Industry, Ministry of Industry and Handicraft	Ministry of Planning and Investment, Ministry of Industry. MPI is studying policies, and MOI reserves its position.	Ministry of Industry, Bangladesh Small and Cottage Industries Corporation
civil code	Civil and Commercial Code (C C C)	Assisted by JICA experts, drafts of civil code and commercial code are being prepared.	Civil Code does not stipulate all necessary provisions. Inheritance Law, Family Law, Contract Law and Law of Non-Contractual Obligations set forth provisions of respective areas.	The law passed Parliament on Oct. 28, 1995 and was made effective on July 1, 1996.	Law of Specific Relief, Law of Trust, Law of Transfer of Property, Personal Laws

commercial law		Drafts are being prepared. For areas to be governed by a commercial law, Directive 241 of Feb. 28, 1996 announced adoption of Common Laws (British/American).	Secured Transactions Law (1994), The Decree on Checks (1996). Recently, discussions being made whether a law on commercial transactions is needed besides the (civil) Contract Law.	The law passed Parliament on May. 10, 1997 and was made effective on January 1, 1998.	Law of Contract, Law of Sale of Goods, Law of Negotiable Instrument
company law	Besides CCC, Public Limited Companies Act (1992, amendment of 1978 Law) was enacted governing listed companies (including those planning to be listed). There are three kinds of companies: private limited company, public limited company and partnership. Private limited companies and partnership are subject to CCC, while public limited companies are to Public Companies Act.		Business Law was enacted.	Laws on a limited liability company, limited partnership, partnership and other private business were incorporated into Law on Enterprise which was promulgated on July 2, 1999 and made effective in January, 2000. The new Law replaces former Law on Company and Law on Private Enterprise.	Companies Act 1994 (Companies Act 1913 was amended), Law of Partnership
labor law	Labor Protection Act was promulgated on Feb. 20, 1998, and made effective	Labor Law passed Parliament on January 10, 1997, and was made effective on March 13,	Labor Law was promulgated in April, 1994, and made effective 60 days later.	Labor Law was enacted in 1994, and is due to be amended.	Labor Law

	180 days later.	1997. There had been labor laws enacted in 1972 and 1992 respectively. Due to coming into force of the new Constitution in September, 1993, the new Law was enacted. The draft of the new Law incorporated earlier provisions. Two years were spent on draft preparation for which French, US and ILO cooperated.			
bankruptcy law	The law was made effective in 1940, and went through major amendment in 1998 and 1999. Five laws related to bankruptcy have been enacted: Amended Bankruptcy Act, Bankruptcy Court Organization Act, Simplified Legal Proceedings Act (amendment), Collateral Seizure Procedures Act (two amended	not yet enacted	The Law on Enterprise Bankruptcy (1994)	Company Insolvency Law was enacted in 1993 and is due to be amended.	

	acts).				
social security law	Social Security Act 1990	draft under preparation	Labor Law covers retirement pension.	Social Insurance Law is due to be enacted.	
intellectual property law	Patent Act, 1992. Patent Act amended in 1999 included provisions of Petty Patent. There also are Trade Act, 1991 and Copyright Act, 1994. Trade Secret is covered by a separate new act.		Trade Mark Decree (1995)	Civil Code (volume 6) covers intellectual property (copyrights, industrial property rights) and technology transfer.	
anti-monopoly law	The earlier Price Control and Anti-monopoly Act of 1979 was amended and divided into Price of Products and Services Act and Transactions and Competition Act, which were promulgated in March, 1999 and made effective in April, 1999.			not yet enacted (being planned)	
registration law	CCC and Land Code (1954). Provincial Land Bureaus file land registration, and Ministry of Commerce files commercial				Law of Registration. Companies Act includes provisions of commercial registration.

	registration.				
law on solution of business disputes	Arbitration Act 1987		The Decree on Resolution of Economic Disputes (1994)		
SME law	None. However, SME Promotion Act is being discussed in Parliament. If enacted, it will be the SME basic act.	None, but requests being made for enactment. Factory Law (1995) covers medium-sized firms.		Prime Minister's Order is being considered.	none
accounting system	accounting standards already provided	French systems are partially incorporated.	accounting standards already provided	The same with left column.	The same with left column.
corporate income tax	standard rate at 30%	standard rate at 20%	standard rate at 35% (20% for JV with foreign investors)	standard rate at 25%	standard rate at 40% (35% for listed companies)
personal income tax	progressive rates	progressive rates	progressive rates (for foreign technicians, reduced rate at 10%)	progressive rates	progressive rates
tariff	imposed	imposed	imposed	imposed	imposed
VAT	10% (monthly filing and paying)	10% (introduced in 1998)	Sales tax is due to be replaced by VAT.	5, 10 or 20 % (introduced in 1999)	15%
comments	Japanese-style legal systems are prevailing. For SME-related laws as well, Japanese-style laws and systems are being prepared based on Mizutani proposal.	Since the end of the disorder, legal systems have been prepared supported by international organizations and developed countries. However, because of hasty work, preparation is piecemeal and	Though slowly, legal systems are being established with support of international organizations and developed countries. However, as basic laws are being enacted, enactment of	Aiming at transformation into market economy, legal systems are being established rapidly with assistance of developed countries. However, due to vertically fragmented ministerial	The legal systems is clear and definite, though it relies on Common Laws, and is not necessarily written. However, because the central Government does not have strong

		has many omissions and inconsistencies .SME promotion laws will be prepared only in later years.	laws setting forth SME promotion will be in later years.	jurisdiction and persistent vested interest, the progress is slow. Though JICA made a proposal of SME promotion, conclusion has no yet been reached.	leadership and enforcement is inconsistent, the legal system is not effective.
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6. SUPPORT OF SME'S FUND RAISING

6.1 JAPAN'S EXPERIENCE AND ITS APPLICATION

6.1.1 Evolution and Outline of Japan's Policy Measures

Japan's policy measures facilitating SME's fund raising consist of loan, guarantee and equity contribution. As these measures are complicated and diversified, their detailed description is difficult. Understanding their essence requires knowledge in SME's needs at the time of planning of each measure and its relevance to the needs. From this viewpoint, the post-War evolution of Japan's fund raising support measures is divided into four stages in an attempt to reveal historical background of each measure.

➤ Reconstruction period (1945 – 1954)

During this period, the major objective of SME policies was to cope with an acute shortage of funds. The three SME policy finance organizations – the People's Finance Corporation, Small Business Finance Corporation and Shoko Chukin Bank – as well as the credit guarantee scheme were established during this period. Also established were related policy schemes such as the management consulting scheme (1948), SME's Cooperative Law (1949) and Chamber of Commerce and Industry Law (1953).

Scheme (year of inception)	Requirement at Time of Inception	Description of Initial Scheme	Subsequent Evolution
SME financing by Rehabilitation Finance Corporation (RFC) (1947)	<ul style="list-style-type: none"> • availability of funds • supply of raw materials and other input materials • rehabilitation of key industries • increased supply of necessities of people's daily life 	<ul style="list-style-type: none"> • supply of funds for equipment and operations of industries needed for rehabilitation of the economy • In 1949, initiated was lending through four agents including the Industrial Bank of Japan and compensation by RFC of the loss of agents within a predetermined ceiling. 	<ul style="list-style-type: none"> • Due to the deflationary policy proposed by Mr. Dodge, RFC's lending was terminated in April, 1949.
SME financing facilitated by special credit of the Bank of	<ul style="list-style-type: none"> • Same with the above (RFC's SME financing 	<ul style="list-style-type: none"> • The Bank of Japan made special credit to Shoko Chukin 	<ul style="list-style-type: none"> • Abolished in 1955 because other schemes

Japan (1949)	accounted for a small part of its total lending.)	Bank in exchange for notes issued by SME or discounted such notes. (Subsequently, three banks including the Industrial Bank of Japan were made eligible as an intermediary.)	were started.
Deposit of Government funds at commercial banks (1949)	<ul style="list-style-type: none"> • Same with the above. • tighter money supply due to the deflation initiated by Mr. Dodge 	<ul style="list-style-type: none"> • Government's idle funds were deposited at commercial banks (banks, credit cooperatives, Shoko Chukin, etc.). 	<ul style="list-style-type: none"> • Gradually, Shoko Chukin and other SME-financing intermediaries took a larger share of the deposit. As operations of other schemes became operative in a larger scale, the deposited funds were gradually withdrawn in 1953 and later.
People's Finance Corporation (PFC)	<ul style="list-style-type: none"> • stabilization of livelihood of owners of micro-firms 	<ul style="list-style-type: none"> • Initially, lending was made only in a small amount for subsistence of people and operation of micro-firms. (without a collateral) 	<ul style="list-style-type: none"> • In December, 1951, PFC started to lend not only to micro-firms but to other SME in exchange for a collateral.
SME financing of Counterpart Funds (1950)	<ul style="list-style-type: none"> • Requirements for funds for equipment increased after termination of RFC lending. 	<ul style="list-style-type: none"> • Revenues obtained through sale of commodities supplied by the USA for the purpose of aid were used for co-financing of industries' equipment investment co-financing with commercial banks. 	<ul style="list-style-type: none"> • Because co-financing commercial banks were reluctant, lending amounts were small. The scheme was succeeded by the Japan Development Bank's SME financing in 1952, and later by the Small Business Finance Corporation in 1953.
Establishment of bank branches	<ul style="list-style-type: none"> • Requirements for working capital 	<ul style="list-style-type: none"> • Commercial banks were recommended 	<ul style="list-style-type: none"> • The scheme failed to eliminate bank's

specializing in SME financing (1950)	increased during the deflation initiated by Mr. Dodge.	to establish branches specializing in SME financing in four major cities.	reluctance to lend to SME.
Reactivation of Shoko Chukin Bank established in the pre-War days	<ul style="list-style-type: none"> • same with the above 	<ul style="list-style-type: none"> • Government contribution to capital replenishment. • financing of Shoko Chukin to members of industrial cooperatives and credit guarantee • issuance of Shoko Chukin bonds and other diversified methods of fund raising 	
Credit guarantee and credit insurance (1950 - 51)	<ul style="list-style-type: none"> • same with the above • inadequate guarantee capacity of credit guarantee associations established in local communities • necessity to back-up creditworthiness of borrowers in view of cautions attitudes of commercial banks 	<ul style="list-style-type: none"> • Government paid 75% of loss of commercial banks, Shoko Chukin, etc, caused by their non-performing loan. 	<ul style="list-style-type: none"> • In December, 1951, Government started to pay up to 50% of the amount paid to banks in lieu of a borrowing SME by any of 48 credit guarantee associations set up in each prefecture. • In 1953 credit guarantee associations were made special public entities, to which Government contributed a part of their equity. • In 1958, the Small Business Credit Insurance Corporation was established to reinsure debt guaranteed by local credit guarantee associations.
Subsidy scheme for modernization of SME's equipment (1951)	<ul style="list-style-type: none"> • Though SME required more funds for equipment 	<ul style="list-style-type: none"> • The central and prefectural Governments subsidized 	<ul style="list-style-type: none"> • In 1956, the scheme was renamed the Assistance Scheme

	investment needed for modernization , lending of the Counterpart Funds was not enough.	exporting and export-related SMEs modernizing their equipment. Because prefectural Governments repaid subsidy proceeds every year, central Government's assistance was loan in effect. (The scheme was extension of the subsidy scheme for jointly-introduced equipment by industrial cooperatives, which had been implemented since 1947, to individual cooperative members.)	for SME Promotion Funds.
Small Business Finance Corporation (1953)	<ul style="list-style-type: none"> • Most equipment became obsolete. • Though demand for funds for equipment investment increased because of innovations, long term lending was inadequate. 	<ul style="list-style-type: none"> • mainly lending for equipment investment 	

➤ Rapid growth period (1955-1972)

During this period, development of heavy industries and chemical industries was encouraged, and industry's international competitive edges were sharpened, while SMEs played an important role as subcontractors. A major objective of SME policies was to rectify SME's handicaps. The policies initiated in this period included:

- (a) enactment of the law for prevention of delayed payment to subcontractors (1956)
- (b) enactment of the law facilitating SME's collaborative actions (1957)
- (c) enactment of the law providing for establishment and operations of the Societies of Commerce and Industry to be formed by SMEs (1960)

- (d) establishment of the scheme of the management-improving extension service personnel (later renamed “SME Management Guide”) (1960)
- (e) establishment of the SME Guidance Center (1962)
- (f) enactment of the Small and Medium Enterprise Basic Law (1963)
- (g) enactment of the Small and Medium Enterprise Modernization Promotion Law (1963)
- (h) enactment of the Small and Medium Enterprise Guidance Law (1963)

Scheme (year of inception)	Requirement at Time of Inception	Description of Initial Scheme	Subsequent Evolution
Assistance Scheme for SME Promotion Funds (1956)	<ul style="list-style-type: none"> • strengthening international competitiveness • strengthening subcontractors for promotion of heavy/chemical industries • coping with labor shortage • to eliminate SME’s handicaps <u>vs</u> large firms 	<ul style="list-style-type: none"> • The central Government furnished subsidy to prefectural Governments, which lent SMEs at a zero interest rate for equipment investment. 	<ul style="list-style-type: none"> • In 1963, the Scheme was renamed again “the Scheme for Provision of Funds for SME’s Modernization of Equipment”, focusing on SME’s “structural improvement” such as joint facilities of SME’s cooperatives and factory concentration. They were also generically called “the Scheme for Lending for SME’s Upgrading.” • In 1966, an equipment leasing scheme was added. • In 1967, the Small Business Department Corporation was established and took over the scheme.
Small Business	• same with the	• Investment	• Since 1986, the

Investment Company Law (1967)	<ul style="list-style-type: none"> above • needs to increase SME's own capital 	Companies were established in three major cities to buy stocks of SMEs attempting to replenish capital.	Investment Companies have been authorized to buy SME's stocks at time of start up.
Small Business Development Corporation (1967)	<ul style="list-style-type: none"> • same with the above • structural improvement for enjoying the economies of scale by means of joint operations, factory concentration etc. 	<ul style="list-style-type: none"> • long-term financing at a low interest rate combined with extension/consultation services for encouragement of joint business operations, collaborative management and other structural reforms 	<ul style="list-style-type: none"> • In 1980, the Corporation was renamed "the Small Business Corporation."

➤ Period of slower growth (1973-84)

The SME policies in this period focused on development of knowledge-based industries and enrichment of managerial resources. At the same time, assistance was provided to the local districts affected by the economic slow-down and industries whose structures were vulnerable to the recession. The SME policies started in this period include a scheme for financing for managerial improvement of small firms. Other major policies affecting SME were:

- (a) the law to adjust opening of a superstore (1973)
- (b) the law to encourage SME's entry into new business (1976)
- (c) the law to restrict start of business by a large firm competing with SMEs already conducting the same business (1977)
- (d) the law to provide assistance to local communities dependent on a large firm adversely affected by the economic slow-down (1978)
- (e) the law to support SMEs clustering in the same local community (1979)
- (f) establishment of so-called "SME Colleges," the Institute for Small Business Management and Technologies, in local regions (1980)

Scheme (year of inception)	Requirement at Time of Inception	Description of Initial Scheme	Subsequent Evolution
Financing of	• SME's inadequate	• Small firms were	• In 1977, a

managerial improvement of SME (1973)	<p>fund-raising capacity due to shortage of a collateral</p> <ul style="list-style-type: none"> • Guidance of management was not backed up by financing. 	<p>given access to a small amount loan of the People's Finance Corporation without a collateral and without a personal guarantee. A small firm was initially defined a manufacturing firm with 5 employees or less or a commercial/service firm with 2 employees or less.</p>	<p>manufacturing firm with 20 employees or less or a commercial/service firm with 5 employees or less became eligible.</p>
Development of so-called "venture-oriented" firms (1975)	<ul style="list-style-type: none"> • development of knowledge-intensive firms • enrichment of so-called "soft" resources like technology, human resources and information 	<ul style="list-style-type: none"> • The newly-established Center for the Development of R&D-oriented Enterprises (VEC) guaranteed, without requiring a collateral, a loan for commercialization of creative R&D outcomes. 	<ul style="list-style-type: none"> • In 1988, a service-providing firm conducting novel kinds of businesses was made eligible for VEC's guarantee.

