

### 3. Application of the Policies to Developing Countries and Other Considerations

#### 3.1 Application of Japanese policies

##### (1) Outline of SMEs Promotion Policies in Developing Countries

Let us begin with a survey of SME definitions in developing countries. Newly Industrializing Economies (NIEs) are countries which have achieved a defined level of accumulated industry. In Korea (an NIE), the related laws outline the definition of SMEs based on the number of employees, and other definitions based on the company's sum of net assets by industry. The latter definition takes priority. In China, SMEs definition is based on the capacity of the manufacturing facilities, the quantity and the sum of fixed net assets. In Indonesia, there isn't a standard definition. Instead, it is set according to each individual policy, using the number of employees, net assets and capital of the company. In Thailand, the SME definition is based on the number of employees and on fixed assets. In Malaysia, although each organization has its own standard, the SMEs Development Public Corporation uses the number of employees and the amount of capital as its standard.

Examination of the size of SMEs in developing countries shows that, on the whole, SMEs make up the majority of the enterprises in the manufacturing industry, which is the same as in Western countries and Japan, even though there is a big difference in the actual numbers. However, separating this out into small, medium and large corporations shows that, in some developing countries, there are relatively few medium-sized enterprises and more large enterprises, creating a top-heavy distribution. In these kinds of cases, that country generally has almost no history of small enterprises developing into large enterprises. Given this, it can be assumed that the targets of the SME promotion policies are the following: cottage industries and small enterprises which have achieved a defined size.

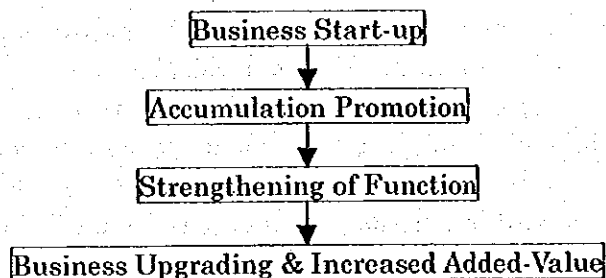
In this age when information is very easily transmitted, some developing countries are using information regarding the SMEs promotion policies implemented in Western countries and Japan as reference, and then proceeding to systematically adapt these policies to suit the situation in their own countries. However, the knowledge and experience of the administrative agencies who draft and manage the policies, as well as the human resources, facilities, and funds of the policy implementation agencies and banking facilities, who actually advise the SMEs, are insufficient. There are quite a few problems which must be solved in order to devise effective policies.

##### (2) Basic Structure of Japanese SMEs policy

The following is a basic explanation of how the Japanese SMEs Promotion Policies are largely based on the current level of enterprise development.

First, support policies are needed from the very beginning, to assist in the establishment of an enterprise or a starting up a new business field, because during this stage, companies don't generally have any profit to speak of, and they require more and more capital investment. Next, once a given number of enterprises have been established, some show the potential of becoming superior enterprises which can make full use of the region's potential. Use of support policies increase during this stage in order to consolidate the industry's power. Support policies are then effectively used to encourage the formation of SME collective and cooperative associations, and other kinds of groups. The types of support vary by industry and by region.

So that SMEs may develop further, it is necessary to strengthen the functioning of the enterprise. Support is given for the introduction of cooperative functioning at the group level (collective & association level, enterprise groups). Also, collaborative and developmental strategies are selected. Following the furthering of accumulation and reinforcement of the core functions, the focus of the strategies shifts towards improving quality, new technology development and computerization, in an effort to encourage business upgrading and increased added-value. At the stage where the enterprise becomes mature and the accumulation of technology becomes ongoing, support is provided to secure markets. Human resources development is also required during the stage of strengthening the business function and during the business upgrading/increased added-value stage. So, the basic progression of policies is:



During each stage, policies which aim at different types of industries, regions, economic reform, etc. are implemented.

### (3) Application of Japanese policies

Application of Policies Adjusted According to the Developmental Stage of SMEs in the Selected Country = Consideration of support policies, keeping in mind the level of development of the targeted SMEs, through reference to Japan's policies

When Japanese Promotion Policies are to be applied in a developing country, due consideration must be paid to that country's promotional goals. As noted above, it is essential that the necessary policies are in tune with the level of development of the SMEs targeted for support

Study of the keiretsu, subcontract structure, parts specialization systems = In order to assist SMEs to become strong in their operations, it is necessary to study the structure of effective cooperative manufacturing with other companies, and the construction of a system for the specialization of parts.

One of the unique characteristics of SMEs in Japan is the supporting industry role SMEs have in relation to large-scale enterprises and new enterprises. This includes the provision of parts and materials. In many cases, the SMEs move toward an exclusive trade relationship with a particular new enterprise, creating a keiretsu or a subcontracting relationship. It is well-known that the parent company supports the companies below it, through the active transfer of technology. This is due to the development of a "family" feeling, due to the existence of the keiretsu relationship. This type of relationship is unique to Japan. For reference purposes, Table 3-1 shows the special characteristics of Japanese, Western and Asian business trade relationships.

In addition, another special characteristic is the move towards collaborative work between SMEs. This helps to improve regional production and processing abilities, and is the path for SME development and growth. The advancement of policies geared to increase collaboration in Japan is based on the precondition of the existence of a keiretsu, a subcontracting or a parts specialization system. It is necessary for developing countries to keep this in mind when applying policies.

Table 3-1 Characteristics of Trade Relationships in Japan, Western Countries and Asia

	European type	Japanese type	Asian type
No. of firms	Extremely small	Large, extended into numerous layers	The number of small- and large sized companies that may receive support is limited
Customer	In general, small and middle sized companies work for several customers, and many of them for more than ten customers. Receiving of orders is diversified.	In Japan, SMEs make supply to few customers exclusively. Receiving of orders focuses on few specific customers.	Although SMEs have several main customers, they tend to receive orders from numerous customers.
Details of orders	Works not directly relating to production lines of customers.	Works directly relating to production lines of customers.	Works in SMEs are designated according to affiliation policy, and protected from invasion by large companies.
Transactions <input type="checkbox"/> Prices <input type="checkbox"/> Quality <input type="checkbox"/> Delivery time	Relatively high High defective ratio Unstable	Use of wage differences per firm scale The defective ratio is within 1%. Production is proceeded with simultaneously with that in customers. System enabling daily delivery.	Relatively high High defective ratio Daily delivery is possible partially.
Technical guidance and information exchange	No technical guidance Little information exchange	Technical transfer from customers Supply of inspection and testing equipment from customer Transfer of management know-how	Education similar to that in Japan is implemented, but assimilation is not enough to achieve quality improvement with some problems to be solved.
Countermeasures taken for the need of producing a wide range of products, with small amount.	Not developed sufficiently	Evolution from the subcontracting of sub-assemblies to that of finished products (OEM supply)	This trend has commenced partially.

source: study of supporting Industry, Japan Overseas Enterprises Association. March, 1994

Application of Policies to SMEs Targeted for Promotion, Based on Size and Industry Classification

There is a necessity to choose policies which are appropriate to the size and characteristics of the industry. Interviews with successful enterprises show that, in

terms of technological R&D support, the subsidies needed by small-scale enterprises are small and the support provided tends to be very effective. On the other hand, for mid-sized SMEs, merely the fact that it has qualified to receive a subsidy increases its public image, which has an extremely beneficial effect on business.

To illustrate the different policies required based on industrial classifications, the types of policies needed for the high value-added machinery and electronics-related industries tend to be very different in nature from those for industries based on regional resources or related to lifestyles. Most machinery and electronics-related industries are focused on acquiring technology, while industries based on regional resources or related to lifestyles, due to their higher consciousness of co-existence and co-prosperity, tend to focus on trade activities through cooperative associations.

**Examination of the policy implementation system = Consideration of the policy implementation system in order to ensure policies are carried out appropriately**

In order to ensure the appropriate application of promotion policies, it is absolutely essential to study the various organizations which are responsible for their application. The usual method is: state → state-related organizations → regional administrations → organizations related to the regional administrations → industrial collectives (of course, there are instances where there is a direct connection with the central government → industrial associations). It is necessary to keep in mind the impact this flow has on the effect and efficiency of policy implementation.

**Examination of Application of Multiple Policies = Study the application of various policies at once in order to increase their effectiveness**

The success of any one of the example cases listed previously was attributed to one individual policy. In reality, there are very few instances where a single policy has led an enterprise to success. The application of consolidated policies is the most effective method of delivery. Some examples include the coupling of financing support and guidance activities, and the coupling of research cost subsidies and cooperative activities with public research organizations. It must also be pointed out that the efforts of the enterprise itself can increase the effectiveness of the policy.

### 3.2 Other Considerations

Below are some of the other considerations which must be kept in mind when referring to SME Promotion Policy in Japan

(1) It is necessary to nurture a "manufacturing" mind-set.

Within Japan's SMEs, there are some micro-industries, which are not interested in increasing the scale of their operations. Rather, some administrators focus entirely on producing a quality product or being technologically innovative.

Twenty people from developing countries with hopes of establishing their own small-scale marketing enterprises visited a woman who has her own cottage industry in Tokyo. Using her two sewing machines, she makes well-known brand-name handbags. They were taken aback by the patented processing equipment and computer-controlled sewing machines that she had, as well as by the fact that she creates and makes her own high-quality designs, which she then submits to these worldwide brand name companies. The people who are involved in SMEs of developing countries need to have this type of perspective towards high-quality workmanship, while thinking creatively and flexibly.

It will take time to nurture this type of mindset, but increasing the desire among SME managers to achieve high-quality manufacturing is one of the mainstays of policy evolution

(2) The historical background of Japan's SMEs should be taken into consideration during policy application.

