

2006

White Paper on Small and Medium Enterprises in Japan

Small and Medium Enterprises at a Turning Point:
Strengthening Ties with Overseas Economies
and Population Decline in Japan



JAPAN SMALL BUSINESS RESEARCH INSTITUTE

JSBRI

Foreword

Japan's private demand led recovery continued in 2005 as business conditions steadily, if gradually, improved, making the present recovery phase the third longest of the postwar period. Regarding the small and medium enterprises that represent 99% of business establishments in Japan, uncertainty over future trends in interest rates and sharply rising crude oil prices have affected business confidence, causing some variation in the extent of the recovery from industry to industry, but overall there has been a modest improvement.

Subtitled "Small and Medium Enterprises at a Turning Point," *The 2006 White Paper on Small and Medium Enterprises in Japan* analyzes two particular changes that SMEs face, one domestic and the other international. These are population decline within Japan, and strengthening economic ties with East Asia overseas.

Considering firstly the situation within Japan, the greatest and unavoidable challenge confronting Japanese society is that formed by the decline of the birthrate, graying of society, and decline of the population. A decline in the ratio of the population of productive age to the population as a whole has a major impact on GDP, and there are fears that demographic decline could also cause the domestic market to shrink. The younger people dubbed "freeters" and "NEETs" need to enter the labor market, and the economy is calling for housewives with children to return to employment for the same reason. Because of their more flexible employment management practices, SMEs potentially have an important role to play in this regard.

Overseas, on the other hand, now that divisions of labor in Japanese industry have expanded to encapsulate the entire East Asian region, the SMEs that form the backbone of manufacturing must now be constantly aware that they face fierce competition from other countries in the region, regardless of whether they expand overseas or continue to do business solely within Japan.

The Japan Small Business Research Institute (JSBRI) is a specialist think tank set up with the support of METI's Small and Medium Enterprise Agency to promote the development of SMEs, and its activities include conducting surveys and research on SMEs, and the provision of support to organizations assisting the development of SMEs at the local level. Because of the importance of fostering international interaction among SMEs, the JSBRI also focuses on activities such as information sharing and personnel exchanges with related agencies in other countries.

This publication is a complete translation made by the JSBRI, with the approval of the Small and Medium Enterprise Agency, of the Agency's annual report on recent trends among SMEs in Japan entitled *The 2006 White Paper on Small and Medium Enterprises in Japan: Small and Medium Enterprises at a Turning Point — Strengthening Ties with Overseas Economies and Population Decline in Japan*.

I hope that this publication helps to improve understanding of the conditions facing Japan's SMEs among researchers and others involved with SMEs overseas who have an interest in SME policies and trends in Japan, and that it also makes its own modest contribution to the development of SMEs around the world.

Masataka Nakano
Chairman
Japan Small Business Research Institute

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Ministry of Economy, Trade and Industry
Japan Small Business Research Institute

2006

First printing : October 2006

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Edited by

**SMALL AND MEDIUM ENTERPRISE AGENCY
MINISTRY OF ECONOMY, TRADE AND INDUSTRY**

Translated by

JAPAN SMALL BUSINESS RESEARCH INSTITUTE

White Paper on Small and Medium Enterprises in Japan 2006



Small and Medium Enterprises at a Turning Point:
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Overseas Economies and Population Decline in Japan

On publication of *The 2006 White Paper on Small and Medium Enterprises in Japan*

The Japanese economy has now emerged from a long tunnel and continues to advance firmly on the road to long-term economic recovery. While the situation naturally varies somewhat according to industry and region, conditions among small and medium enterprises are steadily brightening overall. Now is the time for SMEs to take a good look at the changes occurring in society and to grasp the opportunities that they create to seek out new paths for growth.

Given how Japanese society is forecast to change over the next few decades, present-day Japan is at a turning point on two fronts. Externally, the country's economic ties with East Asia are deepening, while domestically, the birthrate is falling, society is aging, and the population has begun to decline. These major changes in the structure of society as a whole are likely to exert a profound impact on not only the lives of individual citizens, but also on the management and businesses of SMEs.

As a result of the spread of systems of division of labor in Japanese industry throughout the entire East Asian region, for example, the SMEs that form the backbone of manufacturing are finding themselves in a position in which extremely fierce competition with East Asia can never be ignored, irrespective of whether they expand overseas or continue to do business only in Japan.

Domestically, on the other hand, the decline of the birthrate and graying of the population mean that urgent action is required to ensure smooth business successions at SMEs as the large numbers of proprietors who founded their businesses in the high-growth period approach retirement en masse. At the same time, it is now clear that by frantically utilizing limited human resources amid the rapid decline in the birthrate, SMEs provide an environment that makes it easier to balance the demands of work and family.

On the basis of this analysis, the Ministry of Economy, Trade and Industry is committed to taking all necessary steps to assist the small and medium manufacturers that are the mainstay of the international competitiveness of Japanese industry, promote compact town development against the backdrop of population decline, and otherwise support hard-working, dynamic SMEs throughout the country.

I hope that this white paper will be of use to SME entrepreneurs and others involved in SME policy, and that it further increases understanding among the general public of what SMEs are really like.

I would like to conclude this brief introduction by saying that METI is committed to doing everything it can for the dynamic SMEs that will support the Japan of tomorrow.

Toshihiro Nikai
Minister of Economy, Trade and Industry
May 2006

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Introductory notes

1. In this report, the term “small and medium enterprises” (SMEs) refers to small and medium enterprises as defined under Article 2, Paragraph 1 of the Small and Medium Enterprise Basic Law, and the terms “small enterprises” and “micro enterprises” refer to “small enterprises” as defined under Article 2, Paragraph 5 of said law. More specifically, they may generally be categorized as follows.

Industry	Small and medium enterprises (meet one or more of the following conditions)		Of which small enterprises
	Capital	No. of regular employees	No. of regular employees
1) Manufacturing, construction, transport, other industries (excluding 2)-4))	Up to ¥300 million	Up to 300	Up to 20
2) Wholesale	Up to ¥100 million	Up to 100	Up to 5
3) Services	Up to ¥50 million	Up to 100	Up to 5
4) Retail	Up to ¥50 million	Up to 50	Up to 5

2. Business establishments are sometimes regarded as enterprises for the purposes of analyses in this report that make use of statistics based on the number of business establishments. In such cases, SMEs are business establishments that satisfy the above conditions regarding number of employees. In some cases, therefore, the business establishments of large enterprises may be treated as SMEs.
3. This report draws largely on statistical data published by the Japanese Government and Bank of Japan (BOJ). However, use is also made of analyses based on these data and studies conducted by various entities in the private sector. Sources, methods of calculation and other relevant information are specified where data are cited. However, the main sources cited in this report are described briefly below. (Unless otherwise noted below or in the main text, the unit of measurement used in statistical data is the enterprise.)
- (1) Ministry of Economy, Trade and Industry (METI), *Census of Manufactures*
 This survey provides statistics on numbers of business establishments. Surveys conducted in years ending in 0, 3, 5 and 8 are of the total number of business establishments, and surveys in other years are of business establishments and similar entities with at least four workers. Analyses based on these statistics are therefore only of business establishments with four or more workers.
 In this report, the data on business establishments in each year are concatenated for analysis. It is important to remember, however, that if a business establishment has three workers one year and four the next, it is treated as a new entry in that year. (Conversely, a business establishment that goes from having three workers to four will be treated as having exited.)
- (2) METI, *Census of Commerce*
 This survey provides statistics on numbers of business establishments.
- (3) METI, *Basic Survey of Japanese Business Structure and Activities*
 As this survey only covers enterprises with 50 or more workers and capital stock of at least ¥30 million, the results do not cover small enterprises and sole proprietorships.
- (4) METI/SME Agency, *Basic Survey of Commercial and Manufacturing Structure and Activity*
 This survey covers enterprises with less than 50 workers and capital stock of under ¥30 million. Data on enterprises with 50 or more workers and capital stock of at least ¥30 million covered by METI’s *Basic Survey of Japanese Business Structure and Activities* are used treating them as though they were covered by the *Basic Survey of Commercial and Manufacturing Structure and Activity*.
- (5) Ministry of Finance, *Financial Statements Statistics of Corporations by Industry, Annually and Financial Statements Statistics of Corporations by Industry, Quarterly*
 As these statistics do not include sole proprietorships, they do not reveal overall trends among small enterprises. In consideration of the sample sizes and response rates, moreover, the results concerning small corporations need to be viewed with some latitude. It must also be remembered that the quarterly version does not include corporations with capital stock of less than ¥10 million.
- (6) Ministry of Internal Affairs and Communications, *Establishment and Enterprise Census of Japan*
 This census contains statistics on both business establishments and enterprises. In this report, analyses using these

statistics based on enterprises also include sole proprietors (sole proprietorships). However, as statistics on sole proprietorships cannot be compiled by the *nayose* method of aggregating establishments that belong to the same company, the size of sole proprietorships is determined based on the number of workers at its head office or principal place of business. For example, a manufacturing sole proprietorship with 100 workers at its head office and 300 workers at branch offices would therefore be treated as an SME.

4. This report includes analyses of the results of questionnaire surveys of SMEs and other respondents conducted by the SME Agency and private-sector institutions commissioned by the SME Agency. However, as not all enterprises surveyed responded and the response rate appears to be higher the healthier a company is, the results probably paint a better picture than the reality. In addition, totals cited based on the results of these surveys do not always sum to 100% due to rounding to the first decimal place.
5. There are two problems with trying to determine the general situation in the SME sector using only mean values from statistical data on SMEs. These are as follows:
 - (1) Unlike large enterprises, SMEs exhibit considerable variation. Mean values are not therefore always representative of the typical SME.
 - (2) Statistical data on SMEs may not be distributed symmetrically around the mean, but instead skewed leftwards. In this report, therefore, median, top 25th percentile (first quartile) and bottom 25th percentile (third quartile) as well as mean values are used where necessary to provide a better picture of the typical SME.
6. The universities and institutes of the researchers whose findings (both on Japan and overseas) are cited in this report are those to which the researchers belonged when the results were published.
7. The word “significant” is used in this report to denote a figure considered to be sufficiently meaningful using statistical techniques. The smaller the percentage, the greater the degree of certainty.

Part I

Trends among SMEs in fiscal 2005

The private demand-led recovery of the Japanese economy continued in fiscal 2005, and business confidence generally improved among small and medium enterprises (SMEs) too. Driven by the twin engines of private consumption and capital investment, the present recovery phase dating from the trough in January 2002 had already lasted 50 months as of March 2006.

In **Chapter 1**, we examine in detail business trends among SMEs in fiscal 2005. The present recovery phase had by March 2006 become Japan's longest postwar period of economic expansion after the Izanagi boom (from 1965 to 1970) and the "bubble" boom (from 1986 to 1991). SMEs, though still lagging behind large enterprises, are at last showing signs of progress toward the elimination of the "three excesses"—excess capacity, excess debt, and excess employment—that have been a millstone for so long. But despite the overall improvement, the pace of recovery remains more sluggish in certain industries and regions, and so we also examine the factors giving rise to these differences.

Chapter 2 looks at trends in enterprise entries and exits, which are in a sense the "key" to restoring Japan's economic dynamism. We confirm that Japan's declining entry rate recently bottomed out and has begun to rise, focusing in particular on the startup activities of women and the elderly, and analyze their characteristics. As well as entries, we also consider what happens to businesses after entry, and analyze their continuation (survival), trends in bankruptcies, and the state of regeneration efforts.

In **Chapter 3**, we turn our attention to the financial environment in which SMEs obtain financial support for their business activities. Financially, SMEs are naturally in a more vulnerable position than large enterprises, but the evidence suggests that greater efforts are now being made to achieve financial soundness by cutting debt. Financial institutions, too, are adopting a more positive lending attitude to SMEs, and the continued decline to date in outstanding lending to SMEs appears to be coming to an end. Against this backdrop, we look at the growing diversity of methods of finance, especially credit scoring finance ("quick loans") and direct finance, and analyze what functions SMEs most look for from finance and what SMEs should themselves therefore do.

With the Japanese economy having at last escaped the negative legacy of the collapse of the bubble and embarked on full-scale recovery, Part I explains the business environment facing SMEs and the problems that confront them.

Chapter 1 Trends among SMEs

Section 1 The Japanese economy in fiscal 2005

The Japanese economy entered a recovery after reaching a trough in the first quarter of 2002, and the steady if gradual improvement in business conditions continued in 2005.

The present recovery was initially fueled by growth in net exports. Subsequently, however, capital investment has grown on the back of improved corporate earnings, and there has been a gradual increase in private consumption underpinned by an improvement in employment and income conditions driven by growth in demand for labor. Since the second quarter of 2004, private consumption and capital investment have been the twin engines of recovery, which is now clearly led by domestic demand. Under these conditions, the Government declared in its monthly economic report in August 2005 that the recovery had regained its momentum (Fig. 1-1-1).

Using data from the *Reference Dates of Business Cycle* produced by the Cabinet Office, let us then compare the length of the present recovery with previous periods of expansion to date. The present expansion phase (14th cycle) began following the trough in January 2002, and had lasted 50 months as of March 2006. This is already 16 months longer than the postwar average of 33.2 months, and is exceeded in length in the postwar period by only the 57-month sixth cycle, known as the “Izanagi” boom, and the 51-month 11th cycle, known as the “bubble” boom (Fig. 1-1-2).

Next, let us compare the present cycle with other

business cycles since the collapse of the bubble economy, since when Japan has experienced two recoveries.