➤ Transition period (1985 - present)

SME's vitality typified by expansion of "venture" businesses was increasingly recognized essential to sustained economic growth. On this belief, a range of SME policy measures are being taken including equity capital contribution to venture financing funds.

Scheme (year of inception)	Requirement at Time of Inception	Description of Initial Scheme	Subsequent Evolution
Various schemes for start-up and entry into new business (since mid-1980's)	<ul style="list-style-type: none"> • to accelerate economic growth led by SME's creative power • to encourage start-up and entry into new business facing appreciated yen and recession 	<ul style="list-style-type: none"> • loan to an incubator (1986) • loan by Small Business Finance Corporation to a new business (1989) • loan guarantee by the Facilitating Fund for Industrial Structural Readjustment to a novel business in 	<ul style="list-style-type: none"> • In December 1999, the Small and Medium Enterprise Basic Law was substantively amended. Recognizing SME's flexibility, creativity and prompt actions, which are engines

		<p>accordance with the law promoting specified new businesses (1989)</p> <ul style="list-style-type: none"> • loan to encourage entry into a new business in accordance with the law promoting SME's entry into a new business (1993) • loan and guarantee of loan for R&D and commercialization of R&D outcomes in accordance with the law promoting SME's creative activities (1995) • support of a venture through "Venture Foundation" established by prefectural Governments with the following processes: <ul style="list-style-type: none"> (a) The Foundation contributes to a venture financing intermediary. (b) The Foundation guarantees debentures issued by a venture and bought by a venture financing intermediary, and gets reinsurance coverage at the Small Business Credit Insurance Corp. (c) Financed by an interest-free loan of the Small Business Corporation, the prefectural Government contributes capital to the Foundation, which provides a venture with equity 	<p>which are engines of growth and vitality of the economy, the amended Basic Law is based on the principle that SME's self-helping efforts should be supported.</p> <ul style="list-style-type: none"> • Accordingly, with a view to encouraging start-ups and creative business activities, a series of new policy measures has been taken. For financing, for example, equity capital raising is being encouraged instead of heavy reliance on loan in the past; and banks are induced to be less demanding for a collateral.
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6.1.2 Current Status of SME Financing

- In FY1998, the outstanding loan for SME amounted to 320 trillion yen, demonstrating that loans account for a major part of SME's fund raising. As is listed below, commercial banks provided 90.7 % of the total outstanding loan amount, revealing their dominant role. Among commercial banks, local commercial banks, credit banks and credit unions had larger shares than other banks,
 - city commercial bank: 30.8%
 - local commercial bank: 23.5%
 - second-tier local commercial bank: 10.0%
 - trust bank, long-term credit bank: 9.0%
 - trust account of banks: 1.6%
 - credit bank, credit union : 15.8%
 - Governmental financial intermediary: 9.3%
- Policy financing for SMEs supplements loans of commercial banks by making such kinds of credits that are not readily made available by commercial banks. Such credits are exemplified by a long-term loan, fixed interest loan and low-interest loan. The post-War Japanese policy financing for SME focused on rectifying SME's economic/social handicaps so that SME would grow and compete eventually on the basis of self-helping efforts.
- Established in 1948, the Small and Medium Enterprise Agency is responsible for planning of policy financing schemes. Policies are executed by MITI's regional offices or by prefectural Governments. Prefectural Governments execute SME financing by receiving necessary funds from the central Government, blending their own funds with them, or entirely relying on their own funds. For these purposes, each prefecture has a prefectural corporation for SME promotion and credit guarantee association.
- For execution on a national level, special public entities like policy financing intermediaries and the Small Business Corporation have been established. Municipalities are also engaged in SME policy execution whose highly valued effectiveness arises from their close contact with their residents.

(For example, Edogawa Ward of Tokyo, where numerous small and medium factories are located, implemented its own SME promotion policies during the

recession after the burst of the bubble economy. In September, 1998, the Ward administration set forth a Ward regulation providing lending designed to help SMEs needing capital urgently. SMEs in the Ward were entitled to borrow up to 5 million yen, with a 10 year repayment period including a 6 month grace period at 1.5% p.a. interest rate. This emergency relief had been initiated before the Small and Medium Enterprise Agency announced its special measures, and had given a breathing space to a number of local firms.)

6.1.3 Matters to Be Taken into Account in Application to LDC

- Japan's SME supporting policy financing has been implemented for many years and a great deal of expertise has been accumulated. When Japan's experiences are applied to an LDC, socioeconomic conditions which surrounded each measure at the time of its inception need to be fully reviewed and its applicability to the current situations of a particular LDC should be carefully considered.
- Though Japan's policy financing was in a substantial amount, more than 90 percent of the outstanding loan is provided by commercial banks. Furthermore, most of Government financial institutions entrust lending operations to commercial banks to build a nationwide network. In this sense, public financing relies on commercial banks. For SME financing in an LDC, development of commercial banks and banking systems, which are to play a role complementary to public institutions, should be targeted initially. Roles, functions and necessities of Government financing should be discussed in the context of development of commercial banks.
- Japan's SME financing policies have been effective because of its comprehensive link with other measures like SME guidance and tax concessions. Consequently, when our scheme is transferred to an LDC, complementary relations with any other measures are to be taken into account.
- Japan's SME financing is being executed through a national network formed by local Governments, public financing institutions and others. For example, the 521 Chambers of Commerce and Industry as well as the 2,808 Associations of Commerce and Industry form a part of this network, providing consultation and advice. Their proximity to local SMEs helps the scheme become more effective. In an LDC as well, such network building is important.

- Japan's policy financing institutions aim to bring up an SME based on a long-term perspective, taking advantage of their superior appraisal capability cultivated for many years and affluent information of past clients stored in databases. When a similar financial institution is established in an LDC, development of an organization and personnel equipped with such expertise is desirable.
- Japan's financing scheme is devised in such a way that not only funds will be supplied efficiently but the financed proceeds will be used effectively resulting in punctual repayments. Combined with the extension scheme, the Management Improvement Financing Scheme for Small Firms is designed to lend to firms that have been guided by a management improvement guide retained by the Chamber of Commerce & Industry and the like at least for 6 months.
- The emergency financing scheme of Edogawa described in the preceding subsection also required a borrower, as a condition of the loan, to go through consultation/review and follow-up guidance of a management consultant. In an LDC, however, repayments are often interrupted and compulsory recovery tends to be difficult even in the case of a default. A virtuous cycle of funds consisting of effective use of loan proceeds, repayment and relending of repaid proceeds should be established. To this end, an expert knowledgeable in SME's status and SME policies in a particular LDC should support borrower's management.

Extract of Committee Discussions (4th meeting)

(Mr. Tomari, Small Business Fin. Corp.)

(1) Features of Japan's SME financing policy

- three pillars – loan, guarantee and equity capital contribution
- Outstanding SME loan amounts to 320 trillion yen as of end-FY1998.
- Commercial banks account for 90.7% and Government intermediaries for 9.3%.
- A variety of SMEs is financed by 4 agencies in accordance with carefully determined demarcation.

(2) Activities of Small Business Finance Corp.

• **Direct lending and lending through agents**

Direct lending is made by the Corporation going through appraisal and every other procedure. For lending through agents, procedures ranging from client interfaces to appraisal and recovery are contracted to commercial banks. While the Corporation pays commissions, commercial banks guarantee up to 80 percent of the repayments. More

than 700 banks have made such contracts.

• **Lending procedures**

After receiving a loan request, the Corporation (or a contracted bank) goes through an appraisal process assessing applicant's repayment capacity and rationale of the business plan requiring the loan. After lending, follow-up control is important to ascertain, either by visiting the borrower's site or by looking at documents, whether the lent proceeds are being used in accordance with the plan. The Corporation receives annual financial statements of the borrower to familiarize itself with the most up-to-date situations and offers consultation about managerial issues.

• **Lending scheme**

lending ceiling: 480 million yen (240 million yen for working capital)

interest: fixed at the long term prime rate

repayment: for equipment, up to 10 years; for working capital, up to 5 years (grace: up to a year)

collateral: required

other provisions: There are special loan programs designed to meet such policy requirements as pollution control, facilities innovation and energy saving.

(3) History of Corporation

Established in 1953, the Corporation started its lending through agents. In its early stage, lending was mainly to manufacturers but subsequently made to wholesalers, retailers and service industries. The Corporation has had at least one branch in each prefecture since 1974. In an attempt to process the increasing number of applications, the Corporation developed a quantitative company appraisal method to streamline its appraisal process.

(4) Seven features of Corporation

- (a) stable supply of capital
- (b) long-term fixed interest
- (c) lending to firms with limited access to commercial banking
- (d) lending to a new business and ventures
- (e) special programs meeting policy goals
- (f) lending for emergency needs (rehabilitation after a natural disaster, urgent policy financing)
- (g) provision of managerial information and advice

(5) Question and answers

Q: How is the Corporation different from the People's Finance Corporation?

A: The average amount of lending per project is about 7 million yen in the case of the People's Finance Corporation, and is 60 to 70 million yen in the case of the Small

Business Corporation, which mainly lends to medium-sized firms.

Q: How does the direct lending differ from lending through agents?

A: The conditions of loan are essentially common. The lending limit per project, however, is 480 million yen for direct lending and 120 million yen for lending through agents. Therefore, a relatively small amount is lent through agents, while a larger amount is lent directly.

Q: “Lending to firms with limited access to commercial banking” is claimed to be a feature of the Corporation’s lending. Does it mean that a firm performing poorly is borrowing from the Corporation?

A: Because the Corporation conducts a detailed appraisal, it finances such companies that commercial banks are reluctant to lend to but are judged bankable.

(Note) The Corporation is allocated funds under the Fiscal Loan and Investment Program or sells Corporation’s bonds. An examination seems necessary whether the similar way of fund raising is feasible in an LDC.

Q: In applying the system of the Corporation to an LDC, the issue of appraisal ability is often relevant. Concerning this issue and others, is it possible to clarify reasons why the appraisal by the Corporation is working properly in Japan?

A: This is because of expertise acquired through experiences for many years in long-term lending to SMEs as well as of the fair and neutral position of Government financing institutions making borrowers less reluctant to disclose their information. Another reason may be that the Government institutions spend much time and make detailed appraisal.

Q: What is an incentive for a commercial bank to act as an agent of the Corporation?

A: To begin with, an agent is paid commissions. A commercial bank may wish to lend as the Corporation’s agent to a firm needing long-term lending with a fixed rate, when the bank is not able to lend its own funds from viewpoints of risk management and profitability.

6.2 SUPPORT BY BANK FOR INTERNATIONAL COOPERATION

6.2.1 Credit as Official Development Assistance

- In connection with SME support, ODA credits are made usually in the form of a so-called two-step loan. Through LDC’s financial intermediary like a development bank, credit proceeds are supplied to SMEs on medium/long-terms for the purpose of their development. For example, the yen credit to Malaysia, whose loan agreement was signed in March, 1999, was made, through the Malaysian policy financing scheme for SMEs established in 1998, to encourage small firms’

equipment investment mainly in the manufacturing sector. Specifically the terms of the credit were:

- (a) lending by JBIC to the Malaysian Ministry of Finance at 0.75% in the amount of 16,300 million yen
- (b) relending by the Ministry to Malaysian financial intermediaries (Industrial Development Bank and others) at a maximum interest rate of 2.75% (0.75% + exchange risk premiums)
- (c) further relending by the above-said intermediaries to final borrowers at a maximum interest rate of 7.75% (2.75% + administrative expenses + bad debt provisions. etc)

6.2.2 Foreign Loans and Investment (ODA)

- This facility is designed to provide lending or equity investment for private companies' undertakings for development. Especially for SME promotion, the facility helps establish an SME promoting fund, through which equity funds are supplied to SMEs suffering a shortage of funds needed for new business support. In this way, the facility helps activate LDC's economy and supporting industries as well as Japan-affiliated companies indirectly.

6.2.3 Policy Recommendation Based on Special Assistance Facility (SAF), Special Assistance for Development Policy Project (SADEP) and so forth (ODA)

- In addition to financial assistance like yen credits and foreign loans and investment, the Bank provides intellectual assistance like SAF and SADEP. An example of SAF is policy consultation with LDC Governments regarding implementation of a two-step loan in response to changing external conditions like the economic crisis. An example of SADEP is making a policy prescription and deliberation of support measures concerning LDC's economic growth in the aftermath of the economic crisis.

6.2.4 Export Credit (Other Official Flow)

- For the purpose of market penetration, an export credit is made either to an exporter in Japan or to a foreign importer or bank. In the case where an importer in an LDC is an SME, an export amount is small requiring lengthy procedures. Export financing helps both SMEs in LDCs and a Japanese exporter trying to develop a foreign market.

6.2.5 Import Credit (Other Official Flow)

- Import financing aims to facilitate importation of goods and technologies needed for growth of the Japanese economy, and is made either to a Japanese importer or to a foreign exporter. As products like furniture may be produced by an SME in an LDC, financing facilitating such import helps promote SMEs in an LDC and satisfy market requirements of Japan.

6.2.6 Investment Financing (Other Official Flow)

- Investment financing aims to encourage Japanese firm's foreign direct investment, and is made either to a Japanese investor or to its foreign subsidiary. To accelerate economic growth in an LDC, development of industrial bases and SMEs is essential. For this purpose, the Bank is supporting expansion of companies affiliated with Japanese investors. An investment financing scheme provides joint ventures with Japanese companies, including small ones, with necessary capital through LDC's Government financial intermediaries or Japan-affiliated banks. By means of support of Japanese foreign investment, investment financing has a consequential effect of promoting SMEs in an LDC.

6.2.7 Untied Two-step Loan (Other Official Flow)

- An untied two-step loan is designed to provide financing, which is not directly connected with export from Japan, for the purpose of facilitating economic interaction with foreign countries, and is made to a foreign Government or foreign financial institutions. By financing SMEs through LDC's Government and other organizations, the scheme aims to strengthen SME's competitiveness and to develop LDC's industries. It also facilitates procurement of parts/components by

Japanese-affiliated companies located in an LDC or its vicinity. Untied loan also facilitates building of economic infrastructures, which are conducive to SME development and Japanese investment.

Extract of Committee Discussions

- Issues to be solved in designing development loan for SME promotion – Thai example – (4th meeting)

(Mr. Togo, JBIC)

(1) Yen credit for Thailand

- **The yen credits to Thailand have the following five objectives:**

- (a) urgent support (employment creation, domestic currency loan to existing projects)
yen credits to the Tourism Department and others for a counter-measure against unemployment, etc.
- (b) environmental improvement, elimination of traffic congestion
yen credits for construction of Bangkok subways, etc.
- (c) promotion of tourism and export for earning foreign currencies
a two-step loan for an industrial development plan, etc.
- (d) elimination of regional income gaps
a two-step loan to farmers through local banks, etc.
- (e) human resources development
yen credits for construction of training facilities in industrial estates, etc.