The sewing industry in Japan made great strides in development forty or fifty years ago. However, for the last thirty years, their growth has stagnated or declined. At the same time, the sewing industry in developing countries expanded. The sewing industry in developing countries is expanding due to exports, but, Japan is working desperately to hold on to its ever-shrinking market. This helps to illustrate that, when looking at successful cases of Japanese industry, it is necessary to pay due consideration to the differences in the steps of development, rather than just looking at one stage.

On the other hand, when examining case histories of Japan's machinery & machinery-related parts industry and the electricity & electronics industry, it is necessary to remember that developing countries are not yet able to access such high-tech technology. This serves to highlight the fact that each country's industries have their own unique developmental processes.

(3) Collaboration with an eye to fairness

For a collaborative implementation of policies, cooperative activities which are mutually advantageous for the whole are necessary. There is no point to collaborative business if benefits accrue to only one company. It is conceivable that an enterprise will seek to forward promotion policies which would be advantageous to only itself. There is a high possibility of this happening in Japan, given that there have been such cases in the past. However, the administrative organizations have begun working to ensure fairness, by implementing policies with an impartial eye towards the various industries. For developing countries, which have the potential for even stronger state guidance than Japan has, it is necessary to pay a great deal more attention to entrenching equality.

There are many points where the policy development history of Japan coincides with the current development of developing countries. Through examination of the history of development in Japan, which never had a large-scale pioneering period, it is hoped that the origins of these points come to be understood. Additionally, it is hoped that appropriate policies which meet the actual conditions of the developing countries are undertaken.

## **Chapter II**

### **Japanese Policy for Small and Medium Enterprises and Actual Case Examples (Financial)**

1. Introduction

The purpose of this study is to investigate the effects of various factors on the performance of a system. The study is organized as follows: Section 2 describes the methodology used in the study. Section 3 presents the results of the study. Section 4 discusses the implications of the findings. Section 5 concludes the study.



## Chapter II

### Japanese Policy for Small and Medium Enterprises and Actual Case Examples (Financial)

#### 1. Financial Policy for SMEs in Japan

##### 1.1 Background of official support and its development

###### (1) Period of postwar reconstruction (1945~1954)

Postwar SME policy started in the middle of the economic chaos in 1945. At first SMEs were left without government support. In order to reconstruct industries damaged so seriously, priority of government support was given to production by core industries, which are mostly large enterprises. As a result of rampant postwar inflation, SMEs faced so many financial difficulties that many went bankrupt. The first policy for SMEs was to cope with such financial difficulties. The policy then covered three major points.

- a. Financial policy
- b. Rectification of weakness by grouping
- c. Diagnosis and Guidance aimed at strengthening management structure

These main supporting measures have been reinforced over the years that they are regarded as the core supporting measures in today's SME policy.

Various supporting measures to ease financial burdens of SMEs include creation of regional banking institutions. These banking institutions operate as private entities and handle their own accounts. As a result, because of reckless expansion and misconduct by some regional bosses at the time of the bubble economy, a number of institutions now are facing difficulties, themselves. Also, as private institutions they naturally had a limitation in supporting SMEs. This is the reason why public organizations are needed to fulfill the Government policy toward easing the financial burdens of SMEs.

- a. Mutual Bank: As a popular financial institution among people since the prewar days, 'Mujin', the practice of mutual private financing was officially acknowledged by establishing Mutual Finance Companies in various regions in 1945. Then, this company changed to the Mutual Bank in 1951, which lends funds for SMEs and accepts savings deposits from the general public. Later, in 1989 the Bank has been renamed as the 2nd Regional Bank.
- b. Credit Associations operated by members (Shinyo Kinko): Credit Associations were established under the same law in 1950 for members' loans and saving deposits. As the governing organization, the Federation of National Credit

Associations takes deposits from individual Associations and issues bonds. (There are 322 individual Associations nationwide with 2,677 offices. The size of the fund is ¥16,187 billion)

- c. Credit Cooperatives (Shinyo Kumiai): The parent institutions began in the prewar days. In 1949, by enactment of the Small and Medium Enterprises Cooperative Law, Credit Cooperatives were established at various regions aiming at mutual relief among SMEs and office workers. The National Federation, founded in 1954 as the upper body has a fund of ¥3,120.7bil as of March 1999.

In addition to the private institutions mentioned above, three governmental institutions were established or reorganized; Japan Finance Corporation for Small Business (JFS), People's Finance Corporation (PFC) and the Shoko Chukin Bank (The Central Cooperative Bank for Commerce and Industry).

Further in 1953, the Credit Guarantee Association was established in each Prefecture. This is because the former organization was a public entity under the Civil Law and not suitable for providing debt guarantees. Also, the rules for doing business and accounting procedures had to be common among all the Associations in the country.

For the details, refer to 1.3 Role of Public Financial Organizations supporting SMEs and their contribution.

## (2) Period of Rapid Growth Economy (1955-1972)

The reason why financial systems for SMEs was introduced was to cultivate, develop and improve management of SMEs. At the same time, financial policy is a very effective method to lead enterprises in the desired directions in today's economic world characterized by free competition. Therefore, these public financial institutions have implemented various measures and support by application of special financial systems or schemes to respond to needs of the times.

In other words, in the mid-fifties, the country finally finished the process of post war reconstruction and was about to enter a new era of economic growth. But, there arose a problem of difference in the level of SMEs compared to LE (large enterprise). The gap in production and wages became increasingly apparent between LE and SMEs and even in the SMEs themselves. In view of the difference in the level, new measures were implemented to prevent excessive competition among SMEs, to protect SMEs subcontracting for LE, to modernize equipment and to improve technology. Around 1960, the rapid growth of the country's economy caused SMEs serious problems threatening their base of existence by creating a labor shortage and mass production and distribution. This was not solely the SMEs problem, but an internal structural problem of the national economy itself. Under such circumstances, in 1963 the SME Basic Law was enacted to affirm the basic concept of SME policy and to systemize various supporting measures introduced one by one without due coordination. In this direction, the policy of realignment for SMEs was implemented

and expanded to take part in the rapid growth of the economy.

However, after 1970 there was a gloomy side to the rapid growth economy and so in order to increase efficiency in industrial activities, more sensitivity was required in implementing supporting measures for SMEs. At the same time, the negative aspects of rapid growth, which are urbanization and pollution started to be pointed out.

As a result of rapid growth, the economy moved toward globalization. This affected some SMEs and placed them in a difficult position. Measures to cope with the trend toward globalization had to be included in SME policies as well.

The financial policy for this period kept improving the business environment for SMEs. In 1963, the Small and Medium Business Investment & Consultation Co., Ltd (SBIC) was established in Tokyo, Nagoya and Osaka to provide equity capital to SMEs. The fund for modernization of equipment created to advance the structure in accordance with the SME Modernization Promotion Law. A program of interest-free loans for upgrading businesses was introduced to prefectures, encouraging SMEs to construct a factory complex or cooperate in building joint facilities. Credit Insurance without collateral was specially created to promote a loan without a physical guarantee. Also, in order to avoid a chain reaction of bankruptcies the Law for Prevention of Bankruptcy Chain Reaction had a separate insurance arrangement for SMEs involved in deals with bankrupt companies.

### (3) Period of Stable Growth of Economy (1973-1984)

The economic slump that started in mid-sixties seemed to show the limitation of the economic policy of rapid growth. The SME policy was subjected to review in the directions of integration of intelligence and support for SMEs who were unable to adjust themselves to the change of the base of existence.

Recently, in 1999 the "SME Diet" amended various laws, changing the direction of support measures. It can be said that the basic policy was established in this period. In other words, the SME Basic Law was amended in 1973 for a broader definition of SMEs as was the amendment in 1999. Also, the amendment of the SME Modernization Promotion Law supported self-sustaining SMEs financially as well with tax relief. These measures were introduced to support SMEs suffering from economic depression caused by the strong yen. The measures promoted special production regions and emergency financial assistance to those encountering depression in the specific regions, by adding the lease of equipment for saving resources and energy to the Upgrade Project. Support to cultivate venture business was also made as a credit guarantee with no collateral but an additional successful premium to be paid by the payment guarantee. (Refer to Case 7).

### (4) The Transition Period (1985-2000)

During this period, the country experienced boom and slump in the economy and uncontrolled globalization. Various new measures were implemented. Financial

support has been given for conversion of the business line or cultivation of new business fields to qualifying SMEs. These would be enterprises that lost the base of their business due to structural changes in the economy, including changes of foreign trade pattern, technology innovation, difficulty in securing materials, and pollution.

One major project was the amalgamation of management resources, which started with fusion meetings by exchange of SMEs belonging to different sectors. For this purpose a number of financial and tax incentives were provided.

The recession in the Japanese economy is now the longest since WWII. This has seriously damaged not only SMEs but also LEs and Large Banks. Still discussions are being made about the revival of the national economy. While huge amounts of money for recovery, ¥60 trillion, has been poured into the big banks, SME policy is facing change, too. The amendment of the SME Basic Law in 1999 brought a new positive concept "To support the self reliance of versatile SMEs is the origin of vitality and development of our national economy" leaving behind the concept of "Relief of the weak" and "Rectification of gaps with LEs".

The financial policy in the Period covered a wide area, from Emergency Relief Fund for SMEs that suffered from the Hanshin-Awaji Earthquake, Special Credit Guarantee of ¥30 trillion for SMEs to cope with bankers' reluctance to lend money—a sort of credit crunch, and a comprehensive package of supportive measures including new legislation, loan and investment to Venture type business with an awareness of greater number of closing business than opening business.

Refer to 2. Cases of Financial Measures by the Public Organizations Making a Contribution.

It may take some time to see the result of new policy measures by the new legislation and new concepts until they settle well and work effectively for SMEs. We are just in middle of the transition time.