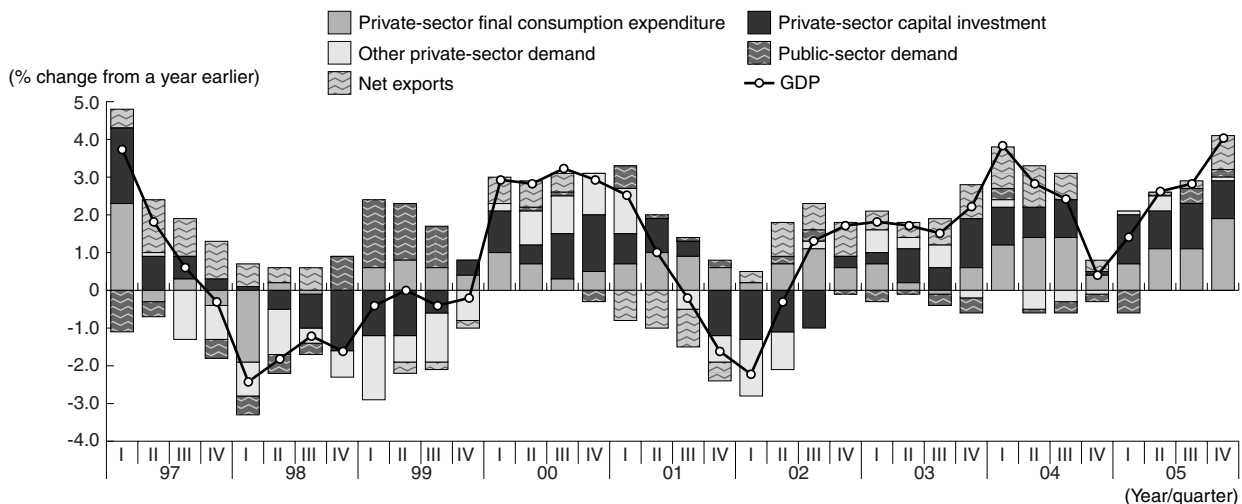
The first recovery (during the 12th cycle from October 1993), was a comparatively long one lasting 43 months. Owing largely to the accumulation of inventory as demand sank following the spike in demand ahead of the consumption tax hike and the slump in exports triggered by the currency crisis in Asia, the economy

Fig. 1-1-2 Business cycles of the Japanese economy
The present recovery is one of the longest of the postwar period

	Trough	Peak	Trough	Length in months		Total cycle
				Expansion	Contraction	
1st cycle		Jun. 1951	Oct. 1951		4	
2nd cycle	Oct. 1951	Jan. 1954	Nov. 1954	27	10	37
3rd cycle	Nov. 1954	Jun. 1957	Jun. 1958	31	12	43
4th cycle	Jun. 1958	Dec. 1961	Oct. 1962	42	10	52
5th cycle	Oct. 1962	Oct. 1964	Oct. 1965	24	12	36
6th cycle	Oct. 1965	Jul. 1970	Dec. 1971	57	17	74
7th cycle	Dec. 1971	Nov. 1973	Mar. 1975	23	16	39
8th cycle	Mar. 1975	Jan. 1977	Oct. 1977	22	9	31
9th cycle	Oct. 1977	Feb. 1980	Feb. 1983	28	36	64
10th cycle	Feb. 1983	Jun. 1985	Nov. 1986	28	17	45
11th cycle	Nov. 1986	Feb. 1991	Oct. 1993	51	32	83
12th cycle	Oct. 1993	May 1997	Jan. 1999	43	20	63
13th cycle	Jan. 1999	Nov. 2000	Jan. 2002	22	14	36
14th cycle	Jan. 2002			50	(As of Mar. 2006)	
Average				33.2	17.1	50.3

Source: Cabinet Office, *The Reference Dates of Business Cycle*.

Fig. 1-1-1 Contributions to real GDP by component
Twin engines of private-sector final consumption and capital investment



Source: Cabinet Office, *Annual Report on National Accounts*.

entered a contraction. During the second recovery phase (in the 13th cycle from January 1999, dubbed the “IT bubble”), meanwhile, external demand growth failed to translate into domestic demand growth, which would have generated a self-sustaining recovery, on account of the downturn in global IT demand triggered by the slowdown in the U.S., and the economy consequently began to contract. How then does the present recovery phase differ from recovery phases to date?

1. Progress in eliminating excess capacity, excess debt, and excess employment

A feature of previous post-bubble recoveries has been the burden on enterprises of what have come to be known as the “three excesses,” i.e., excess capacity, excess debt, and excess employment. Below we examine how this situation on the supply side has changed. Fig. 1-1-3 shows trends in the diffusion indices (“excessive” – “insufficient”), or “DIs,” for enterprises’ views on the sufficiency of employment and capital according to the Bank of Japan’s (BOJ) *National Short-Term Economic Survey of Enterprises in Japan* (known for short as *Tankan*) and the interest-bearing debt repayment period

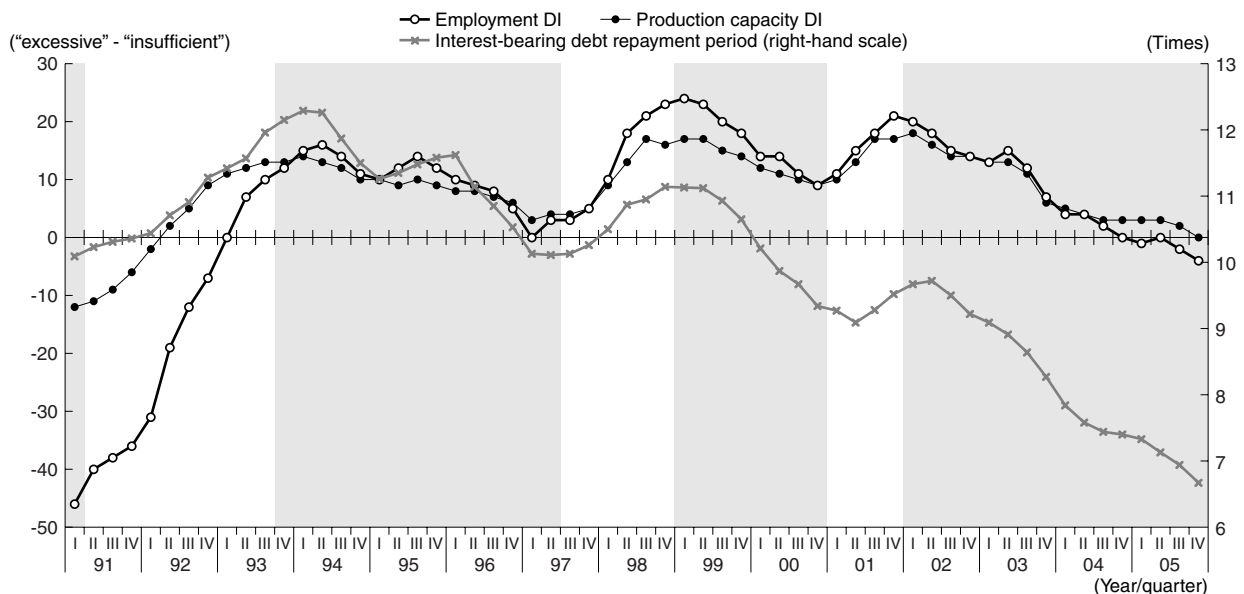
(calculated by dividing enterprises’ outstanding interest-bearing debt by cash flow). From this it can be seen that the “three excesses” hindering the Japanese economy have ameliorated considerably during the present recovery.

The outlook regarding capital investment is also brightening according to projections based on the Cabinet Office’s *Statistical Survey of Machinery Orders*.¹⁾ Data from the latest survey show that machinery orders continued to grow year on year in the fourth quarter of 2005, indicating that firm growth in capital investment is on the way (Fig. 1-1-4).

Employment, too, continued to recover this fiscal year after hitting bottom in 2003. Particularly noteworthy is the fact that while there has been a perceived shift of employment from full-time to part-time workers in recent years, the rise in part-time workers’ share of regular employment at last entered a lull in the latter half of last year, creating the conditions for an improvement in employment feeding through into growth in incomes (Fig. 1-1-5).

During the previous two recoveries, therefore, the burden of the three excesses of capacity, debt, and employment meant that recovery was vulnerable to a decline in foreign demand. During the present recovery

Fig. 1-1-3 Enterprises’ “three excesses”
Progress in eliminating the “three excesses”

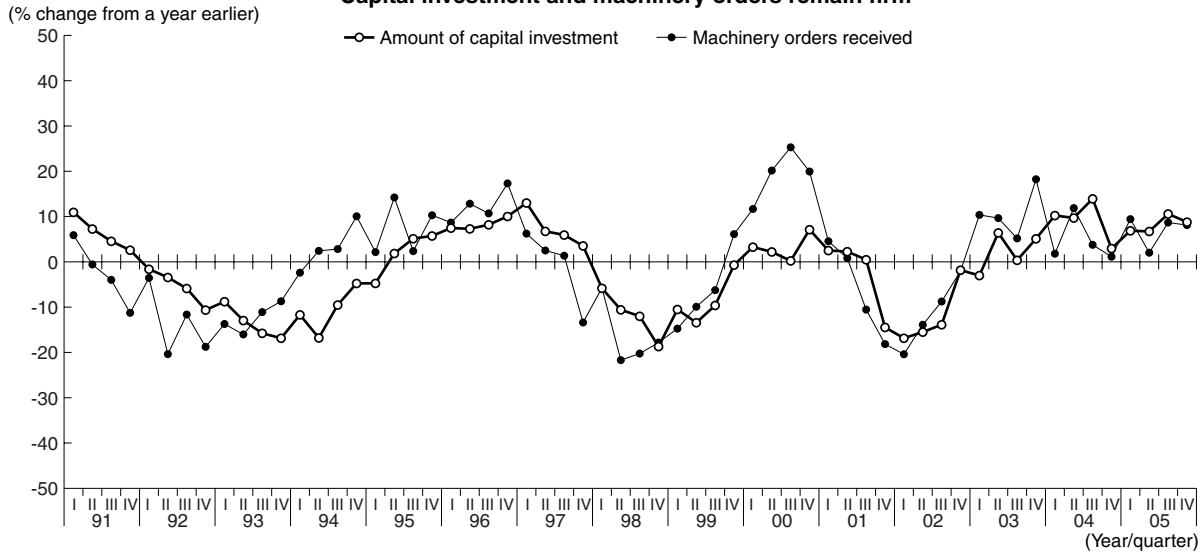


Sources: BOJ, *National Short-Term Economic Survey of Enterprises in Japan*; Ministry of Finance, *Financial Statements Statistics of Corporations by Industry, Quarterly*.
 Notes: 1. Interest-bearing debt repayment period = outstanding interest-bearing debt / cash flow
 2. Outstanding interest-bearing debt = short-term borrowing + long-term borrowing + corporate bonds
 3. Cash flow = ordinary profit x 0.5 + depreciation expenses
 4. The moving average for the past four quarters is used for the interest-bearing debt repayment period.

1) This is a survey of the value of orders received by manufacturers of the main types of machinery and equipment. As it captures data at the stage at which enterprises are placing orders for the machinery required for capital investment with manufacturers, it reveals trends in capital investment. Changes in the value of machinery orders are generally considered to be two to three quarters ahead of changes in actual capital investment hence.

phase, however, the amelioration of the “three excesses” as described above has led to a more robust, demand-led recovery.

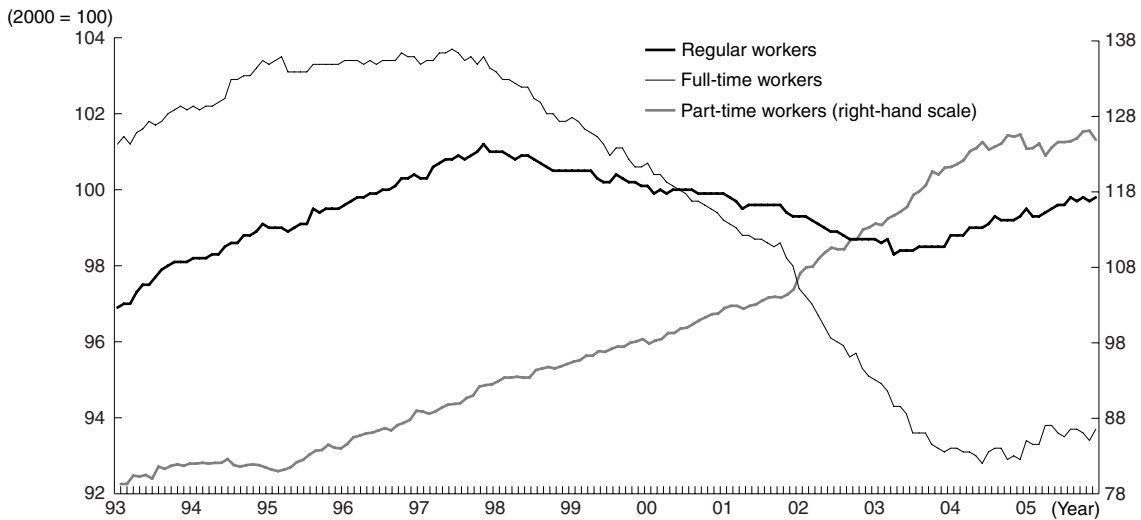
Fig. 1-1-4 Trends in capital investment and machinery orders
Capital investment and machinery orders remain firm



Sources: Cabinet Office, *Statistical Survey of Machinery Orders*; Ministry of Finance, *Financial Statements Statistics of Corporations by Industry, Quarterly*.

Note: Machinery orders received are for private demand excluding shipbuilding and electric power plants.

Fig. 1-1-5 Trends in number of regular workers
Signs of return from part-time workers to full-time employment since 2004



Source: MHLW, *Monthly Labour Survey*.

- Notes:
1. Seasonally adjusted.
 2. Based on employment at business establishments with 5 or more workers.
 3. Terms are defined as follows.

Regular workers:

a) Persons employed indefinitely or for a fixed period of over one month.

b) Persons employed daily or for a fixed period of not more than one month who were employed for at least 18 days in each of the two months before the survey period.

Full-time workers:

Regular workers who are not part-time workers.

Part-time workers:

Regular employees

c) whose normal working hours are shorter than those of full-time workers; or

d) whose normal working hours are the same as those of full-time workers, but whose normal working days per week are fewer than those of full-time workers.

2. Improving consumer sentiment

Next, we look at the present recovery phase from the demand side. Fig. 1-1-6 depicts the relationship between household income and consumption over the long term. After World War II, consumption rose continuously as incomes improved. Following the collapse of the bubble, however, consumption tended not to grow regardless of rising incomes, and from the latter half of the 1990s, consumption began to decline in tandem with falling incomes. In 2004, however, this trend was reversed, and increases were observed in both real disposable income and real consumption expenditure. This indicates that consumer sentiment is changing.

Looking at Fig. 1-1-7, it can be seen that average propensity to consume, which indicates the proportion of households' real disposable income accounted for by real consumption expenditure, began to rise in 1999 having declined continuously since 1983. Considered in conjunction with Fig. 1-1-6, it can be seen that from 2004, household consumption has outstripped growth in real disposable income.

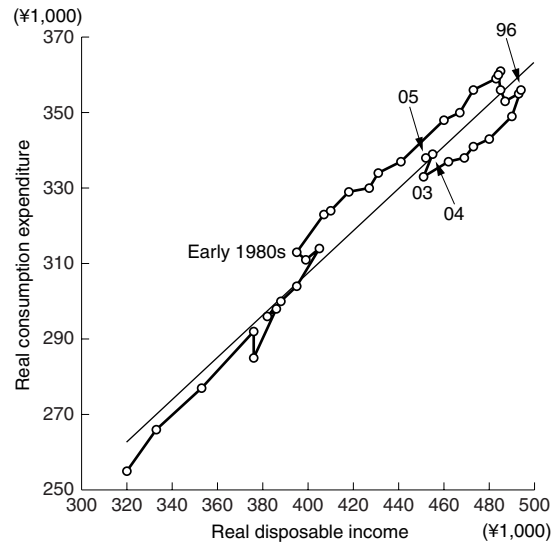
Macroeconomically, there are many possible reasons for a rise in average propensity to consume. A commonly noted cause in the case of Japan is the rising proportion of elderly in the population, who have a comparatively higher propensity to consume. Also playing a part, however, has been the improvement in consumer sentiment buoyed by the brightening outlook regarding household income.