- **Two-step loan for industrial development**

The scheme not only provides financial resources but makes intellectual contribution. Collaboration in an all-Japan style is being made by MITI, JBIC, JODC and JICA. Its notable features are:

- (a) The loan for industrial structural improvement is provided at 1 percent interest, while TA loan is at a 0.75 percent interest for encouraging technology transfer by experts.
- (b) For industrial structural improvement, JICA's assistance is being provided to the Department of Industrial Promotion (DIP) of Thailand making a master-plan.
- (c) For the TA loan, a final beneficiary applies to JODC through DIP. After JODC's examination of the application, an expert is sent.
- (d) JODC bears three fourths of the cost for sending an expert, while the beneficiary pays the balance.

(2) Matters to be confirmed for provision of yen credits (policy financing)

• **Concerning the overall structure of the scheme**

- (a) Does the project to be financed match Japan's cooperation objectives?
- (b) Is the yen credit necessary? (What are other donors doing? Are other sources of funds available than the yen credit?)
- (c) What is the best scheme? (two-step loan, three-step loan or sector loan?)

• **Knowing capability of the executing organization**

- (a) What incentives are given to the financial intermediary? (profitability, risk, etc.)
- (b) What is the market share of the intermediary? (the number of branches, access by ultimate borrowers, etc.)
- (c) What is the past performance of the intermediary? (Does it have enough expertise acquired through borrowing from other donors?)
- (d) Is the intermediary financially sound? (B/S, P/L, cash flow, etc.)

• **Management of financed scheme (Has the objective been achieved?)**

- (a) financing in two tranches (checking in the middle of execution and providing the remaining proceeds in consideration of the outcome of the checking)
- (b) requesting submission of a progress report
- (c) monitoring operations of the intermediary
- (d) reviewing the macroeconomic trend and situations of the financial sector
- (e) monitoring situations of ultimate beneficiaries and propaganda

(3) Question and answers

Q: The yen credit, which has to be repaid in yen, is risky to a borrower. Why is it designed this way?

A: It is to be repaid in yen, because Japanese tax payers should not bear exchange risks.

Q: Who bears credit risks? Should the Japanese bear the risk?

A: Credit risks are taken care of by rescheduling based on an assumption that the rescheduled debt will be repaid in future.

Q: How does a borrower manage exchange risks?

A: A borrower uses swapping facilities and other means.

Q: Is a private intermediary eligible?

A: For policy financing, an intermediary needs to have adequate financial expertise. In general, a private intermediary is acceptable as long as the Government guarantees the credit wishing to strengthen private intermediaries.

Comment: According to a case in Thailand (IFCT), a higher interest charged by an intermediary helped accelerate disbursement. Even a policy-directed intermediary behaves like a commercial bank. Since SME development is a national goal, the

Government should be prepared to incur necessary fiscal expenditures. Such issues should be thoroughly discussed in the context of a Japan-borrower policy dialogue.

Q: The US, EU and other donors contributed funds to a public SME financing foundation in East Europe. Is the Japanese Government prepared to make such contribution?

A: JBIC is entitled to do so. Should there be such legitimate development need in East Europe, JBIC could consider such investment.

Extract of Committee Discussions

- Issues to be examined in designing a loan and investment for SME promotion (4th meeting)

(Mr. Koganei, JBIC)

(1) JBIC loan

JBIC's non-ODA program consists of credits for export, import and investment as well as untied loan. Credits for export, import and investment are designed to support Japanese companies. Untied loans support undertakings by foreign Governments and other organizations, import of products, technology import and, most recently, improvement of the balance of payments. Since an untied loan does not necessarily finance export from Japan, it is designed to promote businesses of Japan-affiliated companies in a recipient country.

(2) Example (untied two-step loan to BDET, Tunisia)

• **Objective**

- (a) For Tunisia, three cooperation programs have been implemented – a two-step loan, yen credit and technical cooperation, contributing to her closer relationship with Japan. The Association Agreement with EU in 1995 improved Tunisia's access to EU markets. Japan-affiliated companies in Tunisia hope to buy parts/components from local SMEs.
- (b) The long/medium terms untied loan is expected to promote private sectors of Tunisia. It is also designed to support BDET, which is to play a central role in Government's efforts to modernize Tunisia's financial institutions.

• **Collaboration with JICA**

The untied loan is provided in collaboration with JICA, which provides technical support to SMEs including management consultation and formulation of SME development policies. JBIC and JICA play mutually complementary roles in this manner.

(3) Matters to be taken into account

• **Appraisal by local intermediary**

Effective appraisal and asset management by Tunisia's financial intermediary need to be assured.

- **Consistency with SME policy**

Any cooperation project should be consistent with economic policies of the recipient country. Without consistency, the cooperation would not have medium-long term impact.

- **Relationship with SME**

JBIC and financial institutions of the recipient country need to be fully acquainted with situations of final beneficiaries, SME. A useful example is provided by Tunisia, where a steering committee has been set up to enable JBIC and BDET to know SME's situations.

- **Follow-up**

Post-financing monitoring is essential to ascertain effectiveness of the loan. Because JBIC's main concern is to assure punctual repayments, however, it may not be eager in follow-up reviews of final beneficiaries except receiving a report from the intermediary or Government.

- **Suggestions**

For the purpose of constant SME support, local money markets should be made more liquid. The World Bank loan/credit for financial sector reforms, for example, helps develop local bond markets. Developed money markets help mobilize local private financial resources, leading to development of local industries. How JBIC will be able to contribute in this respect should be considered.

(4) Questions and answers

Q: The ODA organization and non-ODA organization have been merged into JBIC. How concessional will JBIC's loan be? In which cases will JBIC's loan be concessional? What are criteria for determining JBIC's concessionality?

A: ODA will continue to be concessional. The terms of OOF are somewhere between those of ODA and private loans. Criteria determining how concessional each loan should be have not been fully discussed.

Q: A two-step loan supporting Japanese businesses is likely to be criticized by foreign observers claiming that it is Japan's industrial policy. How do you justify assistance to Japanese businesses in foreign countries?

A: Whether it will be criticized or not is not known at this stage. Although a two-step loan is untied, we feel it desirable to help Japanese businesses as well as the recipient.

Q: In the case of the loan to Tunisia, information supply to Japanese firms is said to be a component of the project. Is information to be supplied only to Japanese firms?

A: In the community of economic cooperation, such practices have not been sensitized so far. In other forums like WTO, however, they may be taken up in relation to investment, and persuasive explanation may be asked for.

6.3 ACTIVITIES OF OTHER DONOR COUNTRIES AND AGENCIES

- Since improved access to financing is important for sound SME development in an LDC, a consensus has been reached in the community of international cooperation as to the necessity of foreign donor's support. However, approaches by foreign countries and donors are different from ours respecting a target group of SMEs and methods, particularly a way of Government intervention.
- Recently, the World Bank and other donors attempt to promote SMEs increasingly from viewpoints of poverty alleviation or private sector development. For this reason, targeted SMEs are mainly small/micro firms, and their access to financing is supported. In this respect, their method differs from Japan's, which will support not only small/micro firms but medium-sized firms with potential competitiveness for the purpose of industrial development.
- By the international cooperation community including the World Bank, SME financing by means of a credit line has been used less frequently in recent years giving way to improvement of SME's access to financing through institutional development such as strengthening of financial intermediaries or developing bond markets. In more specific terms, intellectual support is combined with a sector loan for development of local financing systems and mechanism-building for mobilization of idle funds. Such a shift of emphasis is based on a recognition that the conventional financing through Governmental financial intermediaries benefited only a small part of SMEs and did not necessarily have sustainable impact.
- From this viewpoint, the Committee of Donor Agencies for Small Enterprise Development made guidelines in 1995 on selection and support of intermediaries for financing micro/small firms. The guideline emphasizes that objectives of donor's support should be to give access to financing to more micro-firms, and to build the system assuring continued financing to SMEs even without relying on donor's financial assistance.
- The Forum on Entrepreneurship and Enterprise Development (FEED) co-sponsored by OECD and UNIDO made the following policy guidelines on small firm financing:
 - (a) Improved access to financing is more important than a low interest rate.

- (b) Such legal systems as those for company registration, insolvency treatments, collateral procedures and leasing schemes should be established and their administration should be made efficient.
- (c) Government financing for SMEs should be made only in the case of market failures.
- (d) In evaluating and selecting a project to be financed by a Government scheme, successful cases in the past should be fully taken into account.
- (e) Representatives of business sectors should be invited to participate in the process of lending decision.
- (f) Financial services infrastructures should be improved, covering creditworthiness reference and training of bank personnel dealing with applications for venture financing, leasing and small firms.
- (g) Training and advice for SME entrepreneurs negotiating with a bank should be provided, emphasizing training of personnel making and evaluating a business plan.
- (h) Requirements for financing in local communities should be met more readily.
- (i) Mere copying of SME financing schemes in developed countries should be avoided.
- (j) Efforts should be made to assure financing for SMEs in main manufacturing sectors and for those planning projects using new technologies.
- (k) A micro-financing scheme should be strengthened with a view to assuring their self-reliant growth based a business-like structure.

6.4 MATTERS TO BE TAKEN INTO ACCOUNT IN DESIGNING FINANCIAL INTELLECTUAL SUPPORT PROGRAMS

➤ **Defining clear policy objectives**

During implementation of a cooperation program, discussions of the context of SME promotion policy tend to be neglected giving way to an easygoing design to channel funds to SMEs by any possible means. Among a number of LDC's policy-making authorities such as the Ministry of Industry, Ministry of Finance and financial institutions, policy objectives should be made clear and shared. Only with

such clear definition of policy frameworks, policy financing would become effective.

➤ **Market failure and Government's role**

In Japan, SMEs are being supported with fiscal and monetary means. In the international community, however, different systems and beliefs prevail. Especially from a viewpoint emphasizing market mechanisms, Government's financial support should address clearly identified cases of market failures and should be logically justified.

➤ **Institution building assuring efficient functions of private financing systems**

Though financial support immediately reminds us of policy financing through a Government financial intermediary, policy financing would be ineffective without an efficient private financial sector. Expansion of both public and private financing requires improvement/establishment of institutional environment favorable to development of a private financial sector, including book keeping, and appropriate administration of laws on contractual rights and insolvency. In the process of discussions of rationale of policy financing, considerations should also be made on ways and means to facilitate financial functions by commercial banks and others.

➤ **Assuring transparency**

Concerning financial assistance, transparency is essential for the purposes of not only fairness but efficiency. Especially in providing assistance for establishing a policy financing scheme, proper mechanisms have to be devised so that lending/investing decision making processes will sufficiently be transparent and implementation be constantly monitored.

➤ **Comprehensive measures**

For formation of an effective financial support system, comprehensive discussions should be made, in consideration of situations of the recipient country, covering desirability of measures other than lending including debt guarantee and equity investment. For example, debt guarantee is effective for improving financial access of SMEs which can neither pledge a collateral nor provide personal guarantee. On the other hand, inadequate appraisal capacity would increase bad debts of public institutions and fiscal outlays, causing moral hazards of private banks. Though Government's equity investment would replenish SME's own capital and enable them to borrow from a private bank, it would make fiscal funds illiquid and might cause unnecessary Government intervention in SME's management.

- **Strengthened organization of policy financing intermediaries**
For effective policy financing, improved appraisal capacity of financial institutions is essential. Therefore, intellectual support packaging technical transfer for this particular purpose is required.
- **Target of policy financing**
Policy financing may target either particular sectors or functions (energy saving, particular areas of R&D and so forth). In any event, unless growth potentials or soundness of business is made criteria of target selection, non-performing debts will inevitably mount. Following the recent discussions among the international community of cooperation with LDCs, financial assistance tends to target mainly small firms. Japan, however, should target medium-sized firms with potential growth prospects as well aiming to develop manufacturing and other industries including subcontracting sectors.
- **Size of policy lending**
While the scale of total lending is subject to debate, it is not necessarily easy to determine the optimum scale. In Japan, Government financing accounts for about 10 percent of the total outstanding loan to the private sector, and commercial banks account for the rest. In determining the scale of policy financing, commercial banks' lending capacity has to be looked into.
- **Terms of loan**
Justification of a subsidized low interest loan to SMEs is subject to careful debate weighing special policy requirements against needs for sound development of entire money markets. The terms of loan other than an interest rate, including a repayment period, a percentage of loan against the total cost, a ceiling of the loan, requirements for a collateral or personal guarantee, should be considered at the same time.
- **Link and consistency with other policy measures**
Financing should be linked with other policy measures such as macroeconomic policies, business development service, information provision and management consultation. In Japan, policy financing has often been combined with tax concession. Likewise, combination with other incentive-giving policies should be considered.
- **Sources of funds of policy financing**
In providing intellectual support in connection with policy financing, examinations should be made as to sources of funds to be mobilized for policy financing in

consideration of sustainability of the scheme. (For example, ways to mobilize domestic financial resources should be looked for without solely relying on foreign resources.)

(For reference) Cases where Government intervention may be justified because of market failures

- (a) Public goods are not necessarily supplied in a sufficient amount only by means of market mechanisms.
- (b) Price mechanisms do not work under circumstances prevailed by monopoly or imperfect competition.
- (c) Free competition may not facilitate development of infant industries and industries with the economies of scale.
- (d) In cases where external economies are significant such as spill-over of technologies, and ripple effects of increased production and of use of elements of production, price mechanisms do not fully reflect such externalities.
- (e) In cases where information flow is impeded, the price mechanism does not fully work.
- (f) In cases where upstream industries and downstream industries need to expand at the same time, where several companies need to scrap production facilities at the same time and where overcrowding in large cities should be avoided, Government intervention may be justified.
- (g) In cases where the market has not developed, for example where monetary/financial markets are embryonic, Government intervention is essential.

Extract of Committee Discussions

- SME's fund raising – Thai example – (4th meeting)
(presentation by secretariat)

The following issues were discussed during the deliberation of the design of Japan's proposal on SME financing.

(1) SME policy financing

- Coordination with the World Bank about rationale of Government's SME financing
Is Government financing of SMEs justified?

Discussions were made about justification of Government financing *per se*.

- Choice of a Government financial intermediary that is to play a central role (Which of IFCT, SIFC and others should play a central role?)
- Specification of financing institutions
whether financing should be: long term, at a subsidized low interest rate, for manufacturing or every sector.
- Ability and organization of financial institutions
appraising ability, the number of staff, likelihood of moral hazard

(2) Guarantee

The Thai Government was reluctant to endorse the proposal of Government's guarantee in fear of a moral hazard.

(3) SME's improved access to financing

- More extensive networks
For building a wider network and training of personnel, an agent loan through commercial banks is being considered. Discussions are expected to take place whether a public intermediary or a commercial bank as agent, is to assume the risk of default.
- Link with management consulting
A number of SMEs have gone through management consulting at the advice of a public financial institution or trade association. None of them, however, was financed because of the consultation. Consultation and financing are not readily linked.