## 1.2 Organizations to implement financial policy for SMEs

In accordance with the Small and Medium Enterprise Basic Law (1963), the financial policy for SMEs placed priority on rectifying the disadvantage of SMEs for small size of management. The government intended its policy to improve the business environment for SMEs to correct disadvantages due to economic and social constraints so that SMEs would develop, with self-reliance, efforts to bear competition.

The organization, which makes and implements the policies with budget allocation, is the Ministry of International Trade & Industries. The Small and Medium Enterprise Agency was established under its wing in 1948.

The project is implemented directly by the District Trade and Industry Bureaus or in many cases in cooperation with Prefectures as follows:

- a. Prefectures implement the project with the budget arranged by the government
- b. Prefectures implement the project with a combination of the national budget and their prefectural budget (e.g. The Loan system of Modernization of Equipment of SMEs, Lease system of Equipment and Loan system for strengthening SME

corporate structure)

- c. Prefecture's own project e.g. Project cost supporting establishment of SMEs under the Promotion of New Business Creation Activities. For this purpose, various organizations such as the SME Promotion Association and the SME Promotion Fund Association have been established. For instance, in the business upgrade project, JASMEC loans a portion of the fund to a prefecture, the prefecture adds its own funds and makes a loan to the SME. If the prefecture implements the project on its own, it usually makes a deposit in the city bank, the bank adds its own fund and makes a loan to the SME. In this case the interest rate applicable is a compound of the deposit rate and the bank interest rate.

There are three systems for financial support measures:

- (1) Loans
- (2) Supplementary Credit
- (3) Improvement of Capital

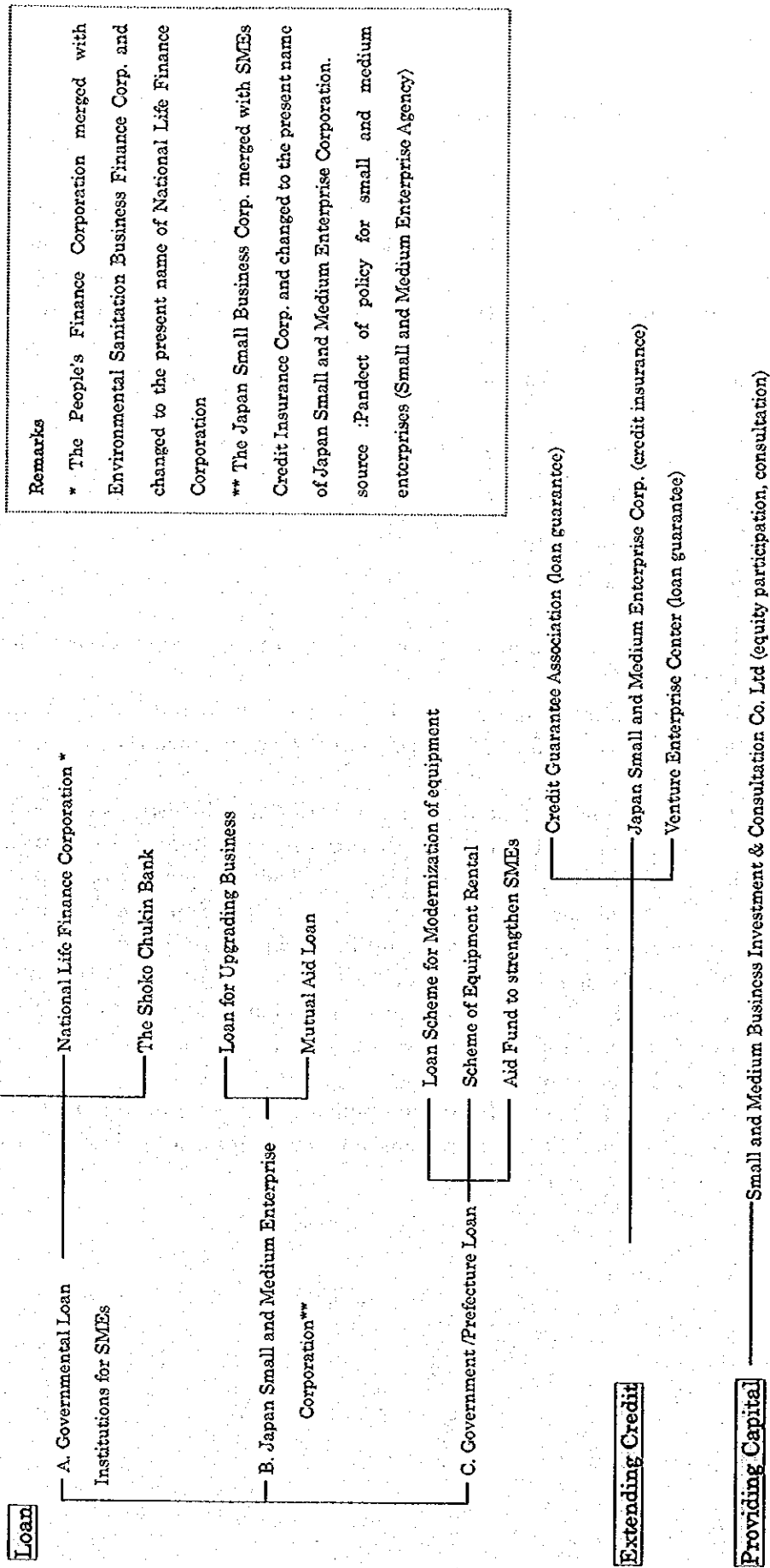
In order to implement these measures, public organizations were established as listed below.

In addition, municipalities such as cities, towns and villages or wards extend the promotional services for SMEs, which are effective since they are located closer to the individual SMEs.

To cite an instance of financial assistance, Edogawa Ward in Tokyo, where many SME factories are located has allocated its own financial resources at times of economic confusion and serious depression. The Edogawa Ward by an Ordinance introduced the "Loan for Emergency Special Measures Fund" in September 1998. The terms of the loan were a maximum ¥5 million to be repaid in 10 years repayment with a grace period of 6 months and interest 1.5% p.a. The measures were introduced before the central SME Agency announced special measures including a Special Credit Guarantee in October 1998. There are many SMEs in this ward that survived thanks to loans from the local government.

One of the features of financial policies for SMEs in Japan is the network of government, local public organizations and municipalities. The following shows a chart of financial system.

Table 1-1 Public Financial Support for SMEs



### 1.3 Role of Public Financial Organizations supporting SMEs and their contribution

The public financial support includes (1)loans (2)extending credit (3)improvement of capital. The main organizations and supporting measures are as follows. Refer to the list of the respective organization for details in 2. Cases of Financial Measures by the Public Organizations Making a Contribution.

#### (1) Loans

a. Japan Finance Corporation for Small Business (JFS): For the purpose of extending loan to SMEs, who have difficulty in acquiring loans from ordinary private banks, the JFS was established in 1953. The organization is fully owned by the Japanese Government. To receive a loan, physical security and a guarantor are required as a rule. The purpose of the loan is the fund for acquisition of equipment to serve for rationalization of the management, which includes improvement of quality, cutting production cost and improvement of production efficiency. The long-term operation fund will be used for rationalization of the company in the shortage of equity capital or long-term fund for testing and research or cultivation of the overseas market, etc.

The Corporation makes some loans directly but in regions where it has no office it makes loans through city banks, regional banks and trust banks acting as its agents. In addition to general loans, there are special loans available for leading SMEs in the desired direction by government policies such as:

- i ) Loans for encouraging industrial structural improvement, including SME modernization structural improvement, loans for promotion of subcontracting SMEs, loans for conversion of business and upgrading of retail commerce
- ii ) Loans for enhancing safety and prevention of pollution, such as loans for prevention of industrial pollution and the loans for industrial safety and hygiene facilities
- iii) Other: many kinds of loans for energy saving, prevention of bankruptcy and information technology.

The loan balance of JFS is ¥7,497 billion, and loans for Fiscal Year 1998 total 1,8148 billion The share of the Corporation is 2.3% of the total loan balance amount among various banking institutions (FY 1998).

b. National Life Finance Corporation (NLFC): NLFC will make small loans to individuals or companies, who are planning doing business independently and have an appropriate business plan but have difficulty in getting loans from banking institutions. Like JFS, NLFC is fully owned by the government but it is older than JFS. Compared with JFS, the loan amount per loan is smaller and terms are shorter. NLFC has ordinary loans and also special loans for specific policy measures similar to JFS. It is worthwhile to note the Small Business Improvement Loan by the Corporation. This loan is for Small Enterprises (SE) whose regular employees number less than 5 for commercial and servicing industries and less than 20 for manufacturing. The purpose of the loan is a small fund for equipment and operation

of the firm. In advance of the loan commitment, the Applicant must receive management guidance for 6 months by the Chamber or Association of Commerce and Industry. Neither collateral nor guarantor is required for the loans up to ¥5.5mil (At present, by Special Measures the amount is ¥10 million). This is very helpful to SMEs who do not have enough physical collateral, required for loans from private banks. Today, among various venture type businesses, since many computer software or system companies lack security for borrowing, they greatly benefit from this sort of public support in starting their business (refer to Case 4). The share of the Corporation in the loan balance amount among various banking institutions is 3.4%. The loan balance is ¥10,754 billion for 1.96 million transactions. The figure is bigger than JFS, though the amount per single transaction is smaller than JFS.