If private consumption expenditure, which accounts for around 60% of Japan's GDP, does really begin to expand as a result of improved consumer sentiment and employment and income conditions, then the gap between supply and demand that has been the principal cause of the deflation of the 1990s should also begin to

shrink.

Let us therefore look at current price trends from the point of view of the corporate goods price index²⁾ and the consumer price index.³⁾

Fig. 1-1-6 Trends in real disposable income and real propensity to consume (1970-2005)
Rise in both real disposable income and real propensity to consume detected in recent years

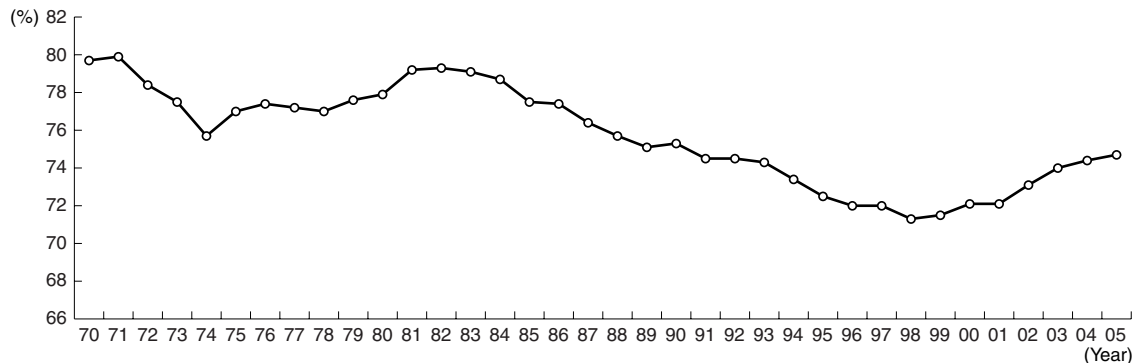


Sources: MIC, *Family Income and Expenditure Survey* (covering households of two or more and excluding households in agriculture, forestry, and fisheries), *Consumer Price Index*.

- Notes:
1. Income and expenditure per annual average month of workers' households excluding households in agriculture, forestry, and fisheries.
 2. Inflation-corrected using the consumer price index.
 3. The straight line is the approximation line.

Fig. 1-1-7 Changes in average propensity to consume (real consumption expenditure / real disposable income) (1970-2005)

Consumer sentiment too has changed due to recent improvement in employment situation



Sources: MIC, *Family Income and Expenditure Survey* (covering households of two or more and excluding households in agriculture, forestry, and fisheries), *Consumer Price Index*.

2) The price of goods traded between enterprises.
3) The price of goods and services purchased by consumers.

As can be seen from Fig. 1-1-8, domestic corporate goods prices began to rise year on year in January 2004, while consumer prices at last began to rise year on year for the first time in 25 months in November 2005.

Why then have consumer prices risen little despite the rise in corporate goods prices?

Considering firstly corporate goods prices, both input prices and output prices are rising according to the BOJ's *Input-Output Price Index of the Manufacturing Industry by Sector*. Recently, however, growth in the input price index has not kept pace with growth in the output price index, indicating a worsening in the terms of trade index for enterprises (Fig. 1-1-9).

Normally when input prices (i.e., the prices of goods

inputted into the production process) rise, enterprises pass on the increase in costs by increasing output prices (i.e., the prices of products outputted). Now, however, the effects of increased volume sales and cuts in labor costs around 2002 have enabled enterprises to maintain solid earnings despite the sluggish rate of increase in the output price index (Fig. 1-1-10).

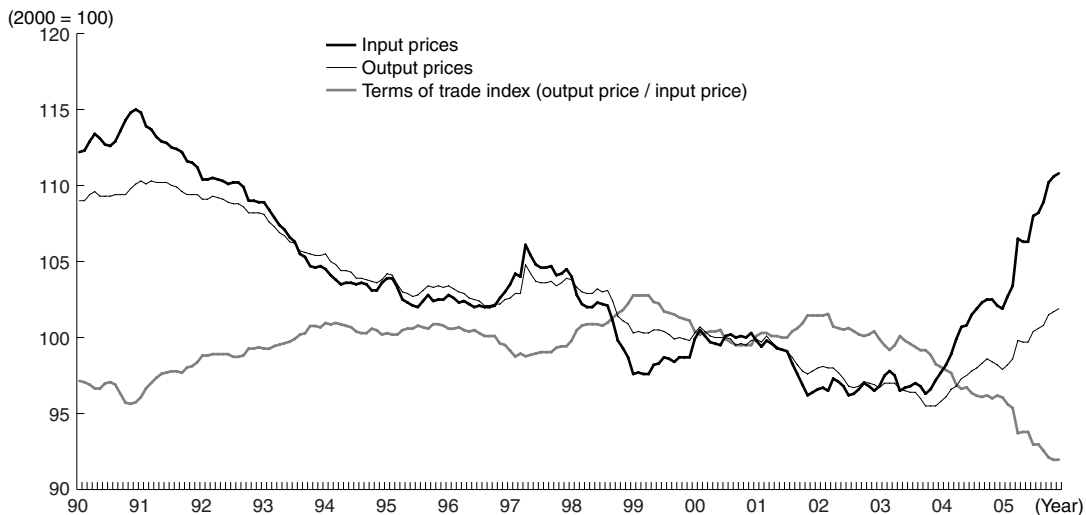
Returning then to the relationship between consumer prices and corporate goods prices shown in Fig. 1-1-8, whereas corporate goods prices are increasing (though output prices are not rising as much as input prices), consumer prices have not risen conspicuously to date. Although differences in the price baskets of the two are also a factor, the major reason for this is that enterprises'

Fig. 1-1-8 Trends in domestic corporate goods prices and consumer prices
Although corporate goods prices have risen, the knock-on effect on consumer prices has as yet been limited



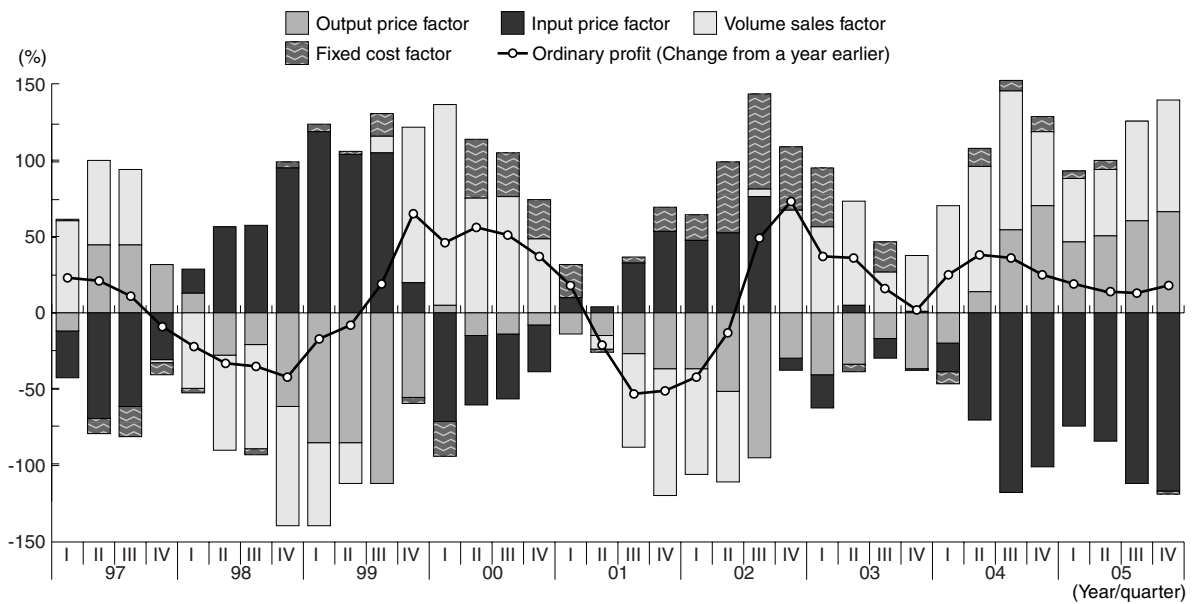
Sources: MIC, *Consumer Price Index*; BOJ, *Corporate Goods Price Index*.

Fig. 1-1-9 Trends in input prices and output prices
Deterioration in terms of trade puts pressure on corporate earnings



Source: BOJ, *Input-Output Price Index of the Manufacturing Industry by Sector*.

Fig. 1-1-10 Decomposition analysis of ordinary profit (manufacturing)
 Rise in input prices offset by growth in sales volume and reduction of fixed costs



Sources: Ministry of Finance, *Financial Statements Statistics of Corporations by Industry, Quarterly*; BOJ, *Input-Output Price Index of the Manufacturing Industry by Sector*.

Where π : ordinary profit, S: sales, V: variable cost ($S - \pi - F$), F: fixed cost, O: sales volume, I: input volume, Po: output price, Pi: input price

$$\pi = S - V - F = (O \cdot Po) - (I \cdot Pi) - F$$

$$\Delta \pi \cong (\Delta O \cdot Po + O \cdot \Delta Po) - (\Delta I \cdot Pi + I \cdot \Delta Pi) - \Delta F$$

Therefore

$$= O \cdot \Delta Po \quad - \quad I \cdot \Delta Pi \quad + \quad (\Delta O \cdot Po - \Delta I \cdot Pi) \quad - \quad \Delta F$$

(output price factor) (input price factor) (sales volume factor) (fixed cost factor)

efforts to increase sales and reduce labor costs have enabled them to keep down price increases passed on to the consumer. However, labor costs are now bottoming out as the labor market has tightened, making it difficult for enterprises to keep down price increase in this way. In the future, therefore, consumer prices may follow corporate goods prices in rising.

Section 2 Business trends among SMEs

1. Business conditions among SMEs

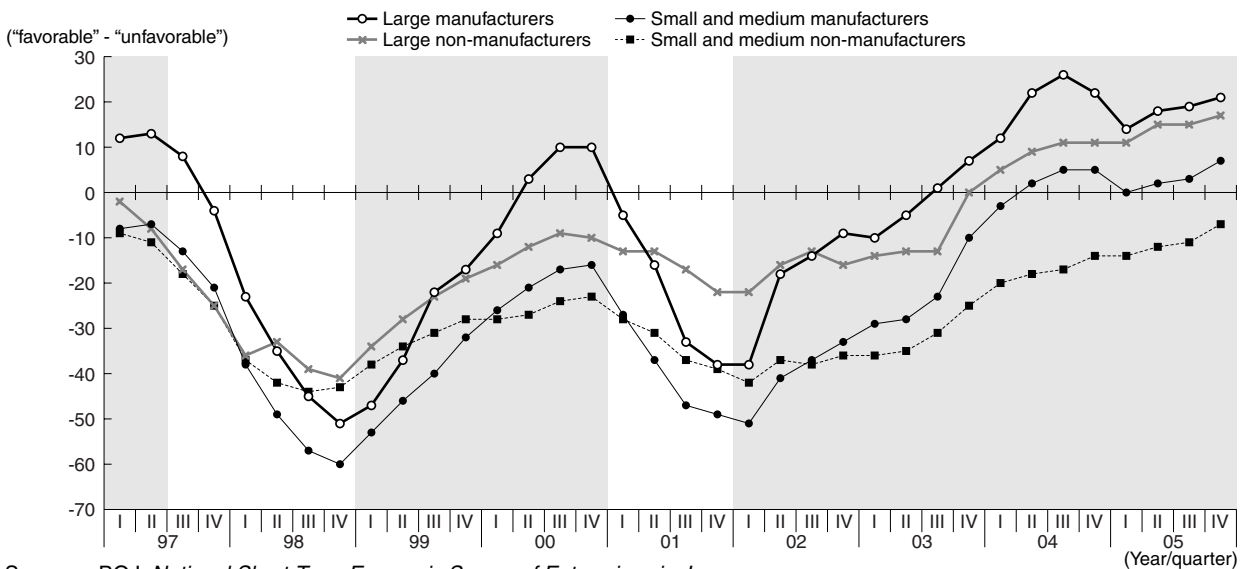
Amid the recovery of the Japanese economy as a whole, business confidence among SMEs, too, improved modestly in fiscal 2005.

According to the BOJ's *Tankan*, the business conditions DI for SMEs has improved since bottoming out in the first quarter of 2002, with manufacturing

leading the way. Nevertheless, this recovery lags behind the recovery in the business conditions DI for large enterprises (Fig. 1-1-11).

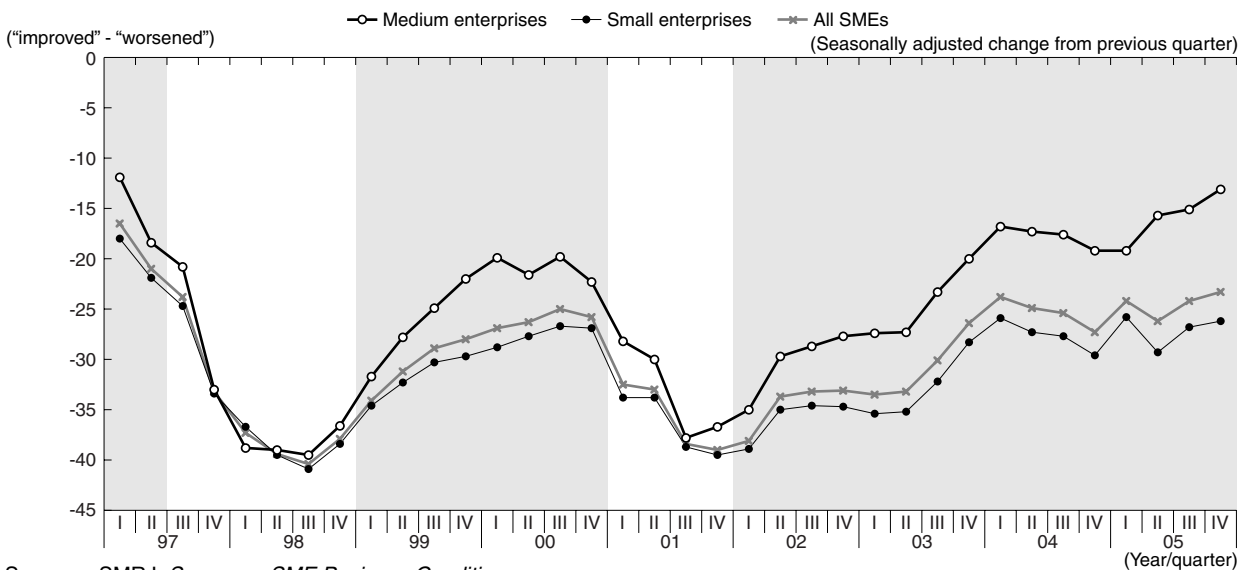
As the BOJ's *Tankan* defines SMEs as enterprises with capital of at least ¥20 million, below we examine trends in business confidence by size using the *Survey on SME Business Conditions*, which better reflects the actual situation of SMEs. The *Survey on SME Business*

Fig. 1-1-11 Trends in business conditions DI by size and industry
Recovery in business confidence among SMEs still appears to be lagging



Source: BOJ, *National Short-Term Economic Survey of Enterprises in Japan*.