• *Pros* and *cons* of lowering an interest rate of policy-directed lending below the rates prevailing in markets (4th meeting)
(secretariat)

(1) Views against low interest rate

- (a) Unprofitable projects are likely to be financed at the expense of more beneficial use of funds, possibly adding to bad loans.
- (b) The total amount of lending will be smaller because Government's resources for subsidy are limited and bank's incentives are not enough. To an SME, availability of loan is most important.
- (c) Because the total lending amount is small, loan-making decisions tend to be influenced by political considerations or by corruptions.

(2) Views favoring low interest rate

- (a) SMEs would not be able to be competitive, should they pay a higher interest rate than foreign competitors.
- (b) Making concessionary loans to prioritized sectors or for prioritized purposes is an essential element of industrial policies.

(c) By obtaining funds at a low interest rate from foreign donors and lending such funds at the market rate, a financial intermediary would earn unreasonably large amounts of profits.

6.5 COLLABORATION BY DONOR AGENCIES

➤ For effective execution of a financing program, multi-agency collaboration is necessary respecting the following tasks:

(a) establishment/improvement of basic legal framework

- (i) making a master plan of SME financing policy
- (ii) legal systems of business accounting
- (iii) legal systems of establishment of a company
- (iv) legal systems of bankruptcy/insolvency
- (v) legal systems of a collateral

(b) support for improving SME's access to financing

- (i) commercial banking systems for SMEs
- (ii) credit guarantee for SMEs
- (iii) bond markets for raising funds needed for SME financing
- (iv) infrastructures and incentives encouraging SME's organization and factory grouping
- (v) capacity building of a policy financing intermediaries

(c) micro-level

- (i) search for a potentially profitable borrower
- (ii) guidance in book keeping and business plan formulation
- (iii) technical support for equipment investment
- (iv) training of SME's financial personnel

➤ Among measures by donor agencies, seemingly most effective is a combination of financial assistance and technical assistance, which is designed to simultaneously

improve lender's appraising ability and borrower's managerial/technical ability. Examples are: (a) the yen credit for Thai industrial development (policy-directed two step loan) combined with JODC's expert dispatching service for a borrower; and (b) the untied loan to Tunisia for industrial development combined with JICA's official technical assistance for development of a Governmental support agency. Meanwhile, for greater impact, LDC's Government and private sector need to share basic premises and perspectives about SME promotion. Furthermore, expert dispatching services aiming to provide policy advice or development studies for master plan making should precede financial cooperation.

7. SUPPORT OF MARKET PENETRATION

7.1 JAPAN'S EXPERIENCE AND ITS APPLICATION

7.1.1 Japan's Policy for Market Penetration

In order to strengthen competitive edges, SMEs, whose managerial resources are limited, must specialize in a particular sector or subsector, and secure markets large enough to justify specialization. During the post-War period, the Japanese Government has taken a variety of policy measures to enable manufacturers to penetrate markets, as outlined below.

➤ **Information supply and consulting/advice for overseas business
(excluding import business)**

JETRO	<ul style="list-style-type: none">• In 1951, mainly at an initiative of local Governments and business circles in the Kansai Region, the Overseas Market Research Association was founded in Osaka as a not-for-profit private foundation. The Government granted a subsidy to the Association for expenses for overseas market research.• In 1953, the Association was merged with other two private organizations into the Overseas Trade Promotion Association, which was to conduct not only market research but assistance to participants in an international trade fair, propaganda in foreign countries and intermediation of trade. In 1955, it started to conduct design-improving measures as well as propaganda and trade intermediation, sharing expenses with local Governments and trade associations.• In 1958, the Association was reorganized into a public entity named the Japan External Trade Organization (JETRO).• Since the 1970's, export promotions measures have gradually been phased out, giving way to defusing trade frictions, import promotion, promotion of incoming-outgoing foreign direct investment, and economic cooperation. Main ongoing measures relating to foreign market penetration are:<ul style="list-style-type: none">(a) information supply for SME's foreign direct investment: supply of information to SMEs about investment climate of foreign countries(b) sending a mission promoting SME's foreign direct investment:
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	<p>(c) trade fair etc. for promoting SME's foreign direct investment: exhibitions, information supply and consulting in collaboration with investment promotion agencies of foreign countries</p> <p>(d) industrial promotion in LDC (called "JOIN"): In collaboration with LDC Governments, consultation on search for a partner, advice on feasibility, information supply and other assistance are provided to SMEs wishing to do business overseas.</p> <p>(e) research in a foreign country and information supply for promotion of SME's international business: research, information collection, information supply, etc. on foreign market trends, product market trends, etc.</p> <p>(f) trade fair: support of SME's participation in a foreign trade fair and SME's organizing a single-product fair.</p> <p>(g) promotion of business of Japan-affiliated companies located overseas: On the basis of a contract with foreign law firms and accounting firms, seminars are organized and consultation is provided for Japan-affiliated companies on laws and taxation.</p>
Japan Consulting Institute	<ul style="list-style-type: none"> • In 1953, subsidized by the Government, the Japan Machinery Exporters' Association set up a Technical Consulting Office for heavy machinery export to conduct studies, PR, consulting and intermediation for plant/equipment export. • In 1955, the Consulting Office mentioned above was absorbed into a new organization named the Exported Plants Technology Association, which was renamed in 1956 the Japan Consulting Institute. In 1959, the Institute was joined by leading engineering companies. The major function of the Institute was consulting for promotion of plant/equipment export. During 16 years from the establishment to 1971, 103 export contracts were awarded because of consulting services of the Institute. This achievement can be evaluated successful. • Subsequently, due to development of engineering companies and increased competitiveness of plant exporters, the consulting services of the Institute have become less closely connected with export, giving way to technical cooperation with LDCs. While the Institute used to conduct propaganda of good quality of Japan-made plants/equipments and technical consulting in foreign countries, these functions were

	transferred to JETRO in 1971.
Small Business Corporation	<p>Founded in 1967, the Small Business Corporation as well as its predecessor, the Small Business Guidance Center founded in 1962, has been engaged in provision of guidance/advice to SMEs. The Corporation has gradually expanded involvement in guidance/advice concerning trade and investment. Its major functions in this respect are:</p> <ul style="list-style-type: none"> • Guidance for encouraging international activities of local areas producing particular goods: For the purpose of closer connection between SMEs in local areas producing particular goods and foreign companies, expert's guidance is provided to SMEs concerning business planning and plan execution. • Guidance and information collection for encouraging SME's overseas business development: For the purpose of promoting SME's overseas business development, information on foreign investment climate is collected and furnished to SMEs in collaboration with prefectural SME information centers, and a foreign investment adviser gives advice sometimes accompanying SME executives who wish to conduct feasibility studies in a foreign country. • Support of local SMEs in international activities: Research information is furnished to local SMEs concerning purchase of materials/components in foreign countries, technical proficiency and other things. • Conference for SME's international interaction: A conference is sponsored between SMEs wishing to do business overseas and company executives in investment-hosting countries. • Seminar on management of overseas facilities and overseas business: In foreign countries, advice is provided supporting Japan-affiliated SMEs, and seminars on business management are organized with participation of locally-employed managers of these SMEs. • Information center: In 1973, the SME Information Center was established under the Small Business Corporation followed by a similar center established in every prefecture by 1989. In 1982, the Small/Medium Enterprise Information Retrieval System was developed and connected on-line with each prefectural center.
Chambers of	• Support of international exchanges in local areas:

<p>Commerce & Industry, Societies of Commerce & Industry, and their Central Federation</p>	<p>The Chambers of Commerce & Industry and Societies of Commerce & Industry support small enterprises' overseas business missions as well as hosting of similar missions coming from overseas.</p> <ul style="list-style-type: none"> • Overseas support program of the Japan Chamber of Commerce & Industry: Foreign representative offices of the Chamber offer consultation to SMEs doing business overseas. • Overseas support program of the Central Federation of Societies of Commerce & Industry: Foreign representative offices of the Federation collect information and supply to SMEs.
<p>Market penetration by subcontractors</p>	<ul style="list-style-type: none"> • Starting in 1965, the national Government encouraged prefectural Governments to establish an Association of Subcontracting Enterprises Promotion in each prefecture in order to stabilize subcontractor's contract award and make subcontract terms more equitable. The Associations are public not-for-profit entities whose entire capital was contributed by prefectural Governments. The national Government also granted subsidy to the Association through the prefectural Government for its operational expenditures. The Association was established in every prefecture by end-FY1977. The Association performs the following activities besides efforts to assure equitable subcontracting terms: <ul style="list-style-type: none"> (a) brokering of subcontracting businesses (b) consultation on complaints and disputes respecting subcontracting, as well as mediation/arbitration for their solutions (c) studies and information collection for promotion of subcontracting businesses • Among the functions of the Association, the number of attempted business brokering reached 107,000 in the 5 year period from FY1977 to FY1982, of which 27,000 led to contract awards (success rate at 25 percent). These records prove its satisfactory performance. • In recent years, the Associations initiated a subcontracting "techno-fair" displaying technologies and products developed by subcontractors (in FY1988), built on-line networks connecting Associations throughout the country (in FY1988), and organized a business negotiating conference on an expanded regional basis (in FY1989).
<p>Other information</p>	<ul style="list-style-type: none"> • Besides the above, information supply and consulting services

supply and consulting	are being provided aiming at penetration in domestic/foreign markets by the Shoko Chukin Bank, Small Firms Finance Corporation, Bank for International Cooperation (former EXIM), and National Foundation for Promotion of Small & Medium Enterprise Linkage (established in 1988).
Training	<ul style="list-style-type: none"> • Trade Training Center: Established in FY1967, the Center started to operate in 1969 aiming to develop human resources equipped with internationally applicable expertise and capability. Subsequently, because human resources development by large firms made remarkable progress and because, for Government's training for SMEs, the Institutes for Small Business Management and Technologies were founded in many regions in FY1980 and afterward, the Center ceased to be an authorized public entity pursuant to a law in 1985, becoming a private not-for-profit foundation in 1986. • Institute for Small Business Management and Technologies: Since 1980, the Institute was established in every region, training SME executives and managers in a variety of subjects (including training of managers of SMEs investing overseas).

• **Export loss compensation and insurance**

Compensation of loss due to exchange rate fluctuation in connection with equipment export	<ul style="list-style-type: none"> • In 1952, the loss compensation scheme was initiated covering exchange rate fluctuation risks arising from export of plants/equipment and others whose payment period was longer than that to be covered by hedging. Initially, the scheme was not often used due to anticipated yen devaluation, but in more use due to speculated pound devaluation from mid-1954 to mid-1957. Since 1958, the scheme became dormant again because more exporters began to be paid in US dollars. Subsequently, the Exchange Fluctuation Insurance was made available within the framework of the Export Insurance Program, absorbing this compensation scheme.
Compensation of loss due to plants/equipment export	<ul style="list-style-type: none"> • In 1959, the scheme was initiated to compensate penalty payments made by plant/equipment exporters because exported plants did not perform as well as had been promised. Because the scheme was essentially based on mutual compensation by exporters, its premiums were so high that compensation had been made only for 22 cases before it was abolished in 1971.
Trade & Investment Insurance	<ul style="list-style-type: none"> • In 1950, the scheme of the Ordinary Export Insurance was initiated covering up to 80 percent of non-commercial risks such as a business restriction imposed by foreign

	<p>Governments, war, revolution and internal disorder occurring after conclusion of an export contract. Since 1962, pre-shipment credit risks have also been covered.</p> <ul style="list-style-type: none"> • Since 1951 until today, mainly the following schemes have been introduced: <ul style="list-style-type: none"> (a) Export payment insurance: Post-shipment non-commercial risks and credit risks such as buyer's insolvency and delayed payments are covered. (b) Exchange fluctuation insurance: Exchange fluctuation risks are covered. (c) Export financing insurance: The scheme pays for debts incurred in connection with export but became unrecoverable because of defaults due to non-commercial risks or credit risks. (d) Export advertisement insurance: The scheme compensates losses in connection with unrecoverable expenses in overseas advertisement. (e) Export bill insurance The scheme compensates losses in the event of defaults of export bills bought by a bank. (f) Export bond insurance: The scheme guarantees various kinds of bonds to be submitted in the process of an international tender. (g) Foreign investment insurance: (h) Foreign business capital lending insurance: • The number of insured export cases and insurance-covered amounts have steadily increased, while export credits are readily made available for insurance-covered export. For this reason, the export insurance is now the most important export promotion policy of Japan.
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➤ **Export credit**

<p>Bills for advance loan for export</p>	<ul style="list-style-type: none"> • The scheme was established in 1946 by the Bank of Japan, as the first step of export promoting financing in the post-War period. Under this scheme, the BOJ discounted, at a low interest rate, bills for pre-shipment loan drawn by an exporter (a maker also became eligible in 1949) for the following purposes: (a) lending to a maker and other suppliers, (b) buying products to be exported, and (c) other expenses
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	<p>needed for exporting. Because a domestic interest was high and money supply was tight for many years after the end of the War, the scheme was very popular as pre-shipment financing, making a great deal of contribution to export promotion. Moreover, due to the tight money policy in 1962 and thereafter, financing through an export bill was made additional to the ceiling set for BOJ's window guidance. This measure further encouraged exporters to use this facility.</p> <ul style="list-style-type: none"> • In around 1965, commercial interest rates started to decline, reducing incentives of low-interest policy financing. Furthermore, BOJ's involvement in export promoting financing became subject to harsher criticism by foreign trade partners. BOJ's discount rate, therefore, has been made comparable to ordinary commercial bills since 1971.
Loan secured with foreign exchanges	<ul style="list-style-type: none"> • Immediately after the War, only sight bills were the eligible means for receiving export payments. In 1952 and thereafter, export bills payable within 3 months after sight was also made eligible and subsequently became the standard payment method. In 1953, the BOJ, therefore, started to lend yen proceeds to a foreign exchange bank that had bought export bills payable in 3 months after sight backed up by an LC and denominated in dollars or pounds. The loan had to be secured with foreign exchanges handed over by the bank to BOJ. • The period after sight was subsequently made longer to 5 months shortly after the introduction of the facility, and then to 6 months. The eligible currencies were also added, finally totaling 14 currencies. Bills without an LC but accompanied by a DP or DA were also made eligible later. • BOJ's interest rate was initially made comparable to the rediscount rate of bills accepted by leading commercial banks in the country of export destination, and was then set at the uniform rate comparable to the rate of lending secured with US dollars. As such a rate was advantageous to an exporter, the facility was used very actively as a means of post-shipment export financing. In 1972, however, the facility was discontinued for the same reason with termination of concessional discounting of export bills, in exchange for improved import financing.
BOJ's purchase of foreign exchange bills	<ul style="list-style-type: none"> • Under this facility introduced in 1965, BOJ bought export bills denominated in US dollars at a rate comparable to a B/A rate prevailing in New York to assume exchange risks that commercial banks would have to bear using the loan facility secured with foreign exchanges. Subsequently, additional currencies were made eligible adding up to 14, and other

	<p>changes were also made.</p> <ul style="list-style-type: none"> • This facility was used as occasional alternative to the foreign-exchange-secured loan depending on situations of foreign exchange markets, but was discontinued in 1970 due to the same reason with the other BOJ facilities mentioned above.
Japan Export-Import Bank	<ul style="list-style-type: none"> • In 1950, the Japan Export Bank was established to provide long-term export credits. • As the post-Korean War boom made it difficult to import raw materials, facilitation of import of essential materials on a long-term stable basis was felt vital. In 1952, therefore, the Export-Import Bank was established and empowered to finance import as well as export, which the Japan Export Bank had financed. • In 1953, foreign investment financing was added to functions of the EXIM Bank. • In the decade beginning in 1945, long-term export credits were provided only in a small amount because Japan's plant export was not competitive. In the following decade beginning in 1955, export of ships increased sharply accounting for 80 percent of the credit amount. In 1956 thereafter, exports relating to reparation payments to the Philippines, Burma and Indonesia increased, while in 1959 exports related to yen credits started. (Because the Overseas Economic Cooperation Fund (OECF) was established in 1961, functions related to yen credits were transferred to it.) Meanwhile, plants/equipments export on a deferred payment basis was progressively deregulated leading to increased export credit amounts. Afterwards, OECD's guidelines on interest rates and other terms of export credit were agreed upon, requiring, among other things, that an interest rate should be comparable to the market rate. Compliance with the guidelines virtually eliminated advantages of EXIM's export credit at least respecting major terms of credit like an interest rate.