- c. The Shoko Chukin Bank (The Central Cooperative Bank for Commerce and Industry): In order to facilitate finance for SME cooperatives and others whose members are mainly SME size companies, the Shoko Chukin Bank was established in 1936. The capital of the Bank has been owned by the government and member cooperatives and other organizations who have a membership in the Bank. The loan fund is derived from the capital, deposits, and issue of bond and treasury funds from the government. As the feature of the Bank, equity of the Bank is partly 21.7% owned by member cooperatives and others qualified whereas the preceding two Corporations are fully owned by the government. Also, the Bank raises fund by issuing bonds. Another unique point is the start of the organization, which was established before WWII in 1936. The Bank limits its loans to cooperatives and associations, their members, federations of cooperatives and associations all having membership. The share of the Corporation in the total loan balance amount among various banking institutions is 3.2% and the amount is ¥11,378bil (FY1998).

Apart from the above three public financial institutions, there is loan agency of the Japan Small and Medium Enterprise Corporation (JASMEC). The function of JASMEC as a government owned corporation covers comprehensive supporting measures for SMEs. In respect to finance, JASMEC handles Business Upgrade Projects to encourage grouping or structural improvement (See Cases 2, 5 and 6) as well as loans for Small Enterprises, SE (refer to (1) b. for the definition of SE) based on the mutual relief fund. The outstanding balance of the upgrade loans is ¥1,200 billion and the balance of equity provision into the public organizations for structural improvement and change of business environment amounts to ¥7.1 billion (as of March 1997). The Corporation merged the SME Credit Insurance Corp. and changed the previous name of Japan Small Business Corporation (JSBC) to its present name. JASMEC now undertakes insurance of credit guarantee for the SME Credit Guarantee Association. The mechanism of this guarantee system is referred to in next (2) Supplementary credit.

(2) Supplementary credit:

- a. Prefectural Credit Guarantee Associations; CGA: CGAs were established by the law of the same name to expedite the borrowing business funds from banking



institutions by providing debt guarantees for SMEs who lack securities and credit. CGA was established in each of the 47 prefectures and also in five major cities, Yokohama, Kawasaki, Nagoya, Gifu and Osaka (These together form the Federation of CGA). A guarantor and physical guarantee are required at the time of the credit guarantee (presently, the conditions are mitigated to ease the finances of SMEs). The mechanism of the guarantee system is for the SME to receive a loan from a bank with the debt guarantee issued by CGA in favor of the bank. If the SME defaults, CGA will make subrogated payment to the bank at the demand of the bank. Upon subrogation of the debt, CGA has the right of compensation against the SME. On the other hand, CGA will insure the credit guarantee obligation to the Bank, by the guarantee credit insurance with JASMEC. Should default be made by the SME, 70% to 80% of the guaranteed amount will be paid to CGA as insurance money. Later, if CGA receives the payment from the SME, the payment will be reimbursed to JASMEC in proportion to the insurance money CGA received. At present, a temporary Special Guarantee is available as a measure against a credit crunch, and guarantee conditions about eligibility, guarantee premium, limit of the guarantee amount are being relaxed. This guarantee is specially made in view of stabilizing finances of SMEs. The total guarantee for this scheme amount is a huge sum of ¥30tril. with 20tril. up to the end of FY1999 and another 10tril. available for FY2000. Except for the temporary Special Guarantee, the outstanding guarantee amount by all CGA is about ¥42 tril. in FY 1998, which means one of three SMEs (equal to 2.1 million SMEs) relies on the Guarantee.

- b. Venture Enterprise Center; VEC: VEC is a public foundation. It extends credit guarantees for venture businesses that borrow funds from banks. The credit guarantee is made without collateral to the R&D type enterprises and the type of enterprises integrating intelligence. If the credit guarantee serves for the success of the business, the reward will be paid in the form of guarantee premium subject to the details to be agreed. Refer to Case 7 for an example of a successful case.

### (3) Improvement of capital:

The Small and Medium Business Investment & Consultation Co., Ltd (SBIC) was established in 1963 by the laws of the same name for the purpose of investment into SMEs to strengthen their capital base. SMEs with only limited profits have to look beyond earnings only to find that capital procurement is neither smooth nor fast. Many SMEs however, do not risk losing management control, if they should succeed in obtaining capital from a third party. By increasing their capital base, SMEs will be able to develop with a solid financial position. The companies were established in Tokyo, Nagoya and Osaka to cover nationwide activities. The companies are semi-public corporations with capital owned by local governments, financial institutions, the security dealers association, insurance companies and blue chip corporations. The activities of the companies are to undertake the following activities to increase capital without taking management control of the SMEs in which the funds are invested:

- a. Initial share offerings
- b. Subsequent share offerings
- c. Convertible bonds
- d. Warrant bonds
- e. Capital provision to venture businesses including individual persons

The companies may relinquish equity holdings when a client goes public. To help it make a small transition to listing on a stock exchange and an increased capital base, the client may transfer a portion of shares to its employees, its customers or financial institutions, with the company's consent. (COMMENT: This paragraph is confusing. "Company" seems to be used to mean both the semi-public corporation making the loan and the SME receiving the loan. In trying to make the meaning clear, I may have changed the meaning.)

There are criteria set for each of the above investments such as undertaking up to 50% of shares issued and maximum of five years for holding bonds. Of course, the applicants must prove they have the potential for growth showing a certain level of pre tax profit. They must be audited by a CPA every fiscal term.

So far, the three SBIC companies have made investments by shares or bonds of 2,861 companies with total amount of ¥136.4 billion in which many companies went public and listed themselves on the Stock Exchange.

We have now discussed major financial institutions and their roles in the financial area. But, there are other institutions with a similar objective to support SMEs though they do not meet the legitimate definition of SMEs.

Lately, the importance of direct financial assistance for SMEs is being emphasized. SMEs tend to rely on indirect financing since they lack a credit rating. It is desirable, however to source the fund directly for the security market from the viewpoint of sound financial management. In December 1999, TSE Mothers started to meet the demand from the small and midsize scale industries. The qualifications were more relaxed than the over-the-counter trading market for the small or mid-sized companies with potential for growth. At present, 4 companies including Internet related business are listed in the Tosho Mothers. In addition, a private version of NASDAC Japan will be set up in June 2000 for similar purpose.

The following table shows a summary of various public organizations for supporting the financing of SMEs with their roles and the cases where they have made a contribution for reference.

**Table 1-2 Public organizations for finance and their main roles**

Category	Organization	Main roles for finance	Case
General	Prefectures	Loan, investment, debt guarantee	Case 1
General	The Japan Small and Medium Enterprise Corporation; JASMEC	Upgrade loan, SE loan, credit insurance	Case 2
Loan	Japan Finance Corporation for Small Business (JFS)	Long term loan for equipment, operation fund	Case 3
Loan	National Life Finance Corporation (NLFC)	Short term operation fund, equipment fund	Case 4
Loan • Bond	The Shoko Chukin Bank	Coop. finance, bond issue	Case 5
Credit Supplement	Credit Guarantee Association (CGA)	Debt Guarantee	Case 6
Credit Supplement	Venture Enterprise Center (VEC)	Debt Guarantee	Case 7
Investment	Small and Medium Business Investment & Consultation Co., Ltd (SBIC)	Equity investment, bond	Case 8

## 2. Actual Case Examples of Financial Measures

### 2.1 Case 1 (Prefectures-The Promotion Fund of the Association of Hokkaido SMEs, A Corporate Entity) S Co., Ltd

**Table 2-1**

Established	1959
Business	Manufacture and sales of Solar Heating System
Capital & Turnover	¥68 million, Sales 70 million (1999)
Staff	7

Since the company was established in 1959, it has been dedicated to the research and development of solar heating systems. In 1997 the Kyoto Congress on Environment (COP3) adopted a resolution in which Japan has to reduce emission of global warming gas by an average 6% from the 1990 level. This goal has to be achieved by the years 2008-2012. In order to realize this goal, there is a target for use of solar heating system equivalent to reduce use of oil fuel by 4.5 million kl. The president of the company is confident this is possible by utilization of solar heating because Hokkaido only consumes 2mil, kl. oil at the moment. This is used for heating homes and warming roads, which is now widely done even on the premises of individual residences in Hokkaido. However, the performance of the conventional solar heating system is inadequate both in heating efficiency and structure. Existing systems use copper and metal materials, which make the system heavy and prone to rust, and are expensive. This is the reason why solar heating systems are not popular in Japan.

In view of this, the company has concentrated its efforts into development of a new system for sunshine collection sheets and heating radiators using plastic materials. The Hokkaido Bureau of International Trade and Industry had granted three-year subsidies for the Sunshine Collection System (Patent pending) under the scheme of the New Industry Technology Development for rationalization of consumption of energy. The grant had been allocated annually ¥40 million during

1997-99 in total 120 million. The new collection system incorporates the polybutane sheets attached with polybutane pipes which both reduces weight and cost of the products.

The new product "Solar PB" maintains high heat capacity, better installation ability, hygiene and less friction resistance. In addition, the company has developed new joint "Gritte" made of plastic which connects the plastic parts of the solar system. This has a new mechanism to join the pipe, simply by 'one touch', for which the patent has been applied in eight countries. Using these technologies, the first plastic radiator for heating in the world was completed. The company sells not only solar heating systems, but also floor heating panels attached with plastic pipes, which are covered with heat insulation.

In order to meet the expenditures for R&D, the company has increased its share capital to ¥68 million of which the Promotion Fund of the Association of Hokkaido SMEs (AHSPF; see the list as below) subscribed ¥18 million.

Further, the company was qualified under the Temporary Law concerning Measures for the Promotion of the Creative Business Activities of Small and Medium Enterprises (so called SME Creative Business Activities Promotion Law), as eligible for ¥45 million loan with a repayment period of 10 years including a one-year grace period. The Promotion Fund of the Association of Hokkaido SMEs with a collateral of equipment provided this financing. Japan Finance Corporation for Small Business (JFS) participated as a joint financier with AHSPF for the amount of 20 million but, without collateral. This indicates that the company business was appraised as providing solutions for environment problems. But, it can be safely said that no private institution could arrange such capital provision and loan without collateral.