Fig. 1-1-12 Trends in business conditions DI among SMEs
Recovery in business confidence lagging among SMEs, especially among small enterprises

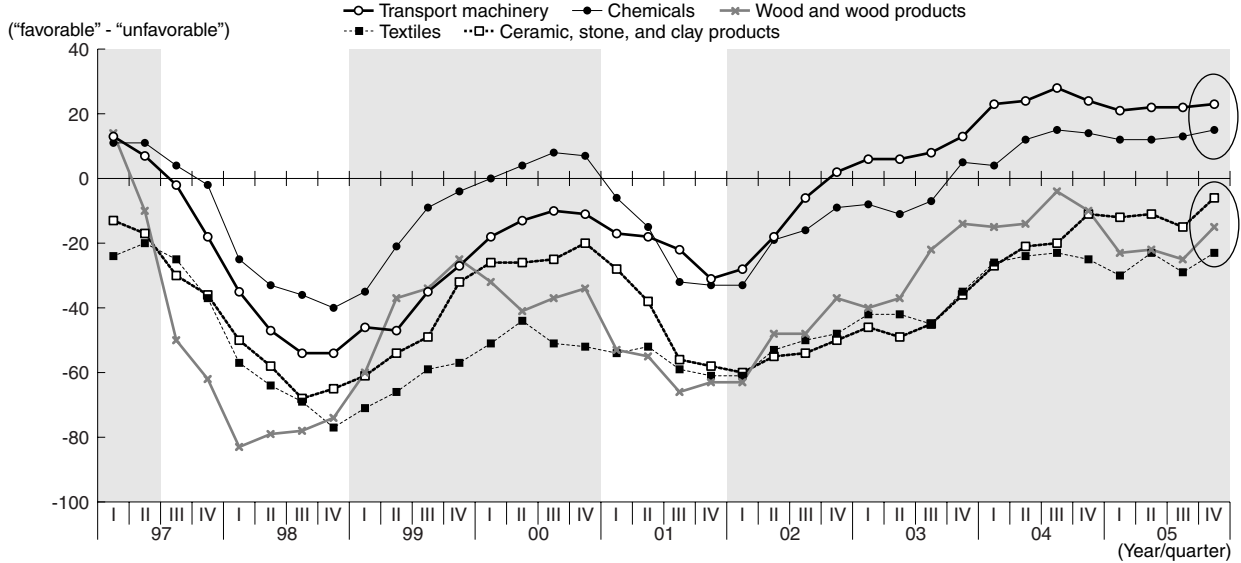


Source: SMRJ, *Survey on SME Business Conditions*.

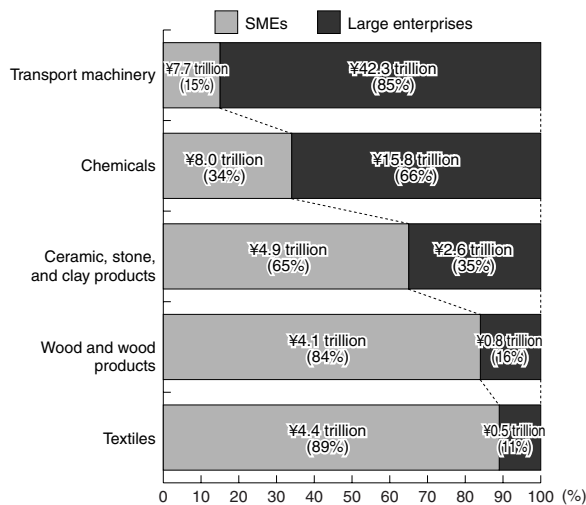
Note: "Small enterprises" are defined as enterprises with 20 or fewer employees in manufacturing and construction, and five or fewer employees in wholesaling, retailing, and services. "Medium enterprises" are other SMEs.

Fig. 1-1-13 Business conditions by industry and SME-ness of each industry
Business confidence stagnates in industries with a large SME presence

1) Trends in business conditions DI by industry (all sized enterprises in five industries)



2) SMEs’ and large enterprises’ shares of shipments (five industries)



Sources: BOJ, *National Short-Term Economic Survey of Enterprises in Japan*; METI, *Census of Manufactures (2003)*.

Notes: 1. “Textiles” includes “manufacturing of apparel and other textile products.”
 2. “Wood and wood products” includes “manufacturing of furniture and decorations.”

Conditions is a quarterly survey conducted by the Organization for Small and Medium Enterprises and Regional Innovation, Japan (SMRJ), and approximately 80% of the enterprises polled are small micro enterprises (Fig. 1-1-12).

Combining the results of this *Survey on SME Business Conditions* with those of the BOJ’s *Tankan* reveals that while business confidence at large enterprises is recovering, the improvement in business confidence at SMEs, and at small enterprises especially,

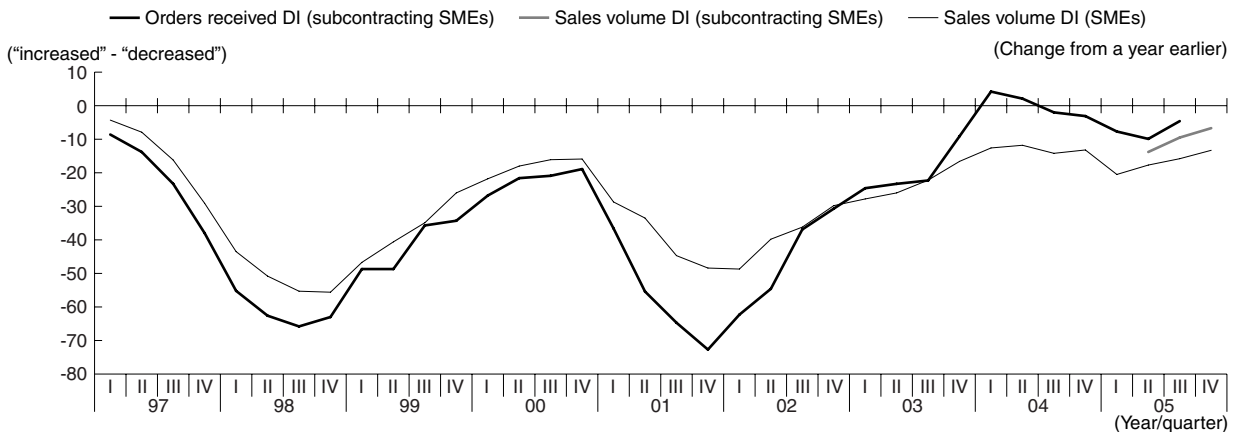
has lagged since the first quarter of 2004. There has thus been a divide along size lines in the recovery in business confidence during the present recovery, but why should this be so?

To try to answer this question, let us divide manufacturing up into industries in which SMEs account for a large proportion of the value of shipments and those in which they do not, and then examine trends in the business confidence DI in each. What we find is that whereas business confidence has improved in industries in which large enterprises account for a large proportion of shipments, such as transport machinery and chemicals, business confidence has stagnated in areas of manufacturing in which SMEs have a comparatively large presence, such as wood and wood products, textiles, and ceramic, stone, and clay products (Fig. 1-1-13).

A divide in business confidence between large enterprises and SMEs is similarly apparent in non-manufacturing. Unlike in manufacturing, however, where a recovery in business conditions among large enterprises has a knock-on effect on SMEs’ profits too owing to orders for parts and raw materials, SMEs and large enterprises in non-manufacturing are often in a position of direct competition. This is most obviously apparent in areas such as wholesaling and retailing. Improved profits at large enterprises thus do not have a knock-on effect on those of SMEs, and this is one reason for the disparity in business confidence.

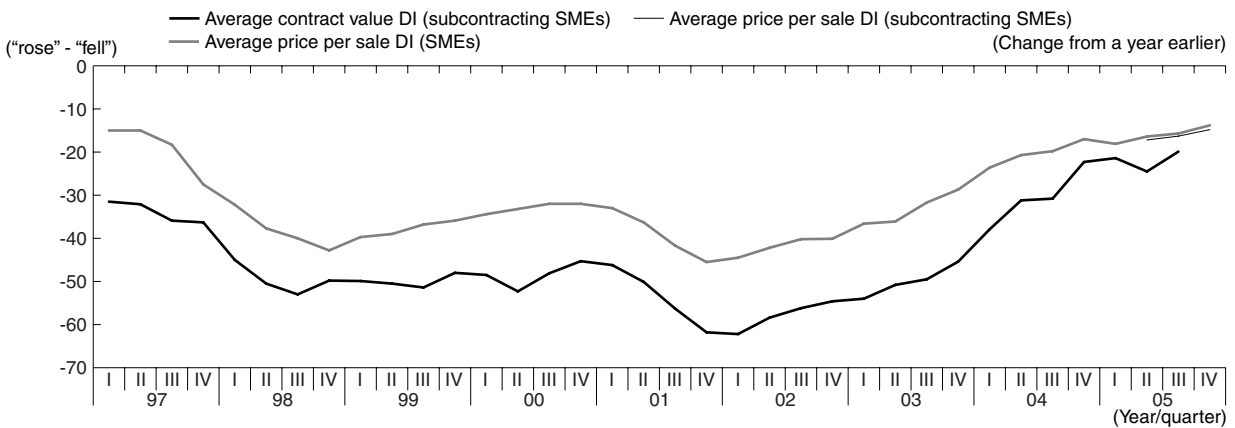
Overall, then, there is a gap in business confidence between large enterprises and SMEs, and the extent of the recovery also varies according to industry. In manufacturing in particular, business confidence is worse in industries with a large SME presence, and this depresses business confidence among SMEs as a whole.

Fig. 1-1-14 Trends in orders received DI among subcontracting SMEs (manufacturing)
Marked growth in orders received and sales volume among subcontracting SMEs in present recovery



Notes: 1. Data on the orders received DI are from SME Agency, *Survey of Short-Term Trends among Small and Medium Subcontractors*. Data on the sales volume DI (for SMEs and subcontracting SMEs) are from SMRJ, *Survey on SME Business Conditions*.
 2. As the *Survey of Short-Term Trends among Small and Medium Subcontractors* is a monthly survey, data for March, June, September, and December are used.

Fig. 1-1-15 Trends in average contract value DI among subcontracting SMEs (manufacturing)
Recovery in terms of average contract value and average price sale also greater among subcontracting SMEs than SMEs in general



Notes: 1. Data on the average contract value DI are from SME Agency, *Survey of Short-Term Trends among Small and Medium Subcontractors*. Data on the average price per sale DI (for SMEs and subcontracting SMEs) are from SMRJ, *Survey on SME Business Conditions*.
 2. As the *Survey of Short-Term Trends among Small and Medium Subcontractors* is a monthly survey, data for March, June, September, and December are used.

It is therefore important to bear in mind continued differences according to industry in SME business confidence.

Next, we turn to explore trends among subcontracting SMEs. Fig. 1-1-14 shows a comparison of trends in the orders received DI and sales volume DI for subcontracting SMEs, and the sales volume DI for SMEs in general. When the volume of SME sales declined during the contraction from the end of 2000, subcontracting SMEs suffered a particularly severe decline in orders. As the figure shows, however, subcontractors’ orders and volume sales have both recovered considerably more than the volume sales of small and medium manufacturers in general during the present recovery phase. Subcontracting SMEs are

undeniably having a difficult time in general amid the structural decline in “subcontracting” as a way of doing business. At the same time, however, those subcontractors that have survived the consequent competition for orders may be finding it easier to win orders during the recovery phase. In other words, they may in a sense be enjoying some of the benefits of being survivors. As further evidence of this, the average price per sale of subcontracting SMEs, though still lower than that of SMEs in general, is recovering more rapidly than among SMEs (Fig. 1-1-15).

2. Trends in production and shipments among SMEs

Next, we consider trends in production and shipments among SMEs.

Fig. 1-1-16 shows trends in manufacturing production indices by comparing the combined index for enterprises of all sizes, including large enterprises and SMEs, with that for SMEs only. From this it can be seen that the production index for SMEs has recovered since the first quarter of 2002, but more weakly than the combined index for enterprises of all sizes. What, then, should we make of the reason for this?

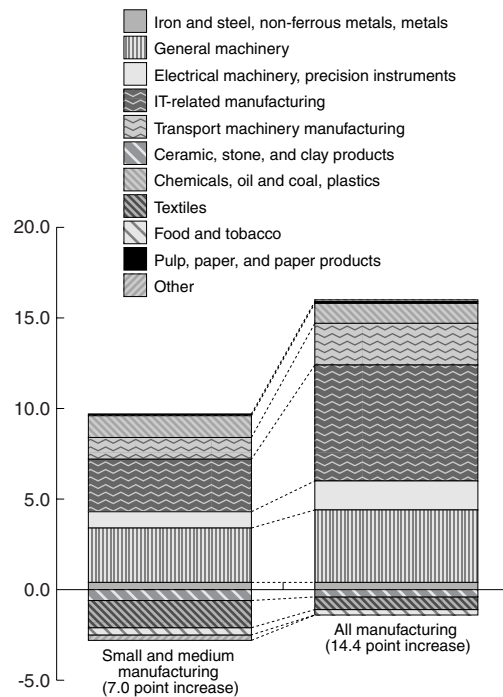
Fig. 1-1-17 gives a breakdown of the contributions by each industry to the increases in the production indices for SMEs and for enterprises of all sizes between the first quarter of 2002 and the fourth quarter of 2005 (the latest quarter for which data are available).

The first thing to understand is that the industries contributing to growth in the production index and to depressing the production index are the same in the case of both SMEs and enterprises of all sizes. In other words, there is no difference between SMEs and enterprises of all sizes in the industries experiencing production growth, and the industries experiencing stagnation.