➤ **Tax incentives for export promotion**

Deduction of export income from a tax base	<ul style="list-style-type: none"> • Initiated in 1953, this scheme authorized a trading company or maker to deduct a certain percentage (1 percent for a trading company, 3 percent for a maker, and 5 percent for a plant/equipments manufacturer) of export revenues from taxable income within 50 percent of export income. These
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	<p>percentages were often modified in later years.</p> <ul style="list-style-type: none"> • However, because this scheme obviously violated the GATT rule prohibiting export subsidy, it was discontinued in 1964 in connection with elevation of Japan to an “Article-8 country” of the IMF Agreement.
Reserve for export loss	<ul style="list-style-type: none"> • Initiated in 1953, this scheme enabled a trading firm to reserve 5 percent of contracted export values for losses to arise from canceling and claims in future and charge the reserved amount to a loss. The reserves must be depleted in 5 years. This scheme was discontinued in 1964, as the export income deduction scheme was.
Deduction of income arising from international transactions of technologies and so forth	<ul style="list-style-type: none"> • Established in 1959, the scheme authorized deduction up to a certain percentage of technology export revenues from a taxable income within 50 percent of income arising from technology export. The scheme survived even after the export income deduction scheme was discontinued, and was renamed as written in the left column, covering consulting and transportation services in addition to technology export. Furthermore in 1965 and thereafter, a variety of service transactions including construction was made eligible as well. The percentages were modified from time to time. • Because of persistent surpluses in the international balance of payments, the scheme was discontinued in 1972 except for export of industrial property rights and technological services. The percentages of deduction ceilings were reduced in later years (currently, 7 percent of revenues for industrial property rights, and 12 percent for technological services).
Accelerated depreciation in relation to export (international transactions)	<ul style="list-style-type: none"> • Initiated in 1961, the scheme authorized accelerated depreciation with a ratio corresponding to a certain percentage (up to 80 percent according to the amendment in 1964) of an export ratio against total revenues. In 1968 and thereafter, technology export was also made eligible for the calculation of the export ratio. • Because of persistent surpluses in the balance of payments, the scheme was discontinued in 1972.
Reserve for development of foreign markets	<ul style="list-style-type: none"> • The scheme was introduced in 1964, when the export income deduction scheme was abolished. The scheme authorized a trading company or maker to reserve up to a certain percentage of revenues arising from international transactions (initially, up to 0.5 percent for a trading company, 1.5 percent for a maker, subject to modifications from time to time in later years). A certain percentage of outstanding reserves had to be depleted every year. Replacing the certain percentage

	<p>mentioned above requiring mandatory depletion, the amendment in 1966 set forth a maximum amount of cumulative reserves, which was to be calculated by multiplying export revenues with a specified percentage.</p> <ul style="list-style-type: none"> • In addition to the above scheme, an SME was permitted to set aside reserve funds jointly with other SMEs. Namely, in the case where an SME contributes funds for such joint reserves to the Society of Commerce & Industry, such reserves were taxable neither to the contributing SME nor to the Society. The ceiling of this payment was set at 2.5 percent of export revenues in the preceding business year of the contributing SME. This scheme was not used often, and was discontinued in 1979. • A merit of this reserve scheme was criticized to be very small in comparison with a huge amount of expenses required for foreign market development including dispatching of a foreign representative. In consideration of persistent surpluses in international balance of payments, the scheme was discontinued in 1972 for a firm whose paid-in capital exceeded a billion yen, and was entirely discontinued in 1990.
Reserve for loss arising from foreign investment	<ul style="list-style-type: none"> • Introduced in 1964, the scheme enabled companies investing mainly in LDCs (acquiring 10 percent or more of equity capital of a foreign company) to reserve up to 50 percent of the invested amount. The reserves were allowed to be kept for 5 years, and had to be depleted in the following 5 years in equal annual installments. • In 1968, countries endowed with oil were made eligible in addition to LDCs. The ceilings were set at 50 percent for LDCs and 10 percent for an oil-producing developed country. At present, only investment for the purpose of natural resources development is eligible.
Accelerated depreciation by a company with eminent export performance	<ul style="list-style-type: none"> • In 1964, the scheme was initiated for recognizing companies with eminent export performance, selected on the basis of a scoring system covering export values, an export ratio against total sales, an export growth rate and the like. In 1973 and thereafter, the recognized company was entitled to apply increased ceilings for the accelerated depreciation and foreign market development reserves. These privileges, however, were abolished in 1971.

➤ **Other export promotion measures**

Export inspection	<ul style="list-style-type: none"> • In 1948, the Export Product Control Law entitled the
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and export product design	<p>Government to set forth the minimum standards for health, sanitation, safety, product purity and quality as well as packaging conditions for 8 products including binoculars and a camera. The Government was also authorized to carry out necessary inspections whenever judged necessary.</p> <ul style="list-style-type: none"> • In 1951, a registration scheme for private inspection agencies was introduced so that the products predetermined by the Law would not be exported without their inspection. • In 1957, the Law was renamed the Export Inspection Law and the control was tightened. Namely, the predetermined products numbering 145 initially and 441 at end-FY1960 were not allowed to be exported without inspection either by Government agencies or Government-designated agencies. • In 1959, the Export Product Design Law was enacted to prevent imitation of export product design. As a result, an organization established by associations of industries producing any of 7 predetermined goods including a fountain pen and camera was empowered to certify export product designs in an attempt to prevent imitation. (For a china/porcelain and textile products, organizations established voluntarily started to take similar certifying measures without recourse to the Law.) • In the early stage of Japan's export promotion, inspection and design certification had a great deal of positive impact on maintaining reputation of our exported goods, and on elimination of foreign Government's excuses for restricting import of Japanese goods. They became less necessary as efforts of private sectors improved quality and reputation of Japanese products. As the number of products subject to these Laws decreased year after year, they were terminated in 1977.
Tariff	<ul style="list-style-type: none"> • duty drawback • bonded area, bonded factory and bonded warehouse

7.1.2 Matters to Be Taken into Account in Application to LDC

- Some of Japan's policy measures for market penetration are judged inappropriate in the light of the current rules of international trade. Furthermore, environment surrounding international trade has changed as exemplified by conclusion of free trade agreements. For these reasons, mere copying of Japan's experiences is inapplicable. In recommending market penetration policy measures, consistency

with such international rules should be ensured and conditions assuring effectiveness of individual measures should be examined.

- While a variety of measures for information supply and consulting is available, not only effectiveness of each proposed measure but availability of complementary schemes should be ascertained. Specifically, the following analysis and evaluation should be made: (a) how the proposed measure was used in Japan, (b) how its effectiveness was evaluated by beneficiaries, and (c) which measures were most effective. On the basis of such an analysis and evaluation, the best measure should be selected.
- Policy measures for market penetration should complement activities of private sectors, and would be effective only when they meet changing SME's needs. Transfer of Japan's experiences should include not only contents of each measure but more basic thoughts like justification of policy intervention per se and ways to reflect beneficiaries' needs.

(For reference) WTO's rules on export subsidy

Export subsidy is defined to be Government's financial support with a specific link with export. It includes not only outright grant but spending Government funds for lending at an interest lower than the market interest rate and for loan guarantee, tax concession and compensation of loss of an export insurance scheme. Nevertheless, the subsidy for the following purposes is acceptable on certain conditions:

- (a) promotion of R&D
- (b) pollution control
- (c) promotion of development of a low-income region
- (d) export credits provided in accordance with an international agreement like the OECD Guidelines

LDCs and countries in transition to market-oriented economies enjoy the following waivers:

- (a) LDCs are entirely exempted.
- (b) LDCs are given an 8 year grace period starting from effectiveness of the WTO Agreement (January, 1995). This period may be extended if WTO approves.

- (c) Countries in transition to the market economies are given a 7 year grace period starting from effectiveness of the WTO Agreement. This period may be extended in exceptional cases if WTO approves.

Extract of Committee Discussions

Questions and Answers

Q: Export promotion measures which Japan executed in the past are not necessarily applicable at present in the light of WTO rules. How should we explain the consistency with the WTO rules to a recipient partner?

A: Though LDCs are given a grace period, after which full application of the rules is obligatory, compliance with the rules on export subsidies should be ascertained in the light of WTO's list of prohibited measures. Business development services like those provided by JETRO do not violate the WTO rules as long as they do not discriminate foreigners. At the same time, examination should be made how Japan's measures in the past were effective and how they were evaluated by users.

7.2 ROLE AND LDC-SUPPORTING FUNCTIONS OF JETRO

Extract of Committee Discussions

- JETRO's support scheme of LDC for export market penetration (5th meeting)
(Mr. Mizutani, JETRO)

(1) LDC's barriers of export promotion

- (a) shortage of human resources equipped with expertise in export promotion policies, in trade business practices, and in English
- (b) shortage of information on foreign markets, foreign customs and import procedures including tariff

(2) JETRO's cooperation scheme

- **Targeting policy**

For export promotion of Japan, JETRO was engaged in information collection, trade consultation, exhibitions and propaganda, targeting specific sectors, products and markets. In other words, JETRO promoted export in the context of industrial policy including infant industry development.

A similar approach was subsequently used by Korea and Taiwan. Many ASEAN countries also founded export promotion agencies modeled by JETRO.

- **Example of cooperation with Thailand**

- (a) in 1972 (around first oil crisis) and thereafter
In these years, the Thai Government began to promote export mainly focusing on processed farm products. At JETRO's advice, a study group on agricultural

and fishery products was organized, participated by representatives of suppliers and consumers. JETRO also helped organize a product fair to introduce Thai products to Japan, and conducted a market research.

(b) in 1979 (second oil crisis) and thereafter

In 1979, Thailand's trade balance and fiscal balance deteriorated. Consequently, JETRO executed a cooperation program for the ASEAN countries consisting of human resources development, product improvement, environmental protection and market penetration.

(c) in 1987 (the Plaza Accord) and thereafter

In 1987 or so, Thai export of manufactured goods and direct investment from Japan expanded remarkably. JETRO began to execute the JOIN Program to help Japanese SMEs invest overseas, as well as the New Aid Plan and Green Aid Plan.

(d) since 1997 (Asian Currency Crisis)

The emergency support for Asian countries' export to Japan was begun, sending Japan's purchase mission to increase Thailand's foreign currency earnings.

• **Export promotion scheme for LDC**

(a) market research:

fact-finding about Japanese markets concerning products, in which a particular LDC is interested

(b) collection of trade information:

supply of information to LDCs about Japan's systems/institutions

(c) provision of opportunities:

sponsorship of exhibitions and fairs

(d) design improvement:

provision of guidance to LDCs about product designs expected to be popular in Japan

In addition to promotion of export to Japan, JETRO provides assistance in ways to promote export to third countries. JETRO also started to disseminate information of LDC's products through INTERNET.

(3) Future course of cooperation

JETRO's cooperation is designed to set targets concerning sectors, products and markets. Currently, JETRO's study group is looking into future courses of its cooperation by analyzing LDC's industries. The study group is using a country-specific approach, an industry-specific approach and their combination. The country-specific approach analyzes an export specialization coefficient and a production specialization coefficient to reveal a specialization pattern of each country. The industry-specific approach is based on the concept of value chains to reveal the position of a particular country in the context of industrial activities. Combining these two approaches and expecting to reveal comparative advantages of each country, JETRO plans to determine its future courses of cooperation.

7.3 ACTIVITIES BY OTHER DONOR COUNTRIES AND AGENCIES

Many other donors are actively engaged in cooperation based on a belief that improved access to market information is of core importance for SME promotion. Meanwhile, other donors are of the view that the highest priority should be given to creation of environment assuring fair competition through deregulation as well as uniform, transparent and simplified enforcement of regulations. According to them, Governments should avoid direct management of institutions like an export promotion center, but should facilitate initiatives by private sectors. Furthermore, concerning institution building for export promotion, other donors emphasize desirability of expertise transfer aiming at financial self-sufficiency and organization strengthening through collection of service fees from beneficiaries.

7.3.1 World Bank

The World Bank provides loans/credits titled “Private Sector Development Project,” “Export Promotion Project,” and the like. The principles underlying these projects may be outlined as follows:

- Regulations impeding export should be abolished or relaxed, and their administration should be made consistent, transparent and simple. Such regulations include: (a) customs clearance and collection of import duties, (b) procedures for duty drawback, (c) procedures for export promotion measures like an export credit, (d) certification procedures like quality control, (e) elimination of monopoly in sectors affecting export like transportation.
- In the case where export promotion agencies or free trade zones are public institutions, they tend to be inefficient. Desirably, they should be privatized or their functions should be contracted out to a private sector. More desirably, a private organization should be chosen as an executing agency from the outset. From 1979 to 1991, the Bank provided 23 loans/credits for export promotion, of which 18 cases were executed by Government agencies. The Bank feels most of these Government-executed projects were ineffective.
- An exporter who is provided services by an export promotion agency established or managed through the Bank’s financing should pay at least a part of the costs (matching grant). Especially in the case where a private sector manages and

operates such an organization following the idea of subparagraph (2), the organization would not be financially viable without collecting fees.