Thanks to the subsidies, equity participation and favorable loan institutions, the company products now start to bring a return. A large chemical company now approaches the company about buying the patented products. One housing company issued test order for the system, with a hope of an additional 100 units, if the test order turns out to be successful. Taking the opportunity, the company considers setting up a sales company in Honshu, hiring a sales manager. The company will have a home page on the Internet, in order to accept overseas inquiries, too.

Yet, there may be a long way before the company really makes a substantial profit, depending upon the results of the sales activity now being planned. Meantime, the company has to further increase equity capital to improve the balance sheet.

**Table 2-2 The Promotion Fund of the Association of Hokkaido SMEs**

Established	1969	
Shareholders	Hokkaido Board, Large enterprises in Hokkaido	
Supporting Measures	Measures based on the SME Creative Action Promotion Ordinance and other general measures including investment to venture enterprises and loan guarantee	Subsidized activity (R&D, training of employees) loan, equity participation)
Eligible company or person	SMEs or an individual to do a business	
Purpose of the Fund	R&D and investment for methodology of new production, sales and services	Acquisition of equipment, hiring, rent, materials, technical license, development of program, personnel expense etc.
Loan period	10 years including one year grace period	Shareholding max. 10
Max limit of loan, subscription of shares	100 million, 80% of the total fund	
	20 million 1/2 of issued shares	
Present loan interest	2% p.a.	

**2.2 Case 2 (The Japan Small and Medium Enterprise Corporation; JASMEC; Shizuoka Pref.)**

**Y Marine Products Processors Cooperative Center**

**Table 2-3**

Established	1972 by the JASMEC Upgrade Project
Capital	¥289,850 thousand
Member Companies	21, Coop. directors 10, staff 108 (99.6)
Coop. site	78,000 m <sup>2</sup> (incl. Coop. member site 48,823 m <sup>2</sup> )
Coop. project	As mentioned below

(as of 1999. 3)

In 1970, the Japanese Government designated Yaizu City as "The Project of Forming Producing Area for Distribution and Processing Center" in order to rationalize processing and distribution of aquatic products. The Cooperative Yaizu Fisheries Processing Center was established in 1972 to build a factory complex. Shizuoka Pref. made a loan to the Cooperative for 60% of the initial project cost, which included ¥5 billion for acquisition of the factory sites and ¥6 billion construction cost for a period of 15 years with an interest rate of 2.7% p.a.. The Shoko Chukin Bank provided joint financing of 17.5% of the initial project cost with an interest rate of 7% p.a.. The remaining portion of the fund, 17.5% was paid from the cooperative members' own funds.

The main facilities built at the Industrial Complex included wastewater treatment, refrigerators, residue processing treatment, cold storage, etc., which are used in common by the coop members. The marine product processing complex to produce a dried stick of bonito as its core business was completed in 1974 with participation of 18 fishery related companies. This is one of the largest complexes in Japan for the production of seafood products, having production facilities and development of new products such as calcium additives from the residue. In addition,

an apartment house was built for workers and staff of the coop, too.

Later, in 1996 and 1997, Supplemental Projects were implemented to expand the wastewater treatment facility and water supply system with funds for upgrading provided by the Japan Small and Medium Enterprise Corporation (JASMEC see the list below). The term of the loan is 15 years including a three year grace period for 80% of the cost with no interest for wastewater treatment and 65% for the rest with an interest rate of 2.7% p.a. The Shoko Chukin Bank and The Norinchukin Bank provided joint financing for 15 years and 10 years respectively for the balance of the fund with the exception of coop members' own funds.

At present, there are 21 coop member companies doing mostly fishery processing and food processing (26 factories, employees 623 in total) who engage in the production of dried stick bonito, canned fish and seasoning. The complex itself earns ¥21 billion by processing 1.2 billion ton raw fish per year, and the coop member companies sell a total of ¥156.5 billion worth of the products annually.

In addition, the coop itself develops such new products of high added value as calcium food and organic fertilizer at the complex. The project motto is "Adding high value to fish calcium and marketing." Shizuoka Prefecture awarded the coop a subsidy (3.3 million among 5.8mil project cost) as promotion of regional industries (Creation of new business utilizing local resources). Since the coop owns several factories and facilities at the complex, its activities are important for the future of member companies, so the coop now itself has 45 staff and 61 bonito processors under 10 coop directors.

In the future, the coop plans to get a certification of ISO14001 and "Zero Emission" of pollution from the Industrial Complex. These will be achieved by establishment of a recycling system with high use of resources and compost of marine products residue. (Project cost 9.1mil, subsidy 8.0mil)

Table 2-4 Japan Small and Medium Enterprise Corporation; JASMEC (Business Upgrade Measures)

Established	1999 Japan Small and Medium Enterprise Corporation (JASMEC) (1967 Japan Small Business Promotion Corporation, 1970 Japan small Business Corporation; JSBC)*	(1999) The Japan Small and Medium Enterprise Corporation Law
Share Capital	¥1,230.3 billion Loan Fund 747.7bil, Insurance Fund 422.6 billion Others) (Nov. 1999)	*1999/11 JSBC merged SME Credit Insurance Corp. and renamed to JASMEC
Finance Route Lender	JASMEC finances the fund to the Prefecture who adds its own funds and loans to the SME for ordinary business upgrade measures	Loans (or investments for special cases)
Borrower	Cooperative doing business structural upgrade such as grouping, industrial complexes, wholesale complexes, area facilities	
Purpose of loan	Acquisition of facility, equipment and operative fund	
Loan period	Max. 20 years with 3 year grace period	10 years for operative fund
Loan limit	JASMEC 60% (investment 40, finance 20) Prefecture 20 total 80%*	For micro enterprises 90% possible
Loan interest	2.1% p.a.; interest free for Structural improvement, Creative industries, and Disaster Relief	Acquisition of the land in advance 1.9%.
Amount loaned	¥4,137.2 billion (FY 1961~1998)	FY97 1,17.5 billion, FY98 90.0bil

See 2.3 of Chapter 3 "Small and Medium Enterprise Management Upgrading Loans System"

2.3 Case 3 (Japan Finance Corporation for Small Business; JFS)  
K Co., Ltd.

Table 2-5

Established	1958
Business	Sales of Card Issuing System, Supply and printing of ID card, train tickets, various cards, Wholesale of various papers
Share capital · Turnover	¥40 million Annual sales ¥1.2 billion
Employee	70

(1) Outline

In 1948, the father of the president started wholesale of various papers and incorporated as K Co., Ltd in 1958 with the capital of ¥2 million Toshiro Kobayashi succeeded the business in 1961 and has gradually taken the business into higher echelons of the paper business world. His concept is a business with a large margin of added value. His first venture was acquisition of a printing machine, by which he has printed and supplied roll papers to the clients. The company now supplies printed train tickets using roll papers to the various private railways. In addition, museums and public halls order the company's admission tickets.

An important turning point for the company was starting to supply of magnetic card "MS card" in 1978. Then, five years later, the company opened Fukagawa Works, where they encoded their own magnetic cards. This means the company has entered into the information industry using the medium of paper. The new company products were exhibited at the various exposition halls in Japan. At that time the company released an "MS card" printing system. At the same time, Mr. Kobayashi has implemented an internal information system transmitting data between the head office and two factories. Company staff have done most of the work on developing the LAN system.

In 1990, the Company introduced laminated card systems, "Spot Lamicard" and "VZCard," to the market. The system can issue an ID card or a card for other purpose on the spot. The photo can be placed, typed with personal data for identification and laminated in seconds. ID data can be written by hand on the paper card where a computer is not available and a barcode or signature can be added upon request. By laminate sealing of a surface, the card can be clean and durable. An advantage of paper cards over plastic is quick issue on the spot. This card system is being used widely as remittance cards at banks, membership cards, entry cards, certificates at various events-seminars, exhibition and at various marketing gatherings. Another application is direct mail enclosing an admission ticket in the sheet for advertisement.

The company has started from "paper" but can make plastic cards as well. At present, clients send the company personal data with photos for ID by email for creating an ID Card at the company. Or alternatively, clients buy the "IDP card

issuing system" so that they can be more flexible to the needs of their employees for the change of data etc.

(2) Finance

The company has successfully developed new business areas to follow current demand without losing its tradition of a paper wholesale business. The management principle of the president seems carefully progressive, knowing the limited management resources he owns. We mentioned above that the information network system was set up by his staff rather than relying upon outside specialists. The president wants to cultivate resources inside the company though it takes time. He considers human resources particularly important and holds training seminars regularly for the staff, inviting outside consultants.

The company actively sought financing when it was expanding into new businesses for acquisition of equipment and operation fund. In 1975, the company increased the capital for acquisition of printing machines for roll papers. Since the company could not borrow from private banks due to lack of credit, it first borrowed from Japan Finance Corporation for Small Business, JFS (See the table below). Since then the company has obtained seven loans successively from JFS now amounting to 50% of the total borrowings. "JFS is not concerned with the balance ratio between loan and deposit and does not apply pressure once the loan made." "In most cases, JFS does not require a Credit Guarantee by CGA other than the collateral the company provides", the President appreciates the JFS loan system. The company has also received a loan from The Shoko Chukin Bank.

The performance of the company is affected by competition in a sluggish economy and profits have recently fluctuated with annual sales of 1.2 million for FY 1999.