If we compare next SMEs and enterprises of all sizes in industries in which production is growing, we find that SMEs make a smaller contribution to growth in production. If we take the transport machinery industry as an example, this industry made a 2.3 point contribution to the 14.4 point growth in production among enterprises of all sizes during the same period. In contrast, the transport machinery industry's contribution to growth in SMEs' production (7.0 points) was just 1.2

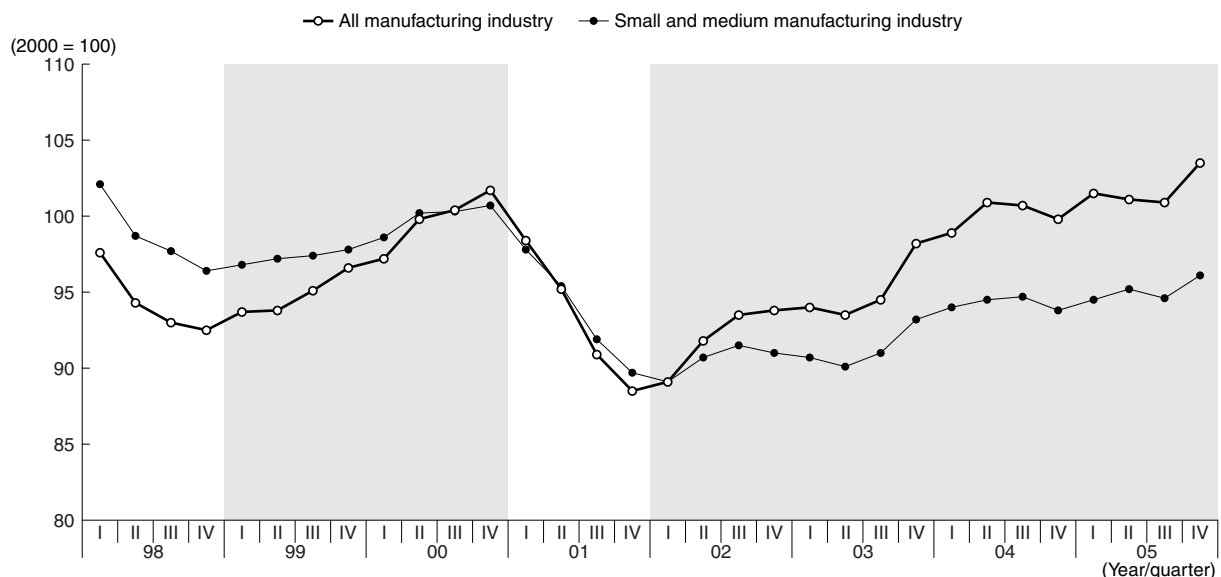
points. However, growth in the production index for transport machinery for SMEs exceeds growth in the

Fig. 1-1-17 Contributions by industry to growth in manufacturing production indices
Transport machinery and IT-related manufacturing output rising among SMEs too



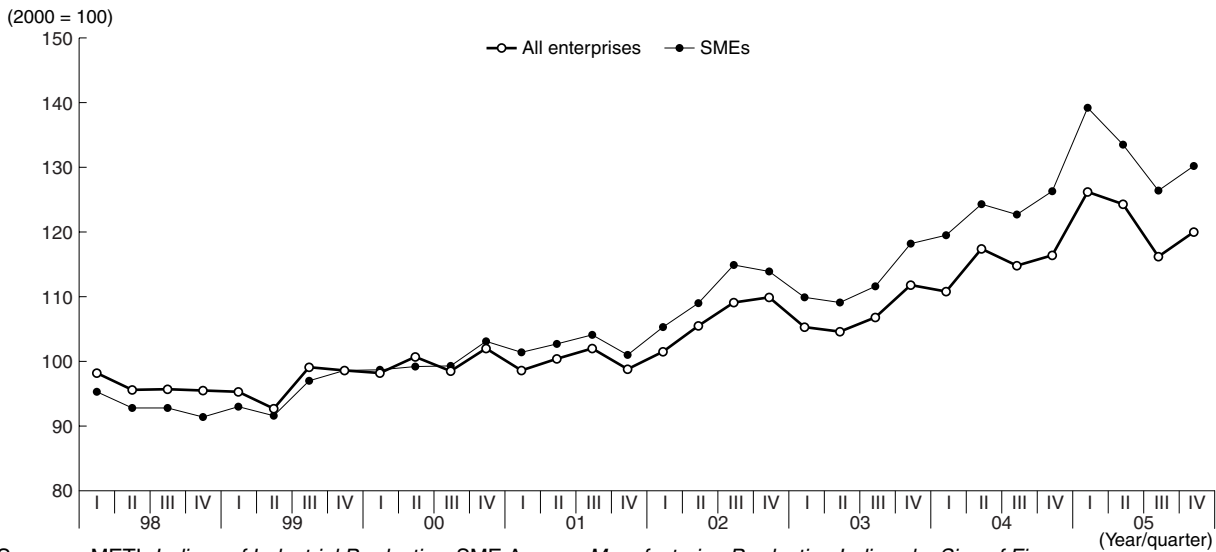
Sources: METI, *Indices of Industrial Production*; SME Agency, *Manufacturing Production Indices by Size of Firm*.
Note: Point difference in manufacturing production index between 1Q 2002 and 4Q 2005.

Fig. 1-1-16 Trends in manufacturing production indices
Recovery in output continues to lag among SMEs



Sources: METI, *Indices of Industrial Production*; SME Agency, *Manufacturing Production Indices by Size of Firm*.
Note: Seasonally adjusted.

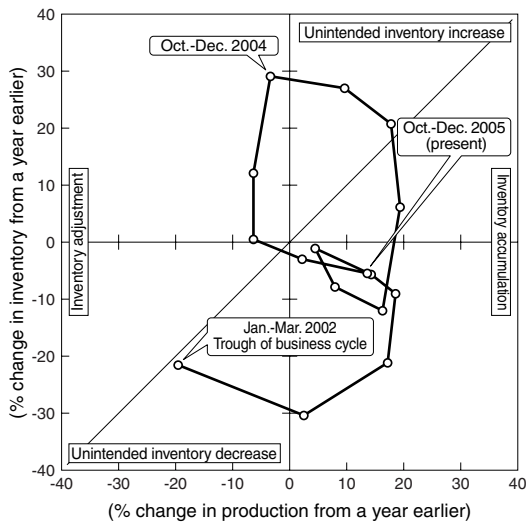
Fig. 1-1-18 Trends in production indices in transport machinery manufacturing
Recovery in transport machinery output stronger among SMEs



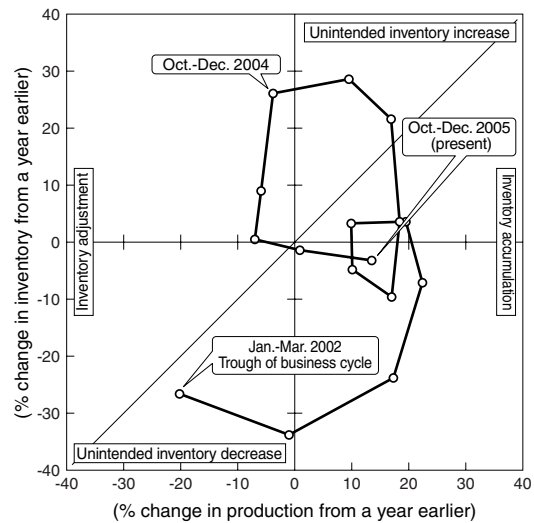
Sources: METI, *Indices of Industrial Production*; SME Agency, *Manufacturing Production Indices by Size of Firm*.
 Note: Seasonally adjusted.

Fig. 1-1-19 Inventory cycle in IT-related manufacturing
Inventory adjustment is finished among SMEs in IT-related manufacturing too

1) SMEs



2) All enterprises



Sources: SME Agency, *Manufacturing Production Indices by Size of Firm*; METI, *Indices of Industrial Production*.

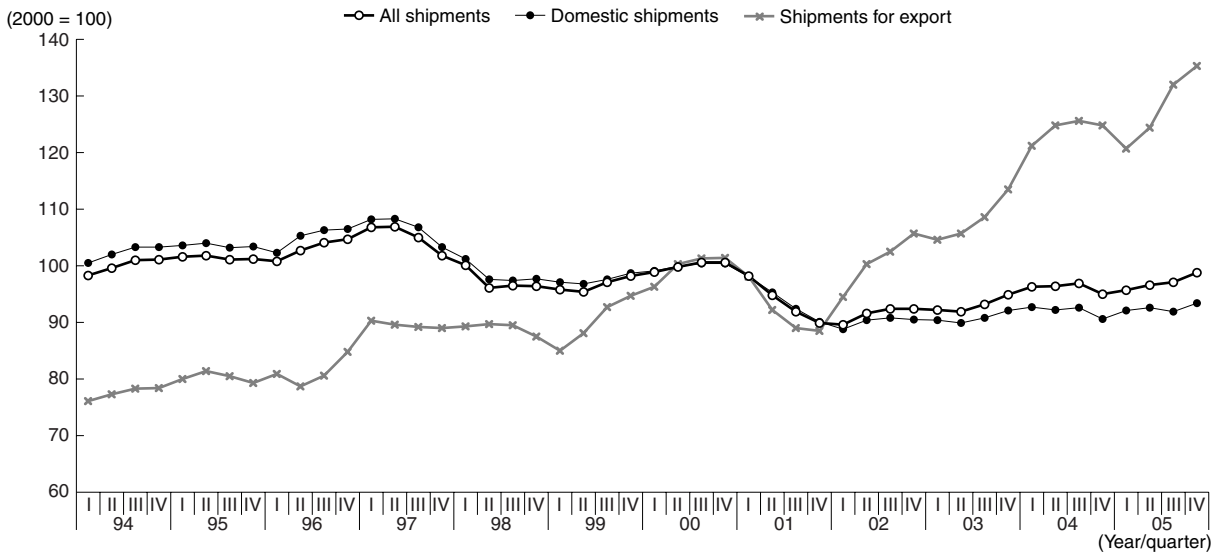
- Notes:
1. IT-related manufacturing = information and communications equipment manufacturing and electronic component and device manufacturing
 2. Data for information and communications equipment manufacturing and electronic component and device manufacturing were recalculated based on their proportionate value.

combined index for enterprises all sizes, as can be seen from Fig. 1-1-18, and in other industries as well, the production indices for SMEs do not differ markedly from those for enterprises of all sizes. (In IT-related manufacturing as well, inventory adjustment by SMEs has been completed as rapidly as by enterprises of all sizes, and the signs are bright that they will ramp up production (Fig. 1-1-19)).

From this it is apparent that the above differences in

contributions to growth in the production index are attributable to differences in the industries in which SMEs and large enterprises tend to be located. Thus industries whose production indices have exhibited greater growth have a higher proportion of large enterprises, and industries whose production indices have increased only sluggishly in recent years have a higher proportion of SMEs. This is reflected in the recent varying extents of recovery in the production indices of

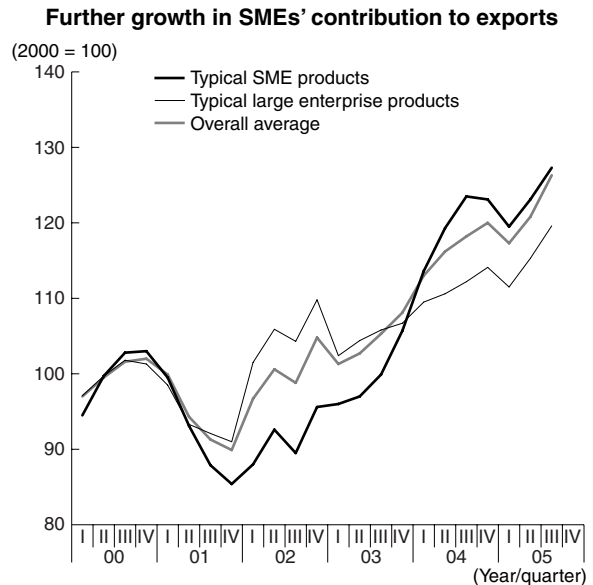
Fig. 1-1-20 Trends in shipments of small and medium manufacturers
Upturn in domestic shipments as well as continuing strong growth in shipments for export



Sources: METI, *Breakdown of Shipments, Census of Manufactures*.
 Note: Seasonally adjusted by the SME Agency using the X-11 ARIMA default.

large enterprises and SMEs indicated in Fig. 1-1-16. SME shipments exhibit a similar recovery trend. In addition to strong growth in shipments for exports, domestic shipments also began to pick up in the second half of 2005 (Fig. 1-1-20). Regarding exports as well, growth in the value of exports of typical SME products has tended to exceed growth in exports of typical large enterprise products since the first quarter of 2004 (Fig. 1-1-21).

Fig. 1-1-21 Trends in exports by type of product
Further growth in SMEs' contribution to exports



Source: SME Agency, *Export and Import Value by Size of Enterprise*.
 Notes: 1. Seasonally adjusted by the SME Agency using the X-11 ARIMA default.
 2. Typical SME products (typical large enterprise products) are defined as products that make up at least 70% of the value of shipments of small and medium establishments (large establishments) as classified according to the Japan Industrial Standard Industrial Classification Sub-Classification (2000 standard).

Section 3 The “three excesses” and SMEs

In Section 1, it was pointed out that during the present recovery phase, unlike the past, the three excesses—excess debt, excess capacity, and excess employment—have been largely resolved, and conditions more conducive to generating corporate profit have started to develop. In this section, we analyze this point in greater detail focusing on SMEs.⁴⁾

1. Financing situation of SMEs

Starting first with the “three excesses,” we begin by reviewing trends in liabilities and borrowing among SMEs. The interest-bearing debt redemption period of SMEs was 11.0 years as the end of the fourth quarter of 2005, considerably less than the post-bubble peak (in the first quarter of 1994) of 18.5 years. Thus although SMEs still have more outstanding borrowing than large enterprises and are in a financially weaker position, they are making progress in reducing their level of debt (Fig. 1-1-22).

As a result, SMEs’ equity ratios have similarly

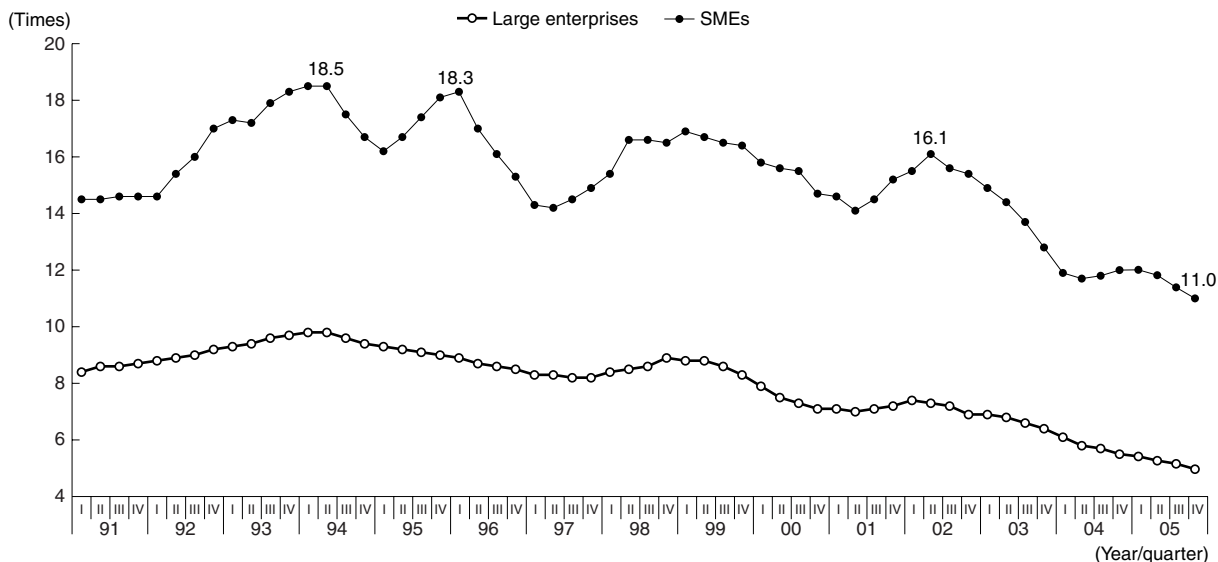
followed an upward trend in recent years, though remaining lower than the average for large enterprises, and their financial strength is better now than it was (Fig. 1-1-23).