- Institution building encompassing upgrading of expertise of agencies implementing export promotion measures is judged essential and often covered by the Bank loan/credit. Because a staff turnover ratio is high, however, institution building often fails. Without transferring export promoting expertise to exporters, impact would not be sustained. Especially in the case where financial incentives are given to exporters, such incentives should be combined with expertise transfer to exporters.
- Examples of World Bank projects
 - **Jamaica: Private Investment and Export Promotion (1994)**
 - (a) services for a foreign market survey, product improvement and foreign marketing
 - (b) technology upgrading and employee training facilitating investment by new firms
 - (c) a free trade zone established and managed by a private sector
 - (d) improvement of communication services in the free trade zone encouraging use of new information technology
 - **Argentina: Private Sector Export Development Project (1994)**
 - (a) The following consulting services were provided to exporters by a private company contracted by the Ministry of Economy:
 - (i) discovery of export opportunities
 - (ii) improvement of a product or development of a new product meeting requirements of export markets, including, if necessary, upgrading of technical ability and acquiring of QC certification
 - (iii) raising productivity and efficiency for strengthened competitiveness
 - (iv) execution of export promotion measures with involvement of trade associations
 - (b) The following export-related institution building was executed by the Ministry of Economy and other agencies:

- (i) improvement and simplification of such procedures as customs clearance, duty drawback and bonded areas
 - (ii) establishment or improvement of existing schemes for QC certification, export credits and export insurance
 - (iii) upgrading the ability of the National Trade Committee to impose anti-dumping and countervailing duties
 - (iv) upgrading the ability of the Ministry of Economic to formulate export promotion policies
- **Ukraine: Export Promotion Project (1996)**
 - (a) export credit through the Ukraine EXIM Bank (two-step loan)
 - (b) institution building of the Ukraine EXIM Bank
 - (c) provision of expertise enabling the Ukraine EXIM Bank to build a database of tariff rates and custom clearance rules in foreign countries and to supply such information to exporters
- **Ecuador: Export Promotion Project (1996)**
 - (a) institution building upgrading the abilities of Government agencies responsible for export policies including abilities to perform the following functions:
 - (i) duty drawback, standards and accreditation, and safeguard against drastic rise in imports
 - (ii) compliance with the WTO rules respecting export subsidy, non-tariff barriers, rules of origin, and tariff evaluation
 - (b) establishment of a public entity for export promotion as a joint venture between the Government and private sectors, which will perform the following functions:
 - (i) advice on means to strengthen competitiveness
 - (ii) market survey
 - (iii) advice on product improvement, quality improvement, standardization and so on aiming at foreign market penetration
 - (iv) training on marketing, international business laws, QC, trademark establishment and the like

- (v) creation or improvement of schemes of export financing and export insurance
- **Senegal: Pilot Project for Promotion of Agricultural Product Export (1997)**

Experts contracted by the Ministry of Agriculture provided the following services:

 - (a) advice to exporters on:
 - (i) market survey, customer finding, and export credits
 - (ii) product development and QC
 - (iii) linkage with foreign companies
 - (iv) discovery of niche in markets
 - (b) the following assistance to trade associations, vocational organizations, professional associations and cooperatives
 - (i) establishment of farmers' union
 - (ii) information supply
 - (iii) establishment and management of a product packaging improvement center
 - (iv) training in cost accounting and management control
- **Ivory Coast: Private Sector Development Project (1998)**

Organizations led by private sectors such as exporters' association performing the following export promotion measures were assisted:

 - (a) advice to exporters on:
 - (i) feasibility studies of export
 - (ii) technical consulting and training
 - (iii) participation in trade fairs
 - (iv) planning and execution of export marketing
 - (v) invitation of buyers
 - (b) sponsoring regular dialogues by representatives of Government and industry for the following objectives:
 - (i) identification of regulations impeding export

- (ii) proposing details of policy changes including deregulation
 - (iii) monitoring execution of the proposals written above
- (c) provision of the following services and establishment of a trade information center to furnish such information:
- (i) supply of information on foreign markets
 - (ii) supply of information needed for liaison with foreign potential customers and partners
 - (iii) transfer of know-how to use INTERNET
 - (iv) exporter's database building to facilitate electronic access by foreign buyers

- **Bangladesh: Export Diversification Project (1998)**

- (a) advisory services for quality improvement, fulfillment of sanitary and other standards, delivery improvement, training of executives/staff of an exporting company and new market development
- (b) formulation and execution of a medium-term plan (5 - 6 years) to improve procedures for customs clearance and for importing raw materials and intermediate goods needed for exported goods
- (c) review by the Customs Committee of trade policies aiming at further deregulation

7.3.2 EU (PHARE and TACIS)

- PHARE and TACIS (Technical Assistance for CIS) are EU's technical assistance grant programs, of which the former assists 13 Central/East European countries and the latter, former Soviet Union counties. These programs help respective recipient countries transform themselves to market-oriented free economies and establish a wide range of socioeconomic systems/institutions. PHARE's cooperation includes harmonization with EU systems. Within the framework of both programs, numerous projects have already been implemented, including those titled SME promotion, private sector development, and export promotion. In the case where a large amount of financial resources is needed exceeding PHARE's or TACIS' budgets, EBRD (European Bank for Reconstruction & Development) or EU members' bilateral

assistance resources are called for. According to PHARE's Interim Report of Evaluation (June, 1997), EU authorities' thoughts are summarized below. Such views are understood to be applicable with TACIS as well.

- PHARE uses the following SME promotion methods:
 - (a) to help establish and manage an SME promotion agency including a national export promotion agency as well as to help formulate and implement SME promotion policies
 - (b) to help establish and manage a local SME promotion agency and help formulate and implement other SME promotion policies on a local basis
 - (c) to help establish a number of business consulting centers, which provide market information and managerial/technical advice in each local area. (The center was already established in most Central/East European countries.)
 - (d) to help establish and manage a variety of financial schemes
 - (e) to help industry associations conduct SME promotion measures and support SMEs
 - (f) to help establish and manage agencies inducing incoming foreign direct investment

- The Interim Evaluation Report makes the following observations:
 - (a) Projects were ineffective when they went ahead in the absence of established Government's SME policy
 - (b) Local SME promotion centers, which were established in a number of regions, were ineffective where local SMEs were in an early stage of development, but had made a positive impact as a matter of overall evaluation. Before establishing such a center, therefore, the development stage of local SMEs should be confirmed.
 - (c) Not only EU but other donors are of the unanimous view that financing through private sectors is more effective than that through Government agencies, with a reservation that private institutions are not firmly developed in some countries.

PHARE's assistance was effective when it was addressed to making of a business plan needed for loan application.

- (d) Without regard to kinds of projects, sustained impact is questionable. Especially, assistance-receiving agencies are not able to lay sound financial bases without constant inflow of donor's funds. Because of a high rate of staff turn-over, guidance and training for institution building have a limited sustainable impact.
- (e) Though agencies attracting incoming foreign direct investment were established in many countries, a causal relationship between agencies' activities and investment actually made is not necessarily identified. The impact of export promotion agencies is also general, and export performance is not necessarily attributable to activities of the agencies.
- (f) For SME promotion, establishment/improvement of legal systems, administrative systems and money markets are the most effective. While financing is the second-most effective, consulting and information services are less effective than the other two.

➤ **Examples of project**

• **Ukraine: establishment and management of Business Communication Center (BCC) and SME Development Agency (SMEDA) (1992 - 1993)**

- (a) BCC supplies information on foreign markets to SMEs and information on Ukraine markets and investment climate to foreign potential investors. SMEDA provides SMEs with information, consulting, training and advice on business planning. BCC and SMEDA were established in Kiev and Zaporozhie.
- (b) While SMEDA in Kiev is judged successful, BCC in Kiev and SMEDA in Zaporozhie were unsuccessful, partly because in Zaporozhie SME development was immature.
- (c) The Project counterpart was initially private managers' association of Ukraine, but was later replaced by SMEDA, which contracted out its functions to a private company. Because the Project manager was replaced from time to time, the impact was not sustained.

• **Georgia: Export Promotion Centre (1999 - 2000)**

- (a) TACIS assisted establishment/management of the above Center, of the SME Promotion Agency combined with dispatch of long-term experts, of a Business Support Center and of Business Management Advisory Center.
- (b) Established in April, 1999, the Export Promotion Centre has 7 staff members including long-term experts sent by EU. Its major functions include information supply, subsidy to experts' trip to importing countries (6 weeks), and an annual workshop. The Centre gives priority to 11 products including wine, which is considered most hopeful at present. Regarding wine, at Centre's request, JETRO completed a market survey in Japan last year mainly on regulations.

- **Hungary: Local Enterprise Support Network (1993)**

Choosing the Hungarian Enterprise Development Foundation as the counterpart, the Project provides local SMEs and start-up planners with the following support:

- (a) encouragement of use of technical information for improvement of SME's market access
- (b) upgrading ability of SME entrepreneurs through training
- (c) supply of information concerning legal systems, financing, marketing and trade

For this purpose, about 100 contact points were set up throughout the country, providing 41,000 cases of consultation in 1993 alone.

- **Slovakia: Subcontracting Exchange Scheme (1997)**

PHARE assists in establishment/management of three financing schemes (for an SME, for a small enterprise and for a micro-enterprise, respectively) as well as the Subcontracting Exchange of Slovakia (SES) for subcontracting promotion. SES supplies information to help foreign companies find Slovakian partners and helps Slovakian companies find foreign partners. SES also support Slovakian firms participating in foreign trade fairs, foreign firms visiting Slovakia, and other exchanges between Slovakian firms and foreign firms.

- **Several Central European Countries: Streamlining Customs Clearance Procedures**

In order to expedite, simplify and harmonize the procedures, PHARE provides the following support:

- (a) computerization of self-declaration and other procedures
- (b) supply of detecting equipment to prevent smuggling and other illegal clearance
- (c) enactment of tariff laws harmonized with EU laws
- (d) training of customs officers

Effectiveness of this Project varied from country to country. Generally speaking, equipment supply was rarely successful when it was executed without combination with other measures, but effective when it was combined with cooperation in software application.

7.4 COLLABORATION BY DONOR AGENCIES

➤ For effective implementation of support for market penetration, donor agencies concerned need to cooperate especially in the following measures:

- (1) establishment of basic systems/frameworks
 - (a) stabilization of macroeconomy
 - (b) formulation of appropriate foreign trade policies
- (2) strengthening of inter-firm linkages, export promotion and investment promotion
 - (a) simplification and enhancement of transparency of administrative procedures affecting business transactions
 - (b) improvement of infrastructures and provision of incentives for development of industries
 - (c) export credit and export insurance
 - (d) capacity strengthening and human resources development of trade promotion agencies and investment promotion agencies
 - (e) creation of institutional frameworks for electronic commerce
- (3) cooperation for individual companies
 - (a) support of development of products and design
 - (b) support of sponsoring trade fairs and fairs for purchasing materials/components
 - (c) information supply for international business

- (d) training of personnel assigned to trade practices

Extract of Committee Discussions

- Issues relating to investment/trade promotion and to closer collaboration among donor agencies for SME promotion (5th meeting)
(Mr. Koizumi, Koei Research Institute and leader of the JICA-sent study mission for industry development and investment promotion in Sri Lanka)

(1) Profile of Sri Lanka

Since 1977, Sri Lanka has been transforming herself to the market economy. Because of the recent fast growth, GDP per capita in 1998 reached \$800. SMEs contribute to 60 percent of manufacturing sector's GDP and 65 percent of employees in the sector. Her trade policy has been more liberal than other south Asian countries. Because of the internal disorder, defense expenditures account for 19 percent of fiscal outlays. As education and medical services are provided free of charge, Government expenditures for these services amount to 20 percent of the total outlay causing serious fiscal deficit.

Sri Lanka's import is being liberalized progressively. In 2005, the import quota system of textile products is to be removed; in 1999, a free trade agreement was concluded with India: in 2008, a free trade agreement among SAARC countries (SAFTA) is due to become effective.

(2) Options for cooperation

Under such circumstances, a future course of industrial development of the country has been subject to debate. Sri Lanka has become so-to-speak a display room of a number of economic cooperation agencies. While the World Bank and IMF advocate a framework approach emphasizing macroeconomic stability and legal and other system building, the Japanese Government support an ingredient approach focusing industrial development. US/European economists have already been sent to the country, and hopeful sectors are being assisted with an aim at stronger competitive edges. On the other hand, productivity of individual factories is low.

(a) World Bank

The Bank provided credits for industrial development totaling \$180 million.

(b) Japan

The former OECF provided small firms with a two-step loan and is helping build an industrial estate, following a JICA-sponsored study. In the context of industrial master plan making, studies in industrial development and investment promotion are being conducted. Furthermore, technical assistance on a project basis to a textile center and a forged iron center is being provided. JETRO and JODC are sending experts actively.

(c) Asian Development Bank

ADB and the World Bank co-financed SME development. ADB is thinking about another loan. Concerning technical assistance, ADB is assisting private sector development.

(d) UNIDO

UNIDO has provided 11 integrated programs for industries, one of which was made in collaboration with JICA's development study.

(e) GTZ, USAID

GTZ combined technical assistance and a loan for hopeful sectors. USAID sent an economist to execute a competitiveness-strengthening project.

(3) Promotion of investment and trade

Though Sri Lanka's investment incentives are satisfactory, investment is not active at present due to racial antagonism. Export is not being subsidized.

(4) Issues of cooperation

(a) While discussions on policy planning should precede other discussions, useful literatures and discussions on policies are scarce. Therefore, in carrying out studies in Sri Lanka, it is difficult to know which policies are to be recommended. For example, which of a framework approach or an ingredient approach is better? In connection with the recent development study, experiences in neighboring countries were exchanged by lecturers coming from these countries. This session was generally evaluated useful.

(b) Japanese donor's cooperation should be closely coordinated. For example, JICA's industrial development master plan formulation followed JBIC's loan. The sequence, however, should have been reversed.

(c) For SME financing, the Japanese cooperation blends a low-interest loan and high-interest loan to enlarge the entire loan amount. Such a scheme may be worth considering for other countries as well.

(d) Regarding combination of a loan and technical assistance, the current two-step loan of JBIC includes interest-free lending for technology transfer, but borrowers are not very interested in this portion of the loan. A better way may be to collaborate with JICA and other technical assistance agencies.

(e) At present, JICA's development study is being conducted in collaboration with UNIDO. However, because of complicated procedures of both organizations, timings of their actions are not necessarily synchronized. A realistic way of collaboration may be to divide responsibilities by phases of implementation.

8. SUPPORT OF PROVISION OF MANAGERIAL AND TECHNOLOGICAL EXPERTISE

8.1 JAPAN'S EXPERIENCE AND ITS APPLICATION

8.1.1 Japan's SME Business Development Services

➤ Management Consulting Service

Management Consulting for SMEs was started in FY1958 by Governments of prefectures and major cities designated by a Cabinet Order. Between FY1946 and FY1948, each local Government set up an Integrated Guidance Center for SMEs (official names differed from locality to locality), where management guiding personnel was assigned to serve as the core staff collaborating with SME management consultants (to be described later) and other experts. Since FY1979, an SME Local Information Center has been established in each prefecture and major city designated by a Cabinet Order, furnishing information in collaboration with management consulting agencies. While the consulting exclusively concerned factory operations initially, it now deals with the following variety of contents:

- (a) for individual SME
 - (i) structural adjustment (financial stabilization of management, business innovation, foreign business, etc.)
 - (ii) information technology
 - (iii) energy saving and environmental protection
 - (iv) factory operations
 - (v) mine operations
 - (vi) retail shop management
 - (vii) labor relations and employee's welfare
 - (viii) facility modernizations
- (b) for a group of SMEs
 - (i) structural adjustment
 - (ii) information technology
 - (iii) industrial estates
 - (iv) commercial estates

- (v) modernization of shopping streets
- (vi) chain formation of retailers
- (vii) factories for joint operations
- (viii) company merger
- (ix) cooperative business by retailers
- (x) introduction of facilities for joint use

SME management consulting consists of the following two kinds: (a) consulting for promotion of modernization, which is addressed to (i) those who are willing to be financed pursuant to the SME Modernization Promotion Law and to (ii) those who are willing to borrow the Upgrading Fund and receive other financial assistance from the Small Business Corporation, and (b) other consulting without connection with financing.

The central Government support to local Governments providing SME management consulting consisted of subsidization of expenses for hiring management consultants and other working expenditures for many years. Since 1983, however, the personnel expenses have no longer been subsidized.

For SME management consultants, who are the core player of this policy measure, a registration scheme was introduced in FY1952. While registration was initially made based on document examination, tougher qualifications were introduced in FY1969 requiring applicants to pass a test given by the Small/Medium Enterprise Management Consultants Association and to have undergone certain experiences. At present, the registered management consultants totaling 16,000 deal with manufacturing, commerce or information.