Table 2-6

Detail of borrowing (Feb. 2000)

Banking institutions	Loan amount	No. of loans	Terms
JFS	134,000	7	repayment 3 years-10years with one year grace period, Interest rate 1.9%-2.5%p.a. Loan with credit guarantee 1
Shoko Chukin	6,200	1	5 years
Sakura Bank	83,300	3	3 years (w/o credit guarantee 1) -7yrs (c/guarantee 2), int. 1.8%+g. fee 0.95%
Tokyo Mitsubishi Bank	50,000	1	Short term
Total	273,500	12	



**Table 2-7 Japan Finance Corporation for Small Business (JFS)**

Established	1953	Japan Finance Corporation for Small Business Law
Share Capital	¥277.7 billion fully owned by Japanese Government	Head Office and branches 59 (1999)
Loans	Ordinary loans and special loans * Direct Loan by JFS, Loan by Agent (Bank or other institutions)	*Loans for new business, new technology, vitalization of regional SMEs, management innovation etc.
Borrowers	SMEs	
Purpose	Equipment, long term operative fund	
Max, loan period	Equipment 10 years. Operative fund 5 years, incl. grace period 1 year	
Limit of loan	Direct loan ¥480 million, Agent Loan 120 million Special loans decided separately	For the specific purpose- for real estate 720 million
Present Interest rate	2.1% p.a. higher interest for longer period	
Loan balance	7,402.7 billion (FY1998)	Disbursement FY1998 1,792bil

**2.4 Case 4 (National Life Finance Corporation; NLFC)**

D Co., Ltd

**Table 2-8**

Established	1991. 3
Business	Contents, multimedia related software, Material CDROM
Capital, Turnover	¥15mi., Sales 540 million (1999 年)
Staff	Directors 4, employees 36

**(1) Outline**

The company is one of the core companies in "Sapporo Valley", located between the North Exit of Sapporo Station and Hokkaido Univ. The Company was established in 1991 and the staff is young, 26 years on average for 36 employees.

The company products are changing as follows:

- a. Printing pamphlet for companies produced using desk top publishing
- b. Contract of computer graphic for TV weather forecast symbol and authoring
- c. Photo and pictures as materials or parts of contents of DTP and Internet presented in CD ROM format (Materials Dictionary)
- d. Contract for internet application and system development using server

At present, the sales of a. printing by DTP has a 1/3 share, while c. Materials Dictionary accounts for 2/3 of the total sales. This item will increase in the future, with 70% for Material Dictionary and 30% for system development contract in 2000 sales target of ¥850 million

"Materials Dictionary" contains a series of photos and design free from copyright. The materials are various, ranging from flowers, fruits, vegetables, persons, animals and nature. Clients are mainly large software companies such as Softbank and Computerwave. In addition, the company sells CDROM as OEM to respond to the

clients needs. One advantage of this product is less likely to become obsolete than other types of computer software products, which can easily become out of date by new development of OS, hardware or data transmission. The product is not extremely fashionable but has a long life. There is no credit risk as clients are mostly big companies. The company has started direct sales to SOHO and companies to meet the future development of EC (Electronics Commerce) with a hope of earning stable and basic sales amount.

## (2) Finance

The company started business in 1991 with the share capital of ¥10 million. At that time, it was not possible for the company, which had just been founded to borrow money from private banks. So, the company obtained a loan for its operation fund from the People's Finance Corporation (the present name, National Life Finance Corporation, NLFC; see the list below). The term of the loan was an amount of ¥5 million for 4 years, and with interest rate 7.7% p.a. based on property as collateral. A regional bank made a loan for 5 million later. However, the company had constant problems with cash flow because profits were small in the midst of fierce competition, as the name of the company was not known yet. But, gradually by development of new products such as symbol marks of TV weather forecast and authoring technology, the credit rating of the company has improved. Hokkaido Credit Guarantee Association (Hokkaido CGA) accepted a loan guarantee, by which the company could borrow funds for development from a regional bank. In 1993, Sapporo City awarded the company a development fund for basic study of authoring technology for museums. As the start of production of the CD ROM "Materials Dictionary", sales have increased, and the company could obtain finance from regional banks without credit guarantee by CGA. The company made a long-term business plan to cope with credit crunch, started from a failure of the Hokkaido Takushoku Bank.

In 1999, Development Bank of Japan has made a loan of 40 million with favorable conditions of interest 2.2% for 5 years.

Besides various loan institutions, the company has started a study of obtaining direct financing in order to rectify small working capital on the Balance Sheet.

The president, a key figure in the Sapporo Valley, started computer related business as a student at Hokkaido University. He is now making an effort to open the "Sapporo BizCafe". This is a version of an Internet cafe but having a broader range of uses including developing ideas, business talk, presentation, restaurant and business convenience store especially for young entrepreneurs. For this idea, many computer related firms are participating with support of a central Small & Medium Enterprise Agency in addition to the Hokkaido Board.

Table 2-9 National Life Finance Corporation (NLFC)

Established	1949*	National Life Finance Corporation Law
Share Capital	¥256.6 billion wholly owned by Japanese Government	*Oct. 1999 People's Finance Corp. merged Environmental Sanitation Business Finance Corp and changed its name
Loans	Ordinary loans, Special loans * Small Business Management Improvement Loans - By Association and Chamber of Commerce & Industry recommendation** Direct loans (by NLFC), Agent Loans (Bank and other institution)	* Loans for New business, Startup Business, Regional Industry, SME Management Promotion etc. **No collateral required up to ¥5.5mil
Borrower	SMEs	
Purpose of Fund	Acquisition of Equipment, Operative fund	
Max. loan period	For equipment 10 years incl. one year grace period. Operating fund 5years incl.6 months grace period	Ordinary loan
Limit of loan	Direct loan ¥48 million Agent loan 24 million Special loan to be arranged separately	Ordinary loan
Present Interest rate	2.2% p.a. higher interest for longer period	Ordinary loan (2000.3)
Loan balance	¥10,754 billion (1,960 thousand loans)	FY 1998

2.5 Case 5 (The Shoko Chukin Bank; The Central Cooperative Bank for Commerce and Industry)

T Corporation

The H Technological Park Association

T Corporation is located in the Industrial Complex of the H Technological Park Association. The President of T has been the Chairman of the Board of Directors since establishment of the H Technological Park Association. The outline of the Company is as follows:

Table 2-10 T Corporation

Established	1969
Business	Welding torch, robotic, welding fume collector, welding wire, rod
Capital · Turnover	¥27 million Annual sales 1.66bil (1999.3)
Staff	Employees 45

In 1988, the company started production on complex premises upon completion of the first stage factory construction. The fund came from transfer of loans (sub-loan) from the Association. The Association borrowed from the Upgrade Fund of JASMEC from Shizuoka Pref. (70% of the project cost for 15 years with an interest rate of 2.7% combined with supplement of a loan by Hamamatsu City for about 20% of the project cost) and the Shoko Chukin Bank (10% of the project cost, 15 years with an interest rate of 6-7% p.a.). The remaining 20% has been paid by the company with funds obtained through selling its previous factory and some of own reserve. The Association retains ownership on the land and building until 2003, when all the repayment by the Association members will be completed. In addition, as funds for operation and

acquisition of equipment, a total of 2 billion has been lent as sub-loans by the Shoko Chukin Bank (see the list below) to the seven to eight Association members including Tokin (term: 5 to 7 years with an interest rate equal to the prime rate of long term lending then prevailing)

The General Manager of the Association is formerly of the Shoko Chukin Bank. The president of T and the General Manager of the Association give the advantages of the Association and the H Technological Park Industrial Complex as follows:

- a. At the time of the move to the Industrial Complex, a sub-loan was made to the Association members with favorable terms, which could not be expected from private banks under the financial situation then.
- b. At that time, the Association members could discount a bill with a much better discount rate applied. For example, a discount interest rate was around 3% for Association members, when a prevailing rate for an individual member company was 8% p.a. or so.
- c. The land at the Industrial Complex was converted originally from farming land, so was inexpensive, only ¥75,000 per 3.3 m<sup>2</sup>, when the land for general use was around ¥100,000 per 3.3 m<sup>2</sup>. Furthermore, the selling price of the factory premises previously owned was ¥400,000 as the former place was located in the middle of Hamamatsu City. The company could well afford to use its own funds.
- d. The land was new and empty, so the layout of new factory was freely designed. The Company made a rational production facility with a view to saving a number of employees.
- e. The Industrial Complex has an ample green belt besides factory sites, which is good for the environment.
- f. Association members can do a business each other, which led to some cases of new development.

The advantage is not only for the Association members, but also for Hamamatsu City who can receive annually a fixed asset tax of ¥120 thousand as an industrial complex against 800 thousand, which the city charged as tax for farming land.

The company became highly regarded in the industry for its welding robotics and a welding fume collector and torch exchange system. In addition, Tokin is tackling aluminum welding and three-dimensional welding. This is a result of joint research and development with Shizuoka University, the Public Testing Laboratory in Shizuoka Prefecture, T Motors and regional companies. In 1997, Director General of the central SME Agency honored Tokin with an award. In 1998, the company was approved by the prefecture for an R&D Program under the SME Creative Activity Business Promotion Law.

Company President Mr. Kanamori has an idea of establishing an R&D technology Center in developing countries under ODA program. Welding equipment will be brought there from Japan and retired experts who had worked at companies in Japan will be sent overseas as trainers for 2-3 years.

The T company performance was affected by the economy in recent years but the forecast shows recovery for this year as follows:

**Table 2-11 Change of T company performance along with time**

	1997.3	1998.3	1999.3	2000.3 (forecast)
Net sales	2,368,950	1,994,858	1,657,983	1,650,000
Operating profit	326,499	229,813	143,568	150,000
Current profit	263,808	90,246	13,644	180,000

(Unit ¥1000)

**Table 2-12 The H Technological Park Association**

Established	1974 By the JASMEC Upgrading Project
Capital	¥10 million
Members of Association	20 companies (December 1999). Member's Businesses: general machinery, electric machinery, auto components, precision machinery, welding equipment, computer peripherals, Plastics, Printing, Packaging materials, etc.
The size of the area	262,856 m <sup>2</sup> (incl. Association member's site 153,886 m <sup>2</sup> )
Association's common project	Joint R&D, joint purchase of gasoline, parking lot, finance etc.