This improvement in financial strength is due in large part to SMEs’ continuing to keep capital investment to within the scope of their cash flows,⁵⁾ and using the remainder to repay borrowing, as Fig. 1-1-24 shows. This trend is apparent also from the long-term downward trend in outstanding lending to SMEs (Fig. 1-1-25).

So has this strategy of curbing capital investment and giving precedence to improving financial strength been voluntarily adopted by SMEs?

Looking at how SMEs’ ease of borrowing from banks changed during this period, it can be seen that the situation rapidly deteriorated following the financial crisis in 1997, and has recently recovered to the level it was at before the financial crisis (Fig. 1-1-26). This would indicate that SMEs were forced to keep capital investment to within the scope of their cash flows—i.e., to practice self-restraint—due to financial institutions’

Fig. 1-1-22 Trend in debt redemption period of SMEs
SMEs move to eliminate excess debt



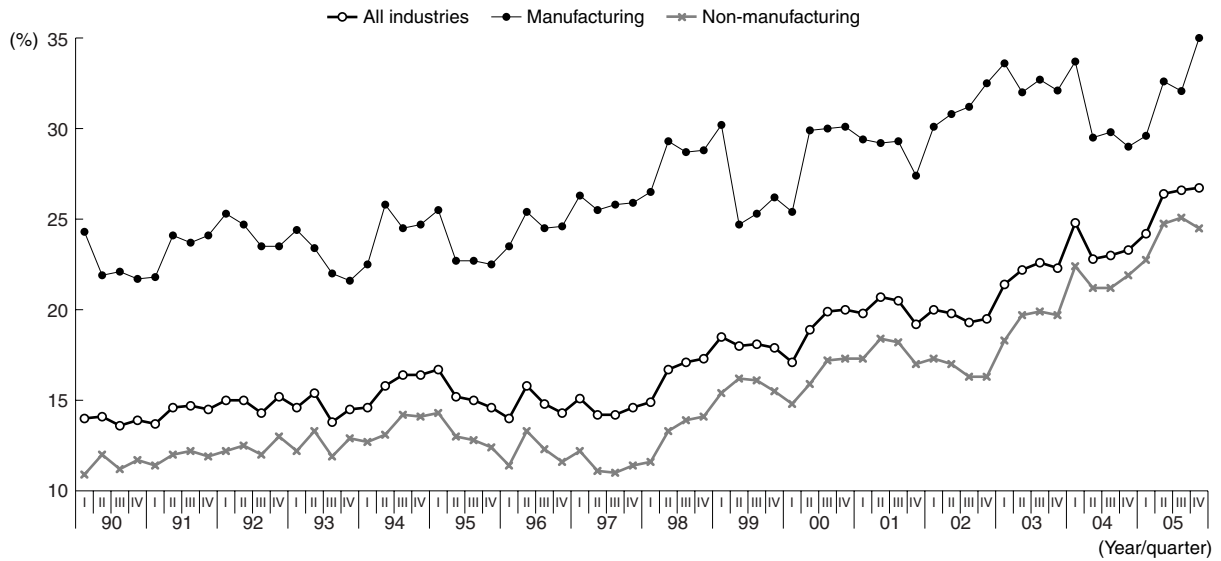
Source: Ministry of Finance, *Financial Statements Statistics of Corporations by Industry, Quarterly*.

- Notes:
1. Interest-bearing debt repayment period = outstanding interest-bearing debt / cash flow
 2. Outstanding interest-bearing debt = short-term borrowing + long-term borrowing + corporate bonds
 3. Cash flow = ordinary profit x 0.5 + depreciation expenses
 4. The moving average for the past four quarters is used for the interest-bearing debt repayment period.

4) The analysis in this section is based mainly on the quarterly version of the Ministry of Finance’s *Financial Statements Statistics of Corporations by Industry* (i.e., the *Financial Statements Statistics of Corporations by Industry, Quarterly*) and the BOJ’s *Tankan*. As noted previously, the BOJ’s *Tankan* covers enterprises with capital of at least ¥20 million. As the *Financial Statements Statistics of Corporations by Industry, Quarterly* is also limited to business corporations with capital of at least ¥10 million, the reader should bear in mind that the analysis in this section concerns SMEs of at least this size.

5) Defined here as ordinary profit x 0.5 + depreciation expenses.

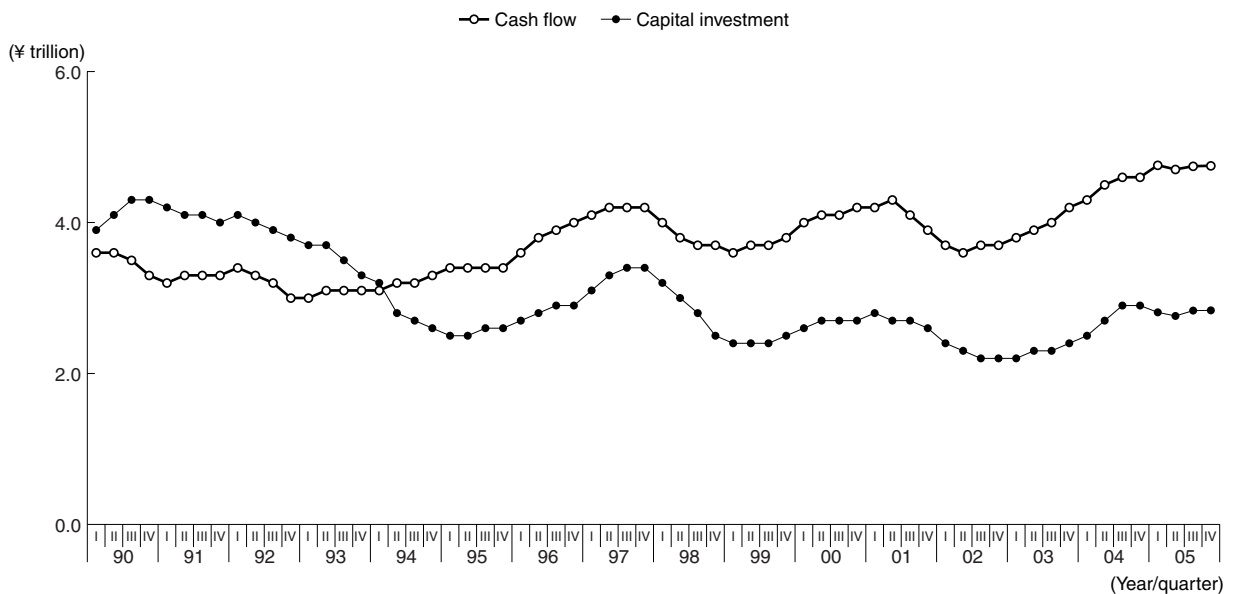
Fig. 1-1-23 Trends in equity ratio of SMEs
Pronounced improvement in financial strength of SMEs from 1997



Source: Ministry of Finance, *Financial Statements Statistics of Corporations by Industry, Quarterly*.
Note: SMEs are defined as enterprises with capital of less than ¥100 million.

Fig. 1-1-24 Trends in cash flow and capital investment of SMEs

Long-term shift in funding of capital investment from external borrowing to use of internal financing by itself



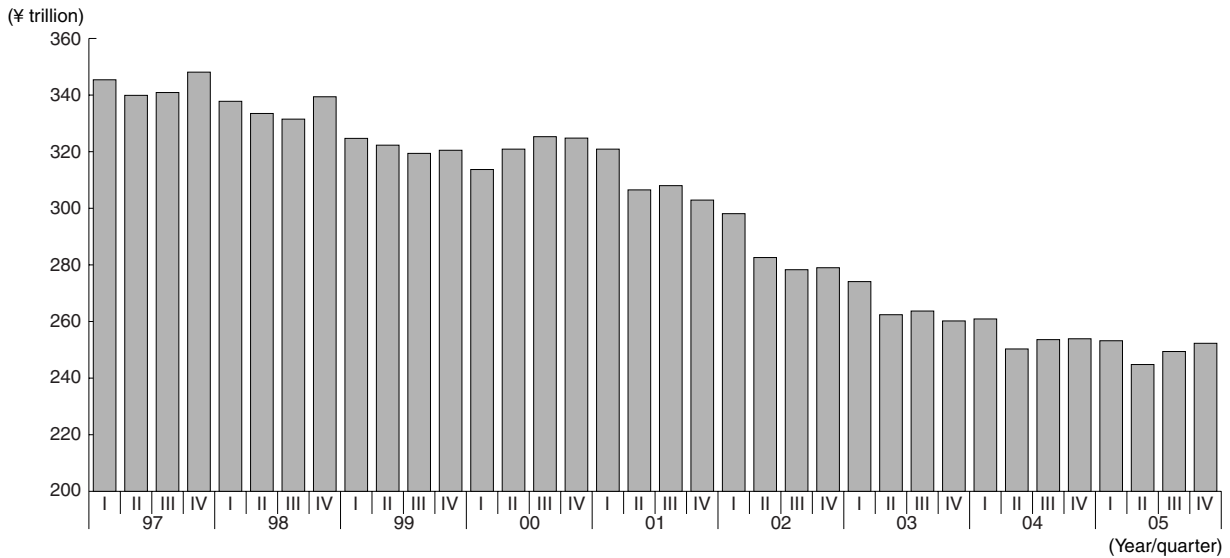
Source: Ministry of Finance, *Financial Statements Statistics of Corporations by Industry, Quarterly*.
Notes: 1. Moving average for past four quarters.
2. Cash flow = ordinary profit x 0.5 + depreciation expenses

unaccommodating lending attitude (i.e., the credit crunch), and this led to their curbing capital investment. In other words, while one of the reasons for the improvement in SMEs' financial strength is considered to be the precedence given to repaying borrowing in order to reduce debt, rather than engaging in capital investment under the deflationary conditions described below, there has also been a strong element of this being a result of having to curb capital investment due to

difficulty borrowing from financial institutions.

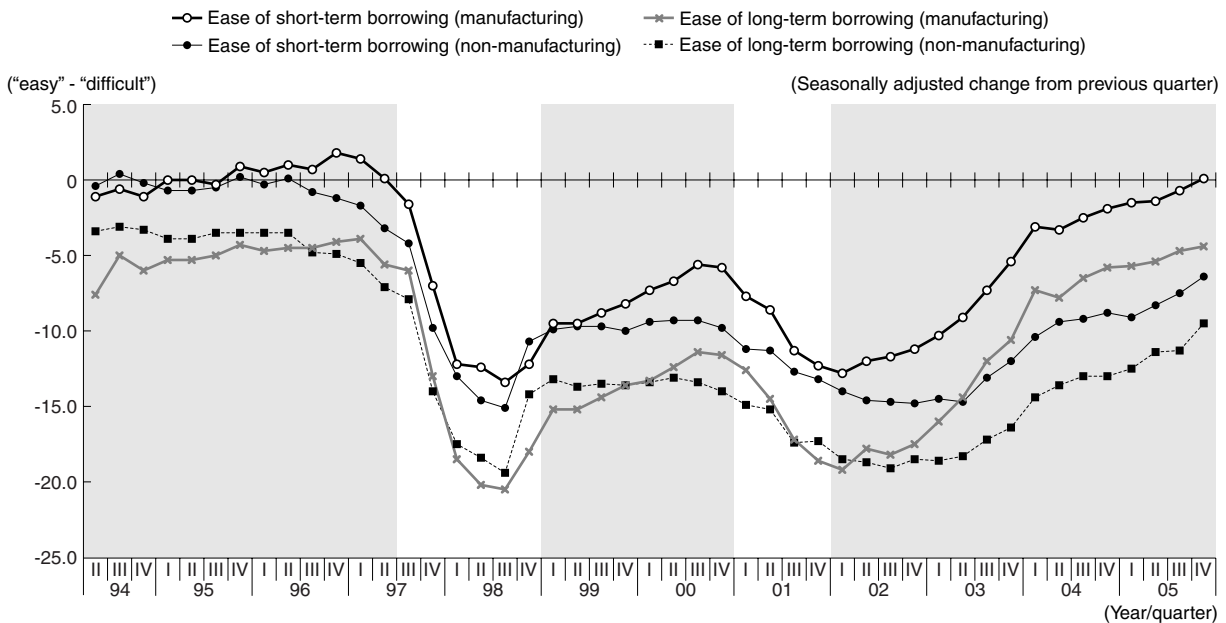
Like business confidence, ease of borrowing from financial institutions varies according to industry, and as Fig. 1-1-26 shows, ease of short-term borrowing in non-manufacturing has been lower even than ease of long-term borrowing in manufacturing in recent years. But despite this variation, borrowing from financial institutions has become easier overall for SMEs, and SME sentiment toward borrowing of funds also appears

Fig. 1-1-25 Trend in outstanding lending to SMEs
 Long-term downward trend in lending to SMEs with recent signs of change



Source: Compiled by the SME Agency based on BOJ, *Monthly Financial and Economic Statistics* and other sources.

Fig. 1-1-26 Trends in ease of borrowing DI among SMEs
 Ease of borrowing returning to pre-financial crisis levels



Source: SMRJ, *Survey on SME Business Conditions*.

to be changing.⁶⁾ As a result, the downward trend in outstanding lending to SMEs is now coming to a halt.