The SME management consulting is based on the Small and Medium Enterprise Guidance Law (1963). According to the amendment bill decided by the Cabinet in February 2000, it is due to be renamed “Small and Medium Enterprise Support Law” to eliminate a connotation of top-down measures. The amendment bill is also designed to facilitate mobilization of private sector expertise through collaboration with SME organizations and consultants in local private sectors. Furthermore, in order to enable management consultants to address increasingly diversified management problems faced by SME entrepreneurs, the bill is designed to improve examinations and on-the-spot training needed for registrations.

➤ Management Improving Extension Service

Starting in FY1960, the Management Improving Extension Service is provided by the Chamber of Commerce & Industry and Society of Commerce & Industry for improvement of management and technology of small firms (employing 20 persons or less for manufacturing, and 5 or less for commerce and service).

At the Chamber and Society, a management guiding expert plays a central role. His/her qualifications are, among other things, experiences in guidance in commerce/industry or in actual management. Besides about 8,700 management guiding experts, assistant management consultants and book-keeping specialists are serving throughout the country. A part of their personnel expenses is subsidized by the Government.

Management guidance covers an extensive range of subjects such as financing, taxes, accounting, labor and transactions. They deal with a little less than 6 million cases in a year, of which about 40 percent concern financing and taxes in a typical year. In order to be eligible for the Small Firms Management Improvement Financing Scheme started in FY1973, an SME is required to receive the above guidance.

The service of this Scheme is provided without a charge to a small firm regardless of its membership of the Chamber/Society of Commerce & Industry.

➤ (3) Local SME Support Center

As a new policy measure initiated in FY2000, the Local SME Support Centers furnish managerial advice to small firms or those planning start-up. The Center models itself on SBDC (Small Business Development Center) in the US, and is designed to function as a managerial consultation window managed at an initiative of private sectors including private universities. Most of the Centers to be established in FY2000, however, will be led by the Chambers/Societies of Commerce & Industry. As a matter of policy, as many private sector experts as possible will be employed, and more centers will be led by private sectors in future.

➤ (4) Training

In FY1962, the Small and Medium Enterprise Guidance Center was established as a foundational judicial person for training of staff of local Governments and SME associations like SME consultants instructing SMEs in local areas, which became a public entity in FY1963 when the Small and Medium Enterprise Guidance Law was enacted. Based on the principle that local Governments were primarily responsible

for SME training, the Center's SME training initially focused on subjects beyond the capability of local Governments such as high level technical training.

In FY1967, the Center was merged by the Small Business Corporation (then named the Small Business Development Corporation) and became the SME Training Institute of the Corporation, which, in FY1980, was reorganized into the Institute for Small Business Management and Technologies. The Institute was subsequently founded in each of 9 regions.

Meanwhile, each prefecture and major city designated by the Cabinet Order initiated the SME Manager Training Scheme in FY1963, to which the central Government granted subsidies. In later years, various schemes were added such as those for commerce (FY1967), information (FY1987) and start-up (FY1995). Trainees in FY1995 totaled about 4,200.

8.1.2 Technical Guidance to SME in Japan by Public R&D Institutions

- National/prefectural R&D institutions play a major role in technical guidance to SMEs.
- Government research activities started in the early Miji Era when state manufacturing enterprises operated R&D laboratories. The first national independent R&D institution was the Insulator Research Institute founded in 1875. Later in 1900, Tokyo National Research Institute was established as the first national R&D institution covering the entire manufacturing sector. As technical guidance to private companies was a major function of the new Institute, the number of tests, analyses and gauging requested by private sectors and conducted by the Institute totaled 918 during the first decade since its inception. In addition, the Institute made great contribution by making and selling sophisticated products like synthetic dye staff and nitric acid that private companies were not able to make, and by conducting R&D using advanced technologies. In 1918, the Institute began to let private companies use its equipments, and in 1928, began to lend its equipments to private companies in accordance with its open laboratory program.
- In 1918, the Osaka National Research Institute was established followed by a dozen of regional and sector institutions performing similar functions.

- In 1901, the Ministry of Agriculture and Industry decided by promulgating its Ministerial Order to promote establishment of prefectural R&D institutions, specifying the following guiding and disseminating functions of technologies:

visiting lecture

distribution of product samples

analysis, testing and appraisal of materials and products

gauging of equipments

response to technical questions

- In the following decade, 14 prefectural institutions were established, and by 1924, 65 were built covering nearly every prefecture.
- In the post-War period as well. the national institutions continued to provide guidance and consultation by setting up a technical consulting office as well as by visiting individual companies. In 1980 and afterward, annual cases of guidance numbered around 1,000, and those of consultation around 10,000 as shown below.

	<u>Guidance</u>	<u>Consultation</u>
FY1980.....	577	9,486
1985.....	1,130	12,591
1990.....	875	11,715

- The institutions have also attempted to disseminate technical expertise by organizing lecture sessions and presentation sessions and by publishing journals. For example, starting in 1950, the institutions actively repeated for some years discussion meetings, seminars and lectures in quality control.
- In addition, the institutions conducted contracted research, tests, analyses, gauging and joint research with private sectors and universities. The number of joint research projects stayed between 20 and 40 in most of the post-War years, but has sharply increased in the 1990's exceeding 200, partly because MITI has encouraged joint research by private companies, universities and public research institutions for "R&D in important local technologies," "SME-supporting R&D" and "venture-supporting R&D". (Please see the table below.)

FY1965.....	9
1970.....	40
1975.....	21

1980.....	23
1985.....	85
1990.....	229
1991.....	251

- When the institution acquired patents and other industrial property rights, willing private companies are authorized to use these rights through the predetermined procedure. Recently, such cases number roughly between 500 and 700 annually.
- Public R&D institutions in prefectures and large cities total 147 in the industrial sector, employing about 5,000 technical staff (as of FY1999). While some of them cover the entire manufacturing sector, others are specialized in local industries like ceramics, garments and food-processing. Like the national institutions, they contribute to private sectors, particularly local SMEs, by performing guidance, tests at requests, provision of open laboratories, lectures and training as well as authorizing use of industrial property rights.

8.1.3 Guidance Including Technical Advice by Small Business Corporation

Extract of Committee Discussions

- Features of Japan's business development services
(Guidance including technical advice by Small Business Corporation) (6-th meeting)
(Mr. Ohno, Small Business Corporation)

Among Japan's business development services, which are complicated and diverse, the service by the Small Business Corporation is summarized below.

(1) Guidance, financing and equity investment for promotion of the "Structural Grade-up"

(a) outline

This scheme aims at SME's structural upgrading by means of loan, guidance and other measures. During the period from the early 1960's to mid-1990's, the scheme functioned as a successful tool for SME development. The scheme makes a special credit to promote SME's grouping and joint operations, requiring management consulting before receiving the credit.

(b) Uniqueness

- (i) Combing a credit and management consulting, the scheme helps SMEs improve their plans.
- (ii) The credits are made in concessional terms: a 2.1 percent interest rate and 20 year repayment period.
- (iii) The central Government and local Government (prefectures and major cities) collaborate each other.

(iv) The scheme aims to achieve a wide range of objectives: to organize SMEs, to raise productivity, to choose better locations, to improve environment, to execute a sector modernizing plan, to make an urban development plan, and so forth.

(c) Records of assistance (as of end-March,1999)

total lending:	4,137,200 million yen
major project components:	industrial estate458
	wholesale/retail estate194
	jointly-operated factory.....412
	jointly-operated retail shops...720

(d) Remarks

The scheme was initiated on the basis of a recognition that SMEs were too small and existed in too large numbers. In other words, the purpose at the outset was to encourage SMEs in the same sector to cooperate or operate jointly in order to enable them to enjoy the economies of scale and to narrow a productivity gap between large firms and themselves. At present, however, the prerequisite that assistance-requesting SMEs must belong to the same sector is being relaxed, and encouragement of expanding strengths of an individual SME is being emphasized. When this scheme is explained to a foreigner, a question is often raised why the Corporation requires cooperation with competitors. Such cooperation sounds strange to some foreigners.

(2) Information supply

(a) SMIRS

SMIRS (Small Business Management Information Research System) builds a database of information needed by SMEs, supplies such information to SMEs through the on-line service systems of the Local Information Center. Because of recent popularity of INTERNET, SMIRS has been remodeled into an information retrieval system.

(b) GIN Net

GIN Net (Global Information Network) is designed to integrate information needed by SMEs among G7 (Group of Seven) countries. GIN Net is being administered by the Japanese Government, specifically, the Small Business Corporation, which is serving as the contact point. Recently, Asian countries have joined in the scheme.

(c) Sending experts

The Corporation sends experts to guide LDCs in information technology, introduction of energy-saving facilities, environmental control and measures for safety.

(3) Support of technological development

While the Corporation has supported technological development for many years, its methods have changed as years passed by. In its early stage, the Corporation developed

machineries and equipment on behalf of SMEs at their request. At present, however, the Corporation encourages creative R&D conducted by SMEs themselves by financing projects selected through evaluation of proposals in response to public announcement.

(4) Human resources development

The Corporation has set up an Institute for Small Business Management and Technology in each of the 9 regions throughout the country for human resource development in the following fields:

(a) management

While the Institute has been mainly engaged in training of management guiding experts belonging to prefectural Governments, the Chambers/Societies of Commerce & Industry as well as management consultants, it stepped up training of SME managers directly since around 1980. Currently, it also trains those who wish to start a business as well as those who have started a business recently.

(b) Technical training

The technical training targets those who guide or instruct SMEs and SME entrepreneurs/managers, covering automating technology and labor-saving technology.

(c) Features

The Institute provides every trainee with lodging in the campus. Besides lectures and desk work, practical training is provided emphasizing trainees' participation and trial.

(d) Remarks

Companies sending a trainee are required to pay a tuition. Companies are willing to pay because trainees are expected to continue to work for them because of the long term employment system as has been customary in Japan. Companies in other countries, where job hopping is customary, are not likely to pay tuitions for their employees. Attention needs to be paid to employment practices in each country.

(5) Questions and answers

Q: In the case where SME's cooperatives borrow funds for Structural Upgrading, is personal guarantee required?

A: Because the Structural Upgrading funds are for facilities/equipments, the assets to be introduced through financing and land are secured as collateral. In the case where a member of cooperatives borrows the funds, the Corporation asks another member of the cooperative to guarantee the debt jointly.

Q: Has the Institute ever admitted a foreign trainee?

A: Training of foreigners is not practicable at this stage. Though training of foreign civil servants might be done, training language and contents would have to be made international. Such internationalization will remain a future task for the time being.

8.1.4 SME Management Consulting and Cooperation for Training of Management Consultants in LDC

Extract of Committee Discussions

- Training of SME management consultants in foreign countries (6-th meeting)

(1) SME management consulting scheme (Mr. Utagawa on behalf of Mr. Kikuchi, SME Management Consultants Association)

Regarding a case report of the project for formulation of a business management consulting scheme in Thailand, the following two points need to be noted. First, not only an LDC but a developed country should learn about SME promotion from experiences of other countries. In the past, the US learned Japan's experiences, and now the Japanese are learning US experiences. Second, though management consulting lays a foundation of SME promotion, it would be ineffective by itself. As financing and guidance are combined, Japan's SME policies usually combine two or more measures. Such combination appears to be effective.

The Management Consultants Association is willing to continue to support LDCs. Because each consultant is specialized in diversified fields, a suitable consultant has to be chosen in response to specific expertise requested by a recipient.

(2) Case report — Project for supporting formulation of management consulting scheme in Thailand (Mr. Kawano, Real Process Research Institute)

(a) Background and significance

The Japanese Government started to support the Industrial Structural Reform Project of Thailand (so-called "Mizutani Project") triggered by her currency crisis. In order to solve problems faced by SMEs, the Project makes a two-pronged approach, enactment of the SME Promotion Law and formulation of concrete policy measures for SME promotion. The formulation of a management consulting system aims to serve the latter objective.

(b) Project

- (i) formulation of a management consulting scheme including that for registration of consultants.
- (ii) training of management consultants
- (iii) consulting and guidance for individual companies (targeting 160 or more)
- (iv) production of managerial indicators

For the Project execution, JICA, JODC and TPA (the Japan-Thailand Economics and Technology Promotion Association) have dispatched experts cooperating in consultant's training courses and consultation with companies. Actual practices of consultation have revealed that Thai SMEs need better intellectual managerial resources, strengthened abilities and international competitiveness. Concerning 44 percent of the Thai companies examined by these experts, improvement in business management has been judged the most urgent.

(c) Future courses of LDC's SME policy and of donor's cooperation

- (i) A common premise should be established that an SME is an engine of economic growth.
- (ii) A systematic policy should be formulated and a mechanism for its continuous execution should be established.
- (iii) A reliable counterpart of cooperation should be identified.
- (iv) Information on past practices should be shared by a donor and recipient and analyzed.
- (v) Suitable cooperation should be made depending on the phase of cooperation: for example, whether it is in a stage of basic planning or that of execution. This distinction is particularly important when situations in a recipient is unknown to a donor.

(d) Questions and answers

Q: While cooperating with a Thai company, did you feel that Thai culture concerning product quality and manufacturing was different from ours?

A: The Thai are not good at collaboration, preparation and arrangements. Their sincerity and attitude, which are bases of learning, were also different from ours.

Q: According to an increasingly influential opinion from a viewpoint of more use of market functions and of the private sector, the public sector should refrain from intervention in private business. In this context, were the Thai not opposed to the management consulting scheme?

A: Because there are a number of private management consultants, the idea is not entirely alien to them and they were not opposed to it. Perhaps the private management consulting business is not yet established firmly enough to resist introduction of the public management consulting scheme.

Q: For the purpose of subcontracting development as well, management consulting is useful. However, without knowing multi-national firms, a consultant would not be able to make a proper judgment. Are there many such consultants in Thailand?

A: In Thailand, subcontracting is not extensively used except for car making. In the training of management consultants, international aspects of business such as international accounting standards are taught, but subcontracting is not specifically focused.

Q: Do you expect that the management consulting system will have sustained impact in Thailand? Is it designed to be extensively used by Thai companies including those owned by the ethnic Chinese?

A: Sustainable impact is not easy to realize. However, a Thai management consultant is required to pass a national examination, while a Japanese consultant is required to be registered by the Minister of International Trade and Industry. On this account, the Thai scheme is superior to the Japanese. Thai companies run by the ethnic Chinese need to adapt themselves to international business practices. For example, their old-fashioned

accounting practice has to be modernized so as to satisfy the international standards. In such areas, they may demand services of a management consultant.

8.1.5 Business Development Services through Public Technological Agencies in LDC

Extract of Committee Discussions

- Current situations of managerial/technical business development service schemes in Mexico and Japan's cooperation – report of a development study (6-th meeting)

(Mr. Moriguchi, Unico International)

(1) Project outline

The ultimate objective is to raise technological abilities of Mexican supporting industries. Accordingly, under this Project, public technological agencies personnel visited makers of the supporting industry to raise their technological abilities. Two agencies were chosen for intensive efforts in the 2 year period of the Project implementation.

(2) Project implementation

The Project was designed to transfer to the public agencies technologies in pressing, plastic molding (including mold making) and production control. The personnel of the public agencies visited makers accompanied by the members of our study mission in an attempt to establish a visiting guidance scheme. A manual was produced respecting the technologies to be transferred and methods of visiting guidance, so that it would be used in the process of future activities of the public agencies.