The Association is making an application for development of an additional 99,000 m<sup>2</sup>. The land will be used to invite two to three research and development companies and to expand present members' factories, add a parking lot, etc. This time, they are seeking a better Upgrade Fund for 20 years (15 years for First Fund) with an interest rate of 2.1% (2.7% p.a. for 1<sup>st</sup> Fund)

**Table 2-13 The Shoko Chukin Bank  
(The Central Cooperative Bank for Commerce and Industry)**

Established	1936	Law
Share capital	¥43,320 billion owned by the Government 33,930, Cooperative 9,390	Head Office and Branch 103 (March 1999)
Loans	Loans on deeds, loans on notes, bill discounted, overdraft, debenture	Special loans (SME business development, new business fund, etc.
Borrower	SMEs cooperatives, cooperative members and others qualified	
Purpose of loans	Acquisition of equipment, Long term operation fund	
Max. loan period	Equipment 15 years (inc. two year grace period, Operation fund 10 years (inc. one year grace period)	
Loan limit	Cooperatives 20bil, Coop members 2bl.	
Interest rate p.a.	2.2% for coop. 2.45 % for members 1 to 3 years, as of 2000.3	2.95% for coop and 3.25% for members.
Loan balance	11,378bil	(1999.3)

## 2.6 Case 6 (Shizuoka Credit Guarantee Association)

### E Industries, Co., Ltd Cooperative T

E Industries, Co., Ltd. is located in the Industrial Complex at Cooperative T the president of the company has been the chairman of the board of directors at Cooperative T since 1999.

Table 2-14 E Industries, Co., Ltd

Established	1901
Business	Manpower saving machinery and instruments, Precision machinery, Medical equipment
Capital · Sales	¥40 million, Annual Sales ¥15 billion (March 1999)
Staff	Employees 87

The company has a long history with changes of its line of business. Since establishment of the company, a main line of the business had been products of pig iron and casting. However, the company withdrew from the steel business, changing to manufacture of labor saving machine and automotive parts. After the end of the bubble economy, its line of business changed more to manpower saving machines using semiconductors, precision machinery equipment of micro units and medical equipment. At present, the company as a hardware manufacturer is aiming at joint businesses with software suppliers in or out of the Industrial Complex.

As an SME having limited management resources, the company tries to avoid risky development projects through joint R&D or by research on contract basis with client companies or utilizing clients' marketing channels for new products. Recently, Mr. Enomoto received approval from the prefecture under the SME Creative Business Activity Promotion Law. The company, as a member of regional consortium is applying for a ¥100 million subsidy for a certain R&D Program

For conversion of the business line and development of new products, the company received sub-loans from the Upgrade Fund (80% interest free for 20 years) from the Cooperative the same as other member companies. In addition, the company has obtained a credit guarantee from the Shizuoka Credit Guarantee Association (Shizuoka CGA, see the list below) for 50 million with a guarantee fee of 0.7% p.a. by which a local banking institution made a loan for 5 years. The company has benefited from such public support, as private banking institutions have tightened the lending policy for SMEs.

The performance of the Company had shown losses in the two years since the end of the bubble economy, but now sales have recovered with a profit of ¥50 million and annual sales of 1.5 billion for this year.

The outline of the Cooperative is as follows.

**Table 2-15 Cooperative T**

Established	1986 by the JASMEC Upgrading Project
Capital	¥17.65mil
Members of Association	14 (1999.12) incl. 2 large enterprises: manufacture of transportation machinery, general machinery, electric machinery, machine tool, precision machinery, software
The size of the area	261,840 m <sup>2</sup> (incl. members' sites 185,295 m <sup>2</sup> )
Association's common project	Joint R&D, joint purchase of gasoline, parking lot, finance etc.

The Cooperative Techno Land Hosoe was established by twelve R&D type companies, as one area of Hamamatsu Region Technopolis to modernize factories and protect the environment. Also, by grouping the companies in the complex, promotion of technology exchange and R&D were encouraged. The idea of congregating at the complex originated during fusion meetings among graduates of Shizuoka University who had business careers at large companies. The name of the fusion meeting was "Venture High Land Study" with members belonging to different industrial sectors. They studied various systems related to the Upgrade Project and joint projects aiming at expansion of fusion from "exchange in the region" to "exchange inter-regions". Therefore, members of the cooperatives were elected by the recommendation of those who originally proposed the idea, subject to all other members' consent. The condition for eligibility was that the development division of the company must move to the complex and the company must not create pollution. Therefore, at present, only seven out of fourteen companies have a head office in the complex. However, the sizes of companies are bigger than the ones at the Hamamatsu Technological Park Association. Four companies are listed on the Stock Exchange. The terms of the Upgrade Fund are for 80% of the project cost and 20 years with an interest rate of 2.7% p.a. Joint financing was obtained from Shoko Chukin.

In 1998, the Industrial Complex Restraining Project was carried out in which five companies expanded their factories. The interest rate was lower by 2.1% than for the first project.

Table 2-16 Credit Guarantee Association

Established	1949 Shizuoka Credit Guarantee Association as incorporated foundation	Credit Guarantee Association Law (1953)
Share Capital	Basic Properties March 1999 1,242.5 billion (total of 52 C. G. Association)	52 Credit Guarantee Associations (All prefectures + Yokohama, Kawasaki, Nagoya, Gifu and Osaka City)
Guarantee	Credit Guarantee for banking institutions for SMEs to get loan funds.	General Guarantee, No collateral guarantee, Special small guarantee, Special guarantee*
Beneficiary	SMEs and their cooperatives in the region of each C.G.A.	*Special guarantee provides more loose eligibility, guarantee rate and limit of guarantee
Purpose of guarantee	Acquisition of equipment, Long term operation fund	
Max. Guarantee period	Equipment 7 years (inc. 1 year grace period), Operation fund 5 years (inc. 1 year grace period)	
Limit of Guarantee	General Guarantee 2bil, Coops 4bl.	
Guarantee rate	Standard rate (1.0%)	Loan interest by the lender banking rate
Guarantee balance	¥41,991tril. for 4.5 million guarantees (FY1998)	C.G.A insures with JASMEC for credit guarantee obligations

2.7 Case 7 (Foundation Venture Enterprise Center; VEC)  
TR INC.

Table 2-17

Established	1970
Business	Manufacture and sales of Area -Sharing Smoke Control
Capital · Turnover	91.3 million Annual sales ¥1.9 billion, Net profit 13 million (1999.6)
Staff	Employees 52

(1) Outline

The father of the present president established the company in 1970, forming N Co., Ltd. merely as an agent for a standard air curtain system. However, his father was not satisfied with the standard products since demands vary depending on the environment. Therefore, he began manufacture of custom-made air curtains. For this purpose, company staff and specialists conducted extensive research and development regarding airflow. The company has been successful in selling to department stores and waste disposal stations.

Background of the success is technology of "artificial tornado", which has enabled prompt exhaust of fumes by use of centrifugal forces and absorbing forces.

Mr. Chikao Matsui inherited this technology and thought about developing exhaust units for tobacco smoke to meet demands of the time. Research and development continued until the company was confident enough to focus on manufacture and sales of tobacco exhaust system only. Mr. Matsui is now 35 years old.



Now, various smoking systems made by the company are used widely in departure lobbies of various airports, hospitals, government offices, universities and company offices. Annual sales have grown from ¥200 million in 1989 to around ¥2 billion now. Orders from overseas markets such as China and South Africa are increasing. Currently, the company system holds about a 65% market share. As a result, income from maintenance including supply of filters is increasing, too.

## (2) Finance

Thus, the company has concentrated development of new products and has been successful so far. On the other hand, the company is faced with the task of additional financing due to increases in the cost of R&D, and for competition with newcomers to the market. This seems a common problem for venture enterprises. However, the company has managed to find sources for various financing, including a public loan system. Without such public support, the company might not have developed new products, since securing the funds from city banks was difficult because of its credit rating.

For Industrial Structure Improvement Fund (ISIF), which MITI introduced, the company has been approved as a Special New Business eligible for loan guarantee of ¥300 million for five years enabling the company to receive a loan from a city bank. (They finished repayment of the loan in full in 1999.)

In addition, a group of six private venture capitals undertook the debenture of private placement with an amount of ¥2.8 billion. The Shoko Chukin Bank made a loan as well. "It took two years until we could borrow funds from Shoko Chukin but, their wonderful information helped the company once the transaction started", according to President Matsui.

The relationship with Venture Enterprise Center (VEC, see the list below) is specially noted from the fact that in 1986 VEC made a loan guarantee for R&D of "Artificial Tornado" system for ¥32 million and the company borrowed funds from Tokyo Mitsubishi Bank. In 1999, the company agreed to pay VEC a special premium ¥4 million as a token of successful reward. VEC generally comments that a key factor for success of venture businesses is not only a unique technology, but also management having a very clear view on its resources and future vision of the business.