2. SME capacity and future capital investment

Next, we consider the state of capacity at SMEs. According to the BOJ's *Tankan*, the capacity DI for

SMEs in manufacturing ("excessive" – "insufficient") stood at 0 points in the fourth quarter of 2005. This was the first time in 15 years (since the fourth quarter of 1991) that the net excess of enterprises saying that capacity was "excessive" had disappeared (Fig. 1-1-27). In terms of actual value, capital investment grew strongly in 2004, but fell slightly below the level the previous year in the first half of 2005. In the second half

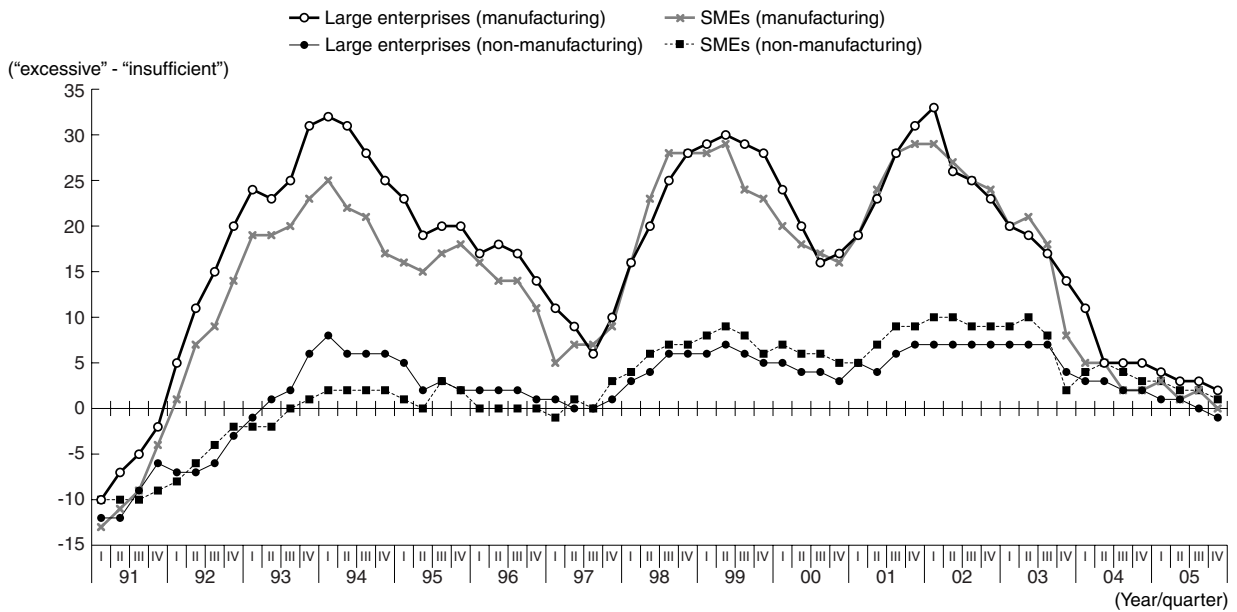
6) See Part I, Chapter 3.

of the year, however, capital investment grew further to exceed the level in 2004, and growth overall remains firm (Fig. 1-1-28). In tandem with this trend, the rising trend in the age, or “vintage,” of business facilities is leveling out (Fig. 1-1-29).
Is this upward surge in capital investment likely to

continue?

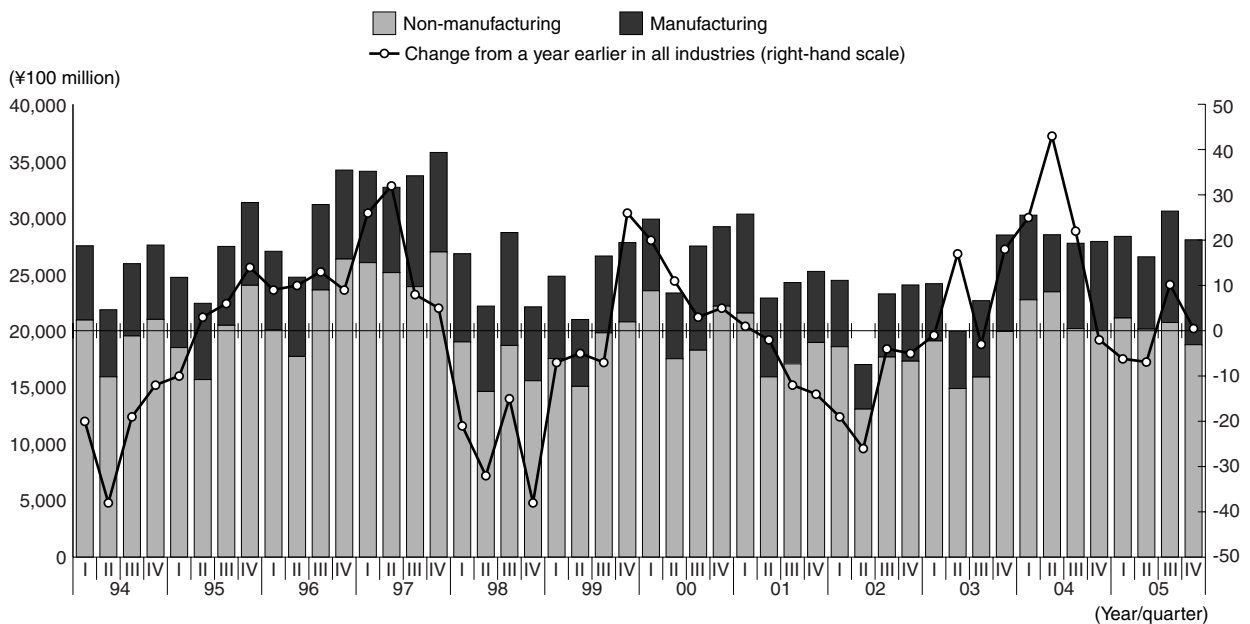
To answer this question, we consider firstly the case in which enterprises fund capital investment internally from cash flow. As Fig. 1-1-24 indicates, SME cash flow has reached record levels in recent years, and considering also the upturn in SMEs’ financial strength,

Fig. 1-1-27 Trends in production capacity DI among SMEs
Sense of lack of capacity at SMEs similar to that at large enterprises



Source: BOJ, *National Short-Term Economic Survey of Enterprises in Japan*.

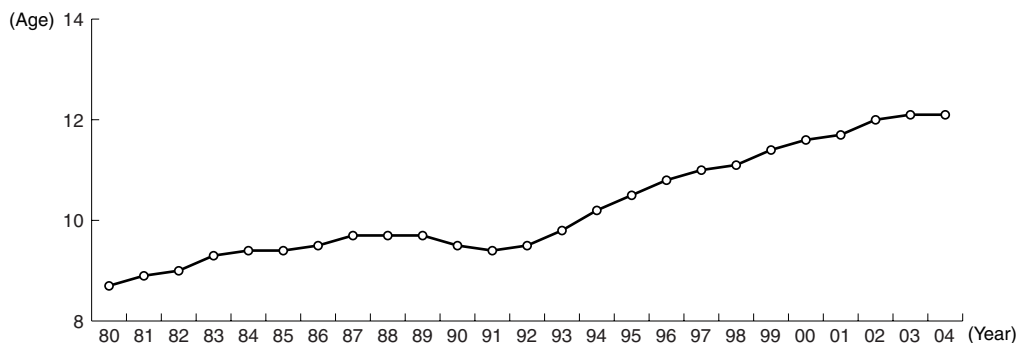
Fig. 1-1-28 Trends in capital investment at SMEs
Capital investment by SMEs continues to rise in 2005



Source: Ministry of Finance, *Financial Statements Statistics of Corporations by Industry, Quarterly*.

Notes: 1. Large enterprises are enterprises with capital of ¥100 million or more. SMEs are enterprises with capital of less than ¥100 million.
2. Capital investment excludes investment in software.

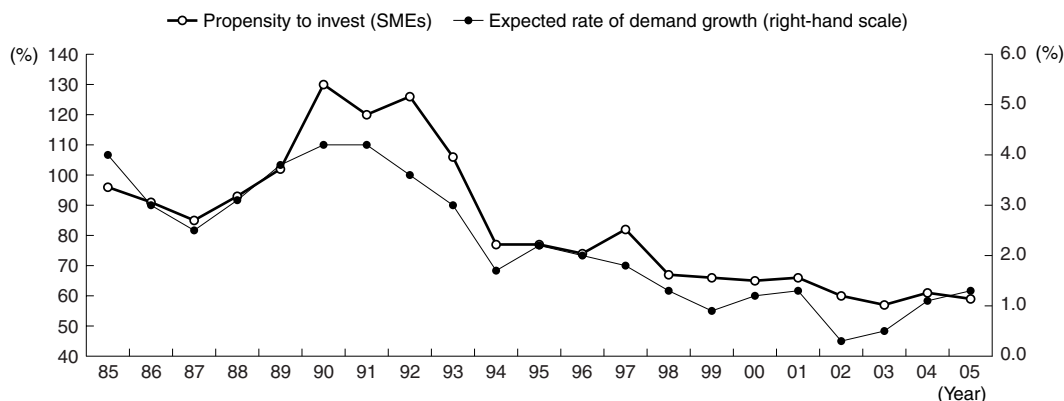
Fig. 1-1-29 Trend in manufacturing plant vintage
Rise in plant vintage slowing



Sources: Cabinet Office, *Capital Stock of Private Enterprises*; Economic Planning Agency, *1970 Survey of National Wealth*.
 Note: Average age = ((average age in previous year + 1) x (capital stock at previous year-end - amount removed in present year) + capital investment in present year x 0.5) / capital stock in present year

Fig. 1-1-30 Relationship between expected growth and propensity to invest of enterprises

If demand is expected to grow, SMEs' propensity to invest also increases



Sources: Cabinet Office, *Annual Survey of Corporate Behavior*; Ministry of Finance, *Financial Statements Statistics of Corporations by Industry, Quarterly*.
 Notes: 1. The results of the Cabinet Office's questionnaire surveys of business behavior each January are treated as the values for that year.
 2. Propensity to invest = capital investment / cash flow
 3. Cash flow = ordinary profit x 0.5 + depreciation expenses
 4. Propensity to invest was calculated using the cumulative totals in each year for capital investment and cash flow in order to eliminate seasonality.

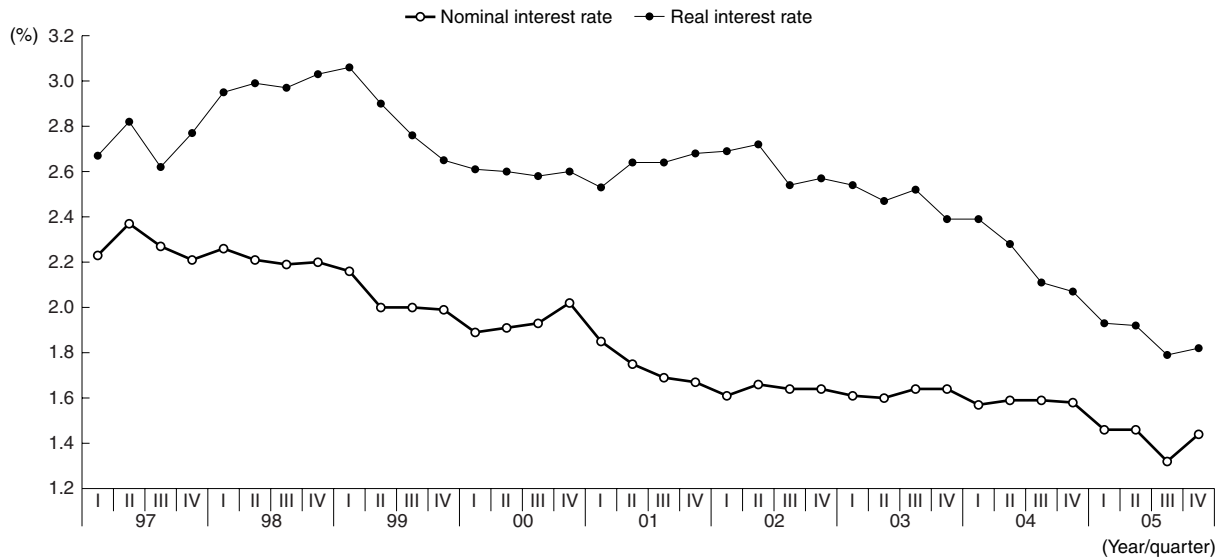
the evidence suggests that SMEs now have increasing scope for capital investment. However, even if they have more cash flow, enterprises will not embark on capital investment unless they themselves expect demand to increase in the future. Enterprises' expectations of future demand are therefore important to determining trends in capital investment. According to the Cabinet Office's *Annual Survey of Corporate Behavior*,⁷⁾ expected growth began to increase from 2003 (Fig. 1-1-30), and expected growth according to the January 2005 survey was a comparatively high 1.3%.

Next, let us consider the case in which enterprises raise the funds for capital investment from bank borrowing. An important factor that enterprises consider

when deciding whether to borrow in order to engage in capital investment is the real cost of borrowing. Given the prolonged deflationary environment, it is possible that many SMEs may have decided that the cost of borrowing in real terms would be too high even if borrowing rates could be kept down in nominal terms due to the expectation that prices would fall. Fig. 1-1-31 shows the nominal interest rate and the real interest rate estimated by taking into account the inflation rate expected by enterprises. This demonstrates that whereas the nominal rate has fallen continuously in recent years, the real interest rate has remained high due to firmly rooted expectations of deflation, and this is one reason why enterprises have given precedence to repaying debt

7) Based on respondents' own projections of the real rate of growth in demand in their industries for the next three years.

Fig. 1-1-31 Trends in enterprise borrowing rate
Downward trend in real cost of enterprise borrowing



Sources: BOJ, *Monthly Financial and Economic Statistics, National Short-Term Economic Survey of Enterprises in Japan*.

Notes: 1. The nominal interest rate is the average contracted interest rate for new long-term loans.

2. The real interest rate is the nominal rate less the inflation rate expected by enterprises.

3. The expected inflation rate is estimated by the SME Agency using the Carlson-Parkin method based on BOJ, *National Short-Term Economic Survey of Enterprises in Japan*.

rather than investing. Since the end of last year, however, the real interest rate, too, has begun to decline in response to signs that the economy is at last emerging from deflation, and if the nominal rate continues to ease, SMEs are likely to adopt a more positive approach to borrowing.

In light of this, capital investment from 2006 should exhibit firm growth for the time being.