(3) Situations after completion of the Project

The Project was completed in November 1999, and a follow-up survey was made in January-February in 2000. One of the two public agencies has made progress in institution building and continues to provide the services. In the other agency, because internal support of the service provision has not been adequate, its services have not been active. In our feeling, therefore, institution building of implementing agencies makes difference in effectiveness. Furthermore, availability of funds for sustained services and incentives of staff are needed.

(4) Observation after Project completion

For the purpose of development of supporting industries, strengthened technology servicing agencies, either private or public, are obviously essential. Meanwhile in Mexico, public agencies' budget appropriations are being cut without discussing rationale of their functions. Such discussions in details among Government and business circles should precede across-the-board budget cuts. Through such discussions, the role of the public sector should be identified and supported by specifying such areas like transfer and dissemination of basic manufacturing/processing technologies that cannot rely on market mechanisms.

(5) Questions and answers

Q: Do you expect the visiting guidance scheme to be sustainable in Mexico? Do you feel it necessary for assistance of this kind to be combined with assistance for development of product markets in order to ensure sustainability?

A: The 2 year implementation of the Project is certainly not enough to enable the public agency to guide companies producing with OEM arrangements. This limitation, however, does not deny their role to guide other companies in the case where only public agencies are in a position to guide. Even technologies transferred only in 2 years have been actively demanded by SMEs. While needs for product market development is undeniable, the Project concentrated its efforts upgrading of key technological skills and their transfer to the supporting industries.

8.1.6 Matters to Be Taken into Account in Application to LDC

- Business development services for SMEs have been for a number of years one of Japan's core SME policy tools as well as financial and SME-organizing support. Expertise and human resources in guiding SMEs accumulated through practices for many years by SME management consultants will meet in a unique manner requirements of SMEs in LDCs lacking fundamental management know-how. On the other hand, such services have been effective because they have been facilitated and complemented by Japan's unique corporate culture and other policy measures.
- The SME management consulting scheme was originated in prefectural Governments, which planned to train civil servants guiding SMEs, and was subsequently privatized in response to economic development. In an LDC where local Governments are not strong enough to have capable staff and organizations, creating the scheme copying our experience would not generate a sustainable impact. The scheme needs to suit situations of each country corresponding to availability of capable human resources and organizations of a counterpart agency, areas to be served by consultants to be trained and situations of companies to be guided.
- Notably, Japan's business development services have had synergy effects because of combined execution with SME-organizing measures and financial assistance. For example, guidance and financing for Structural Upgrading combined financing and guidance as well as tax concessions, generating a number of successful cases. This measure provides concessionary credits for grouped business operations by SMEs, for which going through management consulting was made a pre-requisite for the financing.

- Making up for commercial bank's inadequate appraising capacity, combining business development services and financing, is likely to be effective in LDCs. On the other hand, because financial institutions in LDCs tend to be reluctant to make a loan commitment under the influence of outside experts, collaboration between development service agencies and lending agencies is not necessarily easy. During donor-recipient Government dialogues, confirmation should be made that, without Government commitments to SME promotion and comprehensive policy execution, synergy effects of related measures would not be hoped for. In combining financing and business development service, however, a care should be taken to prevent the development service from becoming unduly preoccupied with assistance for getting financing.
- Training of SME managers and technicians provided by the Institute for Small Business Management and Technology and other agencies assumes that a company trains its employees at its own expenses. The assumption is not necessarily valid in countries where the long-term employment of the Japanese style is not customary.
- While the Japanese Government has allocated a large amount of fiscal resources to disseminate business development services, LDCs suffering financial deficits are unable to spend substantial funds. For the purpose of sustained services of public agencies, a portion of the cost should be recovered. Consequently, a service provider should earn profits by collecting enough fees from large/medium firms and provide small/micro firms with free or low fee services. In order to provide services appreciated by large/medium firms, the service provider should have useful expertise.
- In view of the worldwide trend toward advocacy of free markets and a small Government, the role of public technology supporting agencies in the long-run perspective of economic cooperation is subject to debate. In retrospect of Japan's experience as well, the role of public technology agencies has become smaller in response to development of private industrial sectors. Namely, subcontract-awarding large companies and other business partners have come to play a large role in technology transfer to SMEs. Depending on the stage of development and sectors to be assisted, an optimum blend should be found combining direct execution by the public sector and creation of environment encouraging private sector's initiative.

8.2 ACTIVITIES OF OTHER DONOR COUNTRIES AND AGENCIES

- The activities in business development services by other donors are reflected in discussions of the Committee of Donor Agencies for Small Enterprise Development, which has met about once a year since 1979 under the sponsorship of the World Bank. In 1995, the Committee decided on the guideline for selection and support of financial intermediaries for SME financing. Subsequently in 1988, the Committee also adopted the provisional guideline for business development services (BDS). In addition, the Committee is currently discussing sustainability and methods of measuring the performance of BDS-providing agencies.
- The guideline on BDS was made under the influence of the dominant view shared in the international community that donor-financed BDS should be provided not by a public agency but by private sectors. Notably, this premise widely deviates from Japan's usual approach. Among views largely shared by members of the Committee, the followings are worth noting:
 - (a) The conventional direct support of SMEs by Governments or donors is judged to have failed in terms of both provision of high quality service and extensiveness of outreach.
 - (b) Accordingly, the member donors share the view that BDS should be provided by the private sector on the basis of market mechanisms.
 - (c) The Government agency should play only a limited role, filling a gap where market mechanisms do not work and providing public assets. Consequently, BDS should be mainly provided by the private sector.
 - (d) The actors in the BDS market are SMEs, service providers and service facilitators. Consisting of private companies, NGO, trade associations and Government agencies, service providers provide services directly to SMEs. Being either domestic or international organizations usually financed by a Government or foreign donors, BDS facilitators support BDS providers by developing new services, identifying successful cases. evaluating and monitoring.
 - (e) The gist of indicators measuring performance of BDS organizations is as follows:

- (i) The indicator is to measure whether both each BDS service and entire operations of a particular BDS organization are financially self-sustained. (the ratio between service revenues and costs)
- (ii) The indicator is to measure whether SME's performance has improved continuously. (the survival ratio of SME)
- (iii) The indicator is to measure the scale of services as well as extensiveness of outreach among SMEs usually lacking access to BDS. (the number of companies and persons serviced)
- (iv) The indicators is to measure impacts of BDS, (the start-up ratio among those who have been serviced, the employment growth rate, the revenues growth rate, the percentage of poverty alleviation, or the number of repeat users)
- (f) The Committee is also discussing ways and means to develop markets where BDS are expected to be sustainable as well as indicators to measure efficiency of such markets.

FEED of OECD has also made the guidelines summarized below for BDS for new small firms. Their basic principles agree with the guidelines of the Committee of Donor Agencies described above.

- (i) BDS should be run like commercial operations.
- (ii) BDS should be designed based on SME's needs and provided everywhere in a manner flexibly meeting SME's requirements.
- (iii) As in an early stage as practicable, the private sector should participate in BDS in preparation to play a major role in the long run.
- (iv) With a view to realizing self-sustainability, BDS planning should facilitate mobilization of multiple sources of financing including local resources.
- (v) Training of BDS staff and operations of BDS should be supported by donors.

(For reference) BDS in the US and Europe

Source of Information: Small Business Research Institute, Studies into SME Policies and Situations of SME in Development Countries, and others.

➤ USA

(a) Small Business Development Center (SBDC)

The Small Business Administration (SBA) support SBDCs established by private sectors including companies, colleges and State Governments. More than 1,000 SBDCs throughout the country provide SMEs or individuals wishing to start business with managerial counseling covering marketing, financing, accounting and other matters as well as with technical assistance.

(b) Business Information Center (BIC)

At BIC, SCORE (to be mentioned below) and other organizations used by SBA provide SME with advice and research services using market research databases and other information sources. In such a case, SBA support BIC. There are 45 BICs in the country.

(c) Service Corps of Retired Executives Association (SCORE)

SCORE provides SME with advice and training without a charge, while SBA is supporting SCORE's activities. About 12,000 volunteer retirees are organized into 700 SCOREs throughout the country.

(d) Export Assistance Center (USEAC)

USEAC is managed by SBA collaborating with the Department of Commerce, EXIM, AID and others, providing exporting SMEs with information needed for exporting including export credits and potential foreign partners. USEAC has 19 offices in the US.

(e) Export Legal Assistance Network (ELAN)

ELAN is managed by SBA, the Department of Commerce and National Bar Association, providing exporters with free answering services to legal questions concerning export by lawyers with professional knowledge in exporting.

➤ EU

(a) European Information Center (EIC)

EICs are located in 227 places throughout 15 member countries of EU, supplying information to SMEs.

(b) BC-NET (Business Cooperation Network)

BC-NET is a computerized information network providing SMEs looking for foreign partners with advice by counselors.

(c) Bureau de Rapprochement des Entreprises (BRE)

Making use of the network of 500 correspondents (organizations and agencies) in more than 70 countries in the world promoting SME's international linkages, BRE provides services through EU Commission's Directorate General responsible for SME promotion. Correspondents are Chambers of Commerce & Industry, professional organizations, regional development organizations, consulting companies, banks or others.

➤ UK

(a) Training and Enterprise Council (TEC)

Being an independent organization led by private companies and supervised by the Department of Employment, TEC is subsidized by the Government for its operational expenses. Established in 82 locations in the country, TEC performs the following functions. In Scotland, the comparable Council is named the Local Enterprise Council (LEC), and is located in 22 places.

- (i) advice and information supply to companies
- (ii) facilitation of inter-firm links
- (iii) training of executives/employees and financial support of companies seeking consulting services

(b) Business Link

Business Link is an SME-supporting network coordinated by the Department of Trade & Industry (DTI) and managed by TEC, local Governments, the Chamber of Commerce & Industry and others. Its functions are collection and supply of information needed by SMEs, training of SME managers and support needed for business with foreign partners. Operating through 240 windows in the country, Business Link uses two databases, NEARNET and SUPERNET, connecting with information kept by numerous private information providers. Being a database of companies and human resources, NEARNET supplies information of existing needs/seeds of business, their locations, expertise and abilities needed. Focusing on technical information, SUPERNET supplies

information needed for partnership to be formed by domestic and foreign companies. Business Link offices retain managerial/technical consultants.

(c) SME Center

Supervised by DTI, the Center provides information at 113 locations.

(d) support of foreign market research, etc. by Chambers of Commerce & Industry

Supported by the Government, the Chambers of Commerce & Industry subsidizes expenses for SME's foreign market research, and advises on research methods.

(e) other services

Under DTI's jurisdiction, the Overseas Trade Service (OTS), Export Market Information Center (EMIC), Institute of Export, which is a private organization, and others supply information to SMEs.

➤ France

(a) French Center for International Trade (CFCE)

Supervised by the Ministry of Economy, Finance and Industry, CFCE provides foreign market information, sponsorship of a trade fair and advice on export.

(b) Chambers of Commerce & Industry

About 700 consultants are retained by the 166 Chambers of Commerce & Industry, advising SMEs on managerial and other topics.

(c) Authorized Management Improvement Association

The Association supplies consulting services by its experts for free or subsidized low fees to small firms which are members of the Association.

(d) subsidization of expenses for foreign market research and participation in foreign trade fairs.

The French Trade Insurance Company (COFACE), a public entity, subsidizes up to 50-60 percent of expenses for SME's foreign market research and participation in foreign trade fairs.

➤ Germany

(a) Economic Rationalization Center (RKW)

Sometimes called the Germany Productivity Center, RKW concentrates on business development services for SMEs. RKW has a state organization in each state, and collaborates with the Federal Ministry of Economy through its national headquarters in Frankfurt. RKW subsidizes a part of fees charged by RKW-registered consultants to SMEs.

(b) Chambers and Commerce, and Chambers of Craft

The Chambers provide member SMEs and craft enterprises with free consulting services, while the Government subsidizes a part of expenses needed for seminars organized by the Chambers.

(c) Subsidy of consultants fees paid for business start-up

The Government subsidizes 60 percent of consulting fees paid by SMEs, which are 2 years old or younger, and 50 percent of such fees paid by micro-firms.

Extract of Committee Discussions

The discussions mainly focused on the BDS guidelines of the Committee of Donor Agencies. The gist is as follows.

- (a) The BDS guidelines, particularly its principle to let beneficiaries pay the cost, sound very idealistic. Whether SMEs in LDCs will demand BDS by paying is subject to a question. Even in Japan, SMEs were not required to pay for management consulting services until 1988.
- (b) The *pros* and *cons* of payments by a beneficiary has implicitly been underlying the discussions of this Committee. Helping SMEs because they are weak and treating them as an independent economic unit assuring sustainable BDS are the opposite sides of a coin. Subsidies out of policy considerations should be gradually reduced.
- (c) In Japan, concerning SMEs, the concept of dual structures in recognition of co-existence of those suffering handicaps and those without handicaps, was easy to understand. In foreign countries, so many other handicaps like races attract people's attention that the Japanese way of advocating subsidies because of the company size is hardly justifiable.
- (d) According to the paper prepared by the secretariat to this Committee, a Government is inappropriate as a BDS providing organization in the light of the past experience. In contrast to this observation, Japan's cooperation with LDCs has mostly been made through Government agencies. In this sense, the observation introduced in the paper seems to urge us to reconsider future courses of our policy.
- (e) Each LDC is in its own stage of development. For countries like NIES, such guidelines may be appropriate, but, for other LDCs in earlier stages of

development, they may be inappropriate. How we use this guideline seems to be a relevant question.

- (f) Though how the guideline will be used by each donor is unknown, it is clear and relevant that the donors in the US and Europe as well as international agencies do have such thoughts. Regardless of effects of the guideline, other donors are likely to emphasize such a view. To carry on discussions with them, Japanese donor agencies will need to theoretically organize their views persuasively.
- (g) SMEs appear to be defined in the international community in a way different from our definition. International organizations appear to discuss SMEs in the context of poverty alleviation, and pay attention to service industries and local businesses in addition to manufacturers. On the other hand, the Japanese policy makers' highest priority is given to manufacturing SMEs including supporting industries with the ultimate aim of promoting export. In this respect, the guideline does not seem applicable in every case.
- (h) Is it not reasonable to think in a more straightforward manner about the relationship between a Government and market mechanisms and about cost sharing by a beneficiary? SME support is like elementary/middle school education forming a basis of human resources development, for which Government's financial support is justified without much doubt. On the other hand, it is obvious that a beneficiary should pay for higher level education.
- (i) There is a variety of SMEs. In the case where an SME is discriminated only because it is small, Government's assistance to such an SME is justified even by an international organization. In fact, when this issue was discussed, among a World Bank project team, the same conclusion was reached. At least the World Bank staff participating in the project was of the same view.

8.3 COLLABORATION BY DONOR AGENCIES

- For effective execution of support of acquisition of managerial/technical expertise, the agencies concerned should collaborate especially in the following respects:
 - (a) for formulation of basic frameworks
 - (i) formulation of an SME promoting master plan
 - (b) for improved access to managerial/technical expertise
 - (i) a strengthened supporting network mainly built by a trade association
 - (ii) formulation/support of an SME management consulting scheme
 - (iii) capacity building and human resources development of public technology support agencies

- (iv) creation of environment conducive to private sector's technology transfer
- (c) for inter-company cooperation
 - (i) guide for improving management and training of entrepreneurs
 - (ii) R&D support and training of technical personnel