The company's performance is not disclosed in the company brochure or on the Internet. According to Tokyo Shoko Research, annual sales are ¥1.9bil with net profit of 13 million

**Table 2-18 Venture Enterprise Center (VEC)**

Established	1975 R&D Type Enterprises Development Center → 1994 Venture Enterprise Center as foundation	Tokyo Headquarters, Kansai Branch
Share Capital	Basic Properties ¥7 million Credit Guarantee Fund 1,973 million Operation Fund 1,430 million	
Credit Guarantee	R&D type enterprise (Venture Business type)	Intelligent service type enterprise (New business type)
Beneficiary	SMEs or mid-sized enterprises having concrete plans for new technology or new products. The new project of high potentiality in following criteria: Development of equipment, system itself or parts and materials equipment for social welfare and saving labor	SMEs or mid-sized enterprises having concrete plans for new service. The new project must have a high degree of potential for success according to the following criteria: Development of service itself or equipment in combination of advanced technological development and leading know-how
Purpose of guarantee	Acquisition of equipment for R&D, cost of testing, prototype, machinery and parts before commercial production	Acquisition of equipment and cost of development of know-how for tendering services, development and improvement of facility and testing etc.
Max. Guarantee period	8 years including grace period of 1 year	8 years including grace period of 1 year
Limit of Guarantee	80%, ¥100 million	80%, ¥50 million
Guarantee rate	Max.2.0% p.a., no collateral but guaranteed by representative director. Loan interest as per lending bank's interest rate. Extra lump sum guarantee fee for successful case	Max.1.0% p.a., no collateral but guaranteed by representative director. Loan interest as per lending bank's interest rate. Extra lump sum guarantee fee for successful case
Guarantee (cumulative)	¥22.7mil for 504 projects during 1975 - 1998.3	¥1 billion for 31 projects during 1988 - 1998.3

**2.8 Case 8 (Tokyo Small and Medium Business Investment & Consultation Co., Ltd; SBIC) O Corporation**

**Table 2-19**

Established	1952. 1997 listed at Tokyo Security Exchange
Business	Manufacture and installation of Oil less bearing, precision machinery, machine tools, seismic base isolators
Capital, Turnover	¥8.6 billion, Annual sales 38 billion, Current profit 3.6 billion (1999.3)
Staff	Directors 17, employees 1,018

The company is a TSE listed company with good performance as above. But, in 1952 the company was a small factory at Kamata with share capital of Yen 1 million, where there are still many family-operated SMEs. In 1967, the Company moved its factory to Fujisawa, Kanagawa Prefecture when it asked the Tokyo Small and Medium Business Investment & Consultation Co., Ltd (SBIC; see the list below) to make an investment in the company. Tokyo SBIC agreed to subscribe stock shares of ¥66.6 thousand, which was equal to 30% of total shares issued. Thereafter, capital was increased with subscription of shares by SBIC at critical points of company expansion such as: construction of Shiga Works, starting a business in the US as O America Corp, construction of Oita Works and the establishment of a Taiwanese subsidiary.

In 1989, when the company listed at over-the-counter trading, share holding by Tokyo SBIC reached to ¥480 million equal to 13.3% of the total paid capital.

The principle of SBIC is to discharge shares at the time the company goes to public (or hold small shares as a stable shareholder). However, in the case of this company, SBIC has remained the top shareholder when the Company listed itself on the TSE II Market in 1994 and in the 1st Section of TSE in 1997. This is not usual for SBIC, who complied with polite insistence by the company, though the investment ratio reduced a little to 7.8% in Nov. 1999.

It seems that the company has been comfortable with the SBIC principle of "We will invest a funds but will not intervene in management". It is clear that the company must agree to share management control proportionately with a private investor, if the company asks such private company to make a substantial equity investment.

According to Mr. Hashizume, General Manager of General Affairs Department, regular checks by a CPA appointed by SBIC for auditing and consulting have assisted the company in raising the level of managerial standards of the company.

However, it seems that the success of Oiles is in the company itself. The company has developed a bearing for a sliding apparatus, which can be used anywhere requiring sliding action. The company is a major supplier of oil less bearings used for various equipment for controlling earthquake vibrations, and for aerospace and ocean development by using new materials. These have found application in modern urban areas and super high rise housing.

As of March 1999, the company owned 751 patents in addition to 593 design patents and 326 trademarks. The company may be commended as a successful example of corporate management pursuing "Quality Company" rather than "Big Company".

Table 2-20 Tokyo Small and Medium Business Investment & Consultation Co., Ltd (SBIC)

Established	1963	Small and Medium Business Investment & Consultation Co., Ltd
Share Capital	¥6.7 billion (18 prefectures 1.4bil, Banks 4.0bil, 1.3 billion Blue chip industries, insurance cos. etc.)	Sister companies incorporated at Nagoya and Osaka. Total capital of 3 companies 17.8bil
Investment	Subscription of new stock at company establishment, increase capital, convertible bond, investment to venture business	Management consulting to the invested companies available
Eligible body	SMEs	
Use of Investment	Not specified. Subject to audit by CPA every fiscal term.	
Investment period	Long term as stable neutral shareholder. Bond 5 years. Selling of the shares made at listing of the companies at the security market*	*Transfer of shares to the clients companies, employees and banks possible
Limitation of investment	50% of the issued shares.	
Interest of the Bond	Long term prime lending rate+0.3% (min.)	
Balance of investment	For 772 companies ¥33.3 billion (1999.3)	3 SBICs total 2,861 companies 136.4 billion

### **3. Possible application of financial systems for SMEs in Japan to developing countries**

#### **3.1 Understanding to the stage of economic and industrial development in developing countries.**

It was after the establishment of the Small and Medium Enterprise Basic Law that Japan had comprehensive policy measures for SMEs. One must consider how economy and industry have developed in the developing country. It is necessary to take various factors of nationality and the level of education into consideration to draw the scheme of the policy measures for a certain developing country. For instance, if the country's economy is too undeveloped to have a stock market, introduction of SMEs Business Investment Consultation Company is not effective. If the society is multiracial or has strong social classes, it may be difficult to have an exchange of business sectors as fusion meeting or possible mergers of businesses at a later stage. For the same reasons, linkage between LE and SMEs and business upgrade by grouping may have only limited results at such nations.

The budget for SME support is over ¥1,000 billion for the General Account in the 1998 budget of the Japanese Government. There are many developing countries suffering from budget constraints where the total national budget is well under the budget for SMEs in Japan.

It is wrong, first of all, to apply Japanese successful cases, legislation and policy measures as they are, to developing countries. The applications of Japanese systems and experiences are considered below.

#### **3.2 Networking activities required**

SME policy in Japan is implemented by networking local governments, municipalities, and public organizations. Networking is official or unofficial, legitimate or de facto, voluntary or involuntary. There are 521 Chambers of Commerce and Industry and 2,808 Association of Commerce and Industry, which daily accept consultation by SMEs on availability of finance, etc. The Chamber of Commerce, itself offers management guidance and makes recommendations for financing under the Scheme for Small Enterprises through the National Life Finance Corp. (see Case 4) as well as introduction of other financial institutions. These policies are most effective when there are contact locations in the region close to the SME. In many developing countries, promotion of SMEs has been seriously discussed and many supporting organizations have been created, but they lacked coordination with each other. It is advisable to start networking where possible, by common use of information. For example, a database of the SMEs could be constructed based on the application of financing, etc. For this purpose, initiative of the central government is essential through legislation. Utilization of private funds must be considered, as the national budget is limited.

### 3.3 Support for self-reliant efforts by SMEs

In Japan, financial support is designed not to give merely monetary assistance but for SMEs to use the fund effectively so that repayment is timely. The above financing scheme for Small Enterprises is coupled with the Management Improvement System by the Chamber of Commerce. The SE must receive guidance by the Advisor at the Chamber of Commerce for management improvement for more than 6 months. Also, the Emergency Special Loan by Edogawa Ward requires the visit to the SE for diagnosis by the Registered Management Consultant (RMC) before approval of the loan. Also, a visit by the RMC to the SE is required for follow up guidance during the repayment period.

Generally speaking, in developing countries, the rate of default is higher and recovery of the fund is more difficult once the default is made. It is important to have such a recycling system. The loan should be used effectively to generate a profit. This will enable the loan to be repaid with interest. Funds received in repayment should be used to make loans to other enterprises. For this purpose, the system must train specialists or consultants for advising the business activities of SMEs.

At least 10% of the firm's own funds is normally required in the loan system in Japan even if the other terms are generous. This makes SME borrowers responsible for examining the project itself. This is reasonable since the source for the fund originated from taxpayers.

Also, it is important to study the policy measures from the viewpoint of the national economy and avoid too much protection, which might work against structural improvement of the industry. In such a cases, the policy decision may lead such industries to cultivate a new business field or in the worst case, to withdraw from the business.

### 3.4 Overall support for implementation of SME policy measures

The Japan Small and Medium Enterprise Corporation (JASMEC) has a role of development and training of human resources. It has the Institute for Small Business Management and Technology in the Corporation. When it implements projects like business upgrades, it starts with education and guidance.

In doing this case study, one SME representative commented "regular checks by a CPA appointed by SBIC for auditing the accounting and financial condition of the company, assisted us in raising the level of managerial standards at the company "(O Corporation, Case 8). A representative from another SME said, "It was two years until we could borrow funds from the Shoko Chukin but, their wonderful information services helped the company very much once the transaction started" (TR Case 7). Such remarks can never be overlooked as SMEs lack management resources and therefore useful information or guidance from the outside is so much appreciated. This is especially true for a venture type business that has an excellent technology, but not a management capability at the start.

Venture Enterprise Center has for a long time engaged in holding seminars and exchange meetings among the member companies and now many organizations

promoting the creation of the new businesses try to extend various services. This approach is effective in cultivating new ventures.

Some developing countries are inclined to think that if there are ample funds, all development of SMEs can be done by the country without any other assistance. Finance is an important and essential element but there are other elements for the promotion of SMEs. For example, the Creation of New Business measures is based on three laws, including the Law for Promotion of Creative Business Activities of SMEs, with a package of supporting schemes consisting of various loan institutions. These measures include upgrade loans, subsidies, tax reduction for equipment and Angel tax system, CGA credit guarantees, JASMEC special insurances, SBIC equity provisions, training and dispatch of specialists and advisors, collaboration with academics, public technical laboratory, and so on. Support must be all inclusive to be beneficial for most SMEs.