3. Employment trends among SMEs

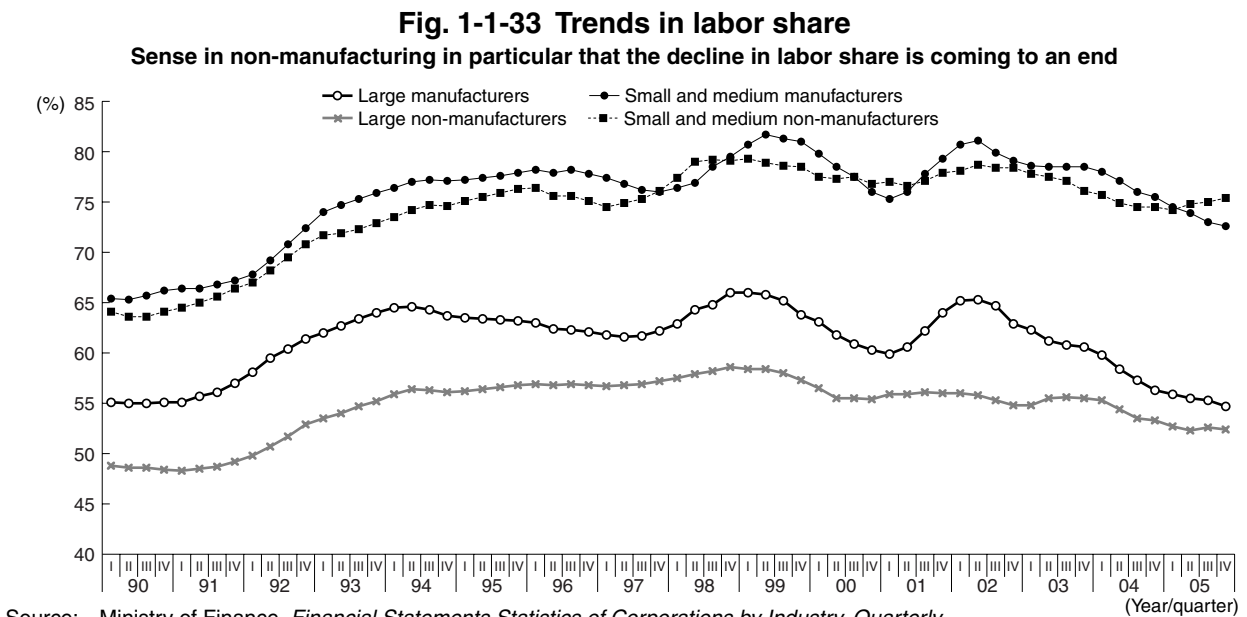
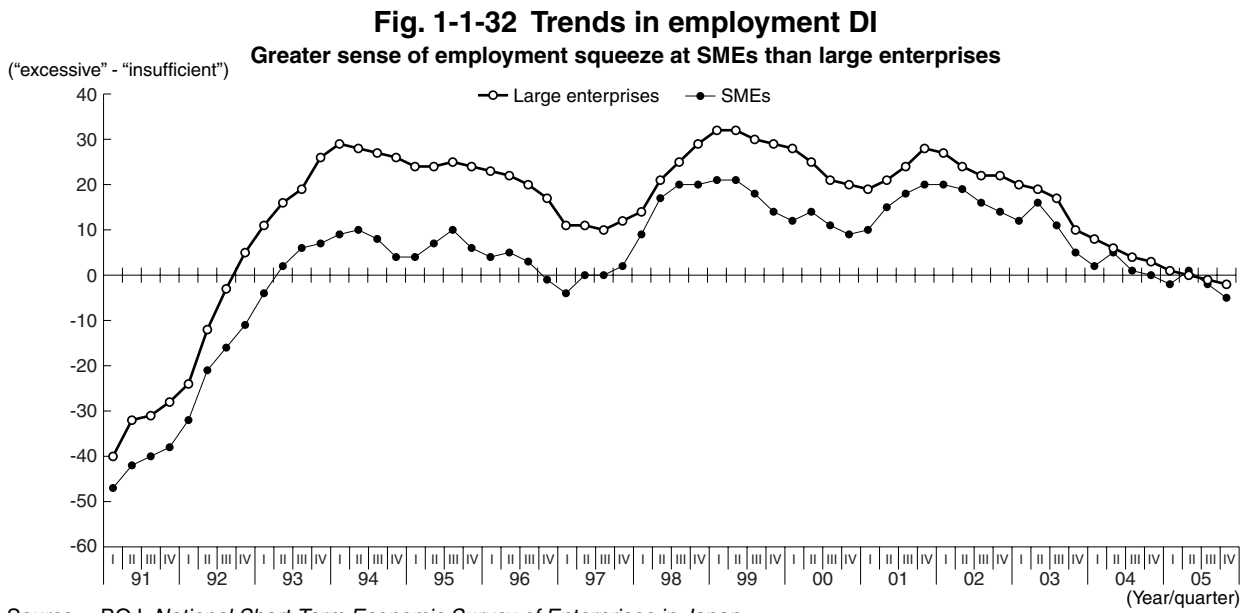
We look lastly at trends in employment among SMEs. The general feeling is that the employment market has recently grown tighter, and according to the BOJ's *Tankan*, the employment DI ("excessive" – "insufficient") for SMEs (all industries) shows that the sense of over-employment has disappeared more rapidly at SMEs than at large enterprises (Fig. 1-1-32). As the sense of excess employment has disappeared, to be replaced by a recent growing sense of a shortage, labor share⁸⁾ too has shown signs of bottoming out from the beginning of fiscal 2005 (Fig. 1-1-33). If we break down the various reasons for this, we find that while sales growth acts as a downward factor, the labor cost factor acts has an upward effect (Fig. 1-1-34). It can thus be seen that behind the bottoming out of labor share at a

time when sales are growing is that, as a result of reduced pressure to lower wages and restructure, labor costs at SMEs are also rising, if only slightly (Fig. 1-1-35).

Although still insufficient compared with large enterprises, profitability at SMEs is thus at its highest level in a decade, whether measured in terms of the ratio of ordinary profit to net sales or the breakeven point ratio, and profitability overall has returned to a level almost on a par with what it was before the bubble (Figs. 1-1-36, 1-1-37). As we shall see in detail in Part II, the number of corporate bankruptcies dropped sharply in 2005 to 12,755 (12,998 among enterprises of all sizes), the lowest level since the collapse of the bubble (see Fig. 1-2-23 in Chapter 2).⁹⁾

8) Labor share (Ls) indicates the proportion of value added accounted for by labor costs. If labor costs are W and value added V divided by sales T is the ratio of value added v, then labor share may be expressed as $Ls = W / V = W / (v \cdot T)$. Labor share declines if the total labor costs fall or value added rises.

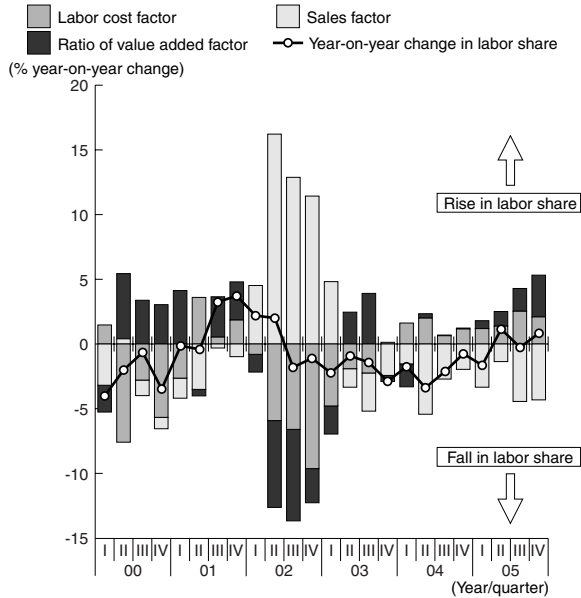
9) The number of subrogated payments by credit guarantee corporations throughout Japan also fell in fiscal 2005 compared with the previous fiscal year, both in terms of number and total value (Fig. 1-1-38).



Notes: 1. Moving share for past four quarters.
 2. Labor share = labor costs / value added (ordinary profit + interest expenses and discount charges + depreciation expenses + labor costs)

Fig. 1-1-34 Decomposition analysis of SME labor share

Labor share tends not to fall due to rise in labor costs offsetting rise in sales



Source: Ministry of Finance, *Financial Statements Statistics of Corporations by Industry, Quarterly*.

Note: The decomposition analysis of labor share was performed as follows.

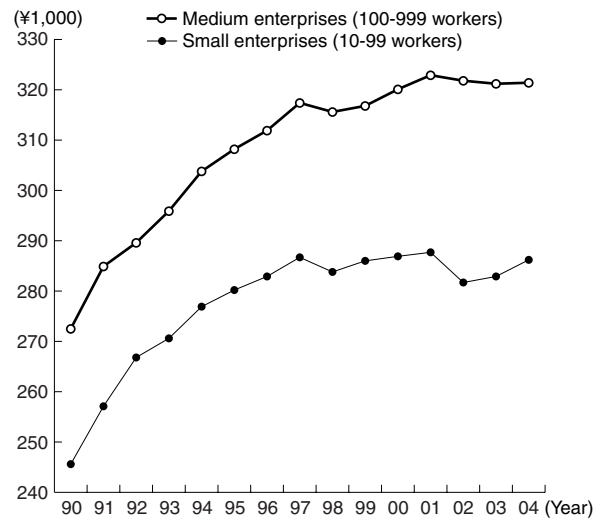
Where Ls: labor share, W: labor costs, T: sales, V: value added, v: ratio of value added (V/T)

$$\text{Labor share (Ls)} = W/V = W / (v \cdot T)$$

Therefore

$$\Delta(Ls) = \underbrace{(W/V) \cdot (\Delta W/W)}_{\text{labor cost factor}} - \underbrace{(W/V) \cdot (\Delta T/T)}_{\text{sales factor}} - \underbrace{(W/V) \cdot (\Delta v/v)}_{\text{ratio of value added factor}}$$

Fig. 1-1-35 Trends in wages by enterprise size
Slight upward trend in wages, mainly at small enterprises

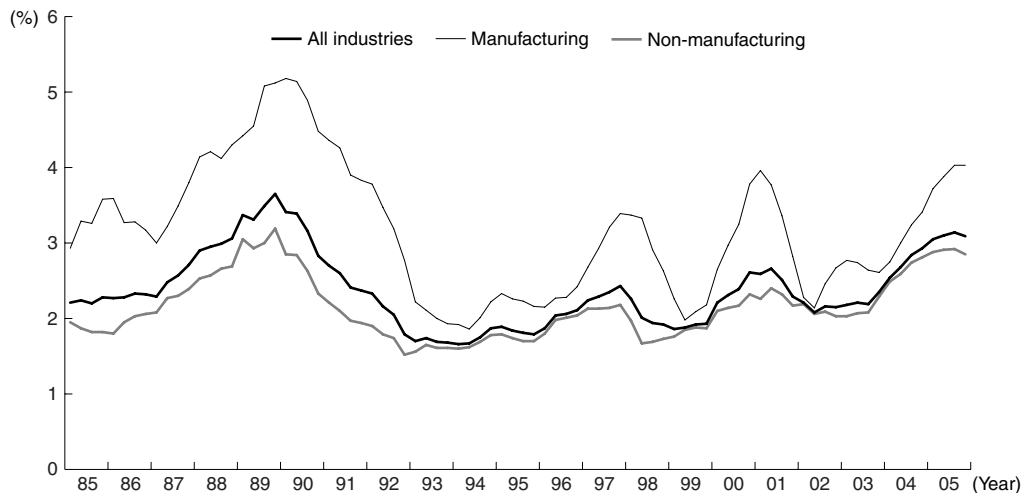


Source: MHLW, *Basic Survey on Wage Structure*.

- Notes:
1. Values indicate the amounts routinely paid to full-time workers, and are the amounts paid for June in each year.
 2. Size categories are as defined by MHLW.

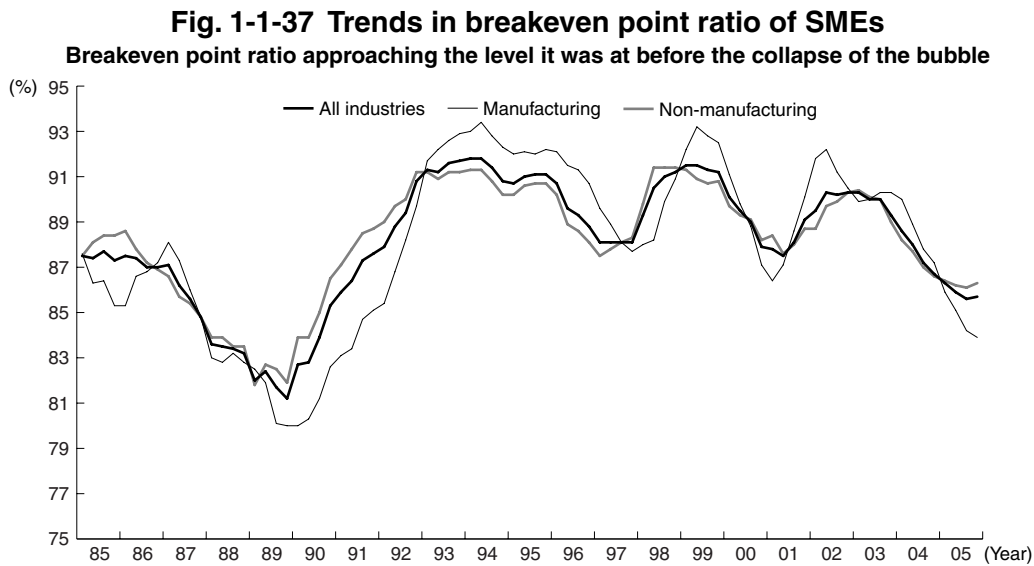
Part I — Trends among SMEs in fiscal 2005

Fig. 1-1-36 Trends in ratio of ordinary profit to net sales at SMEs
Improvement in SMEs' ratio of ordinary profit to net sales, including in non-manufacturing



Source: Ministry of Finance, *Financial Statements Statistics of Corporations by Industry, Quarterly*.

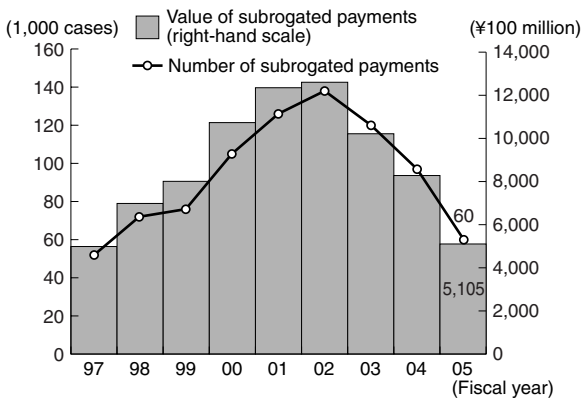
- Notes:
1. SMEs are defined as enterprises with capital of less than ¥100 million.
 2. Moving average for past four quarters.



Source: Ministry of Finance, *Financial Statements Statistics of Corporations by Industry, Quarterly*.

- Notes:
- The breakeven point ratio was calculated as follows.
Where breakeven point sales: π , sales: S, fixed costs: F, variable cost: V
 $\pi = F / (1 - V/S)$, fixed cost ratio = F/S , variable cost ratio = V/S
Breakeven point ratio = π / sales
 - SMEs: Enterprises with capital of less than ¥100 million.
 - Moving average for past four quarters.

Fig. 1-1-38 Trends in number and value of subrogated payments
Downward trend in both number and value of subrogated payments



Source: National Federation of Credit Guarantee Corporations.
Note: Date for fiscal 2005 are for April-December 2005.

Section 4 Economic trends and SME policy since the late 1990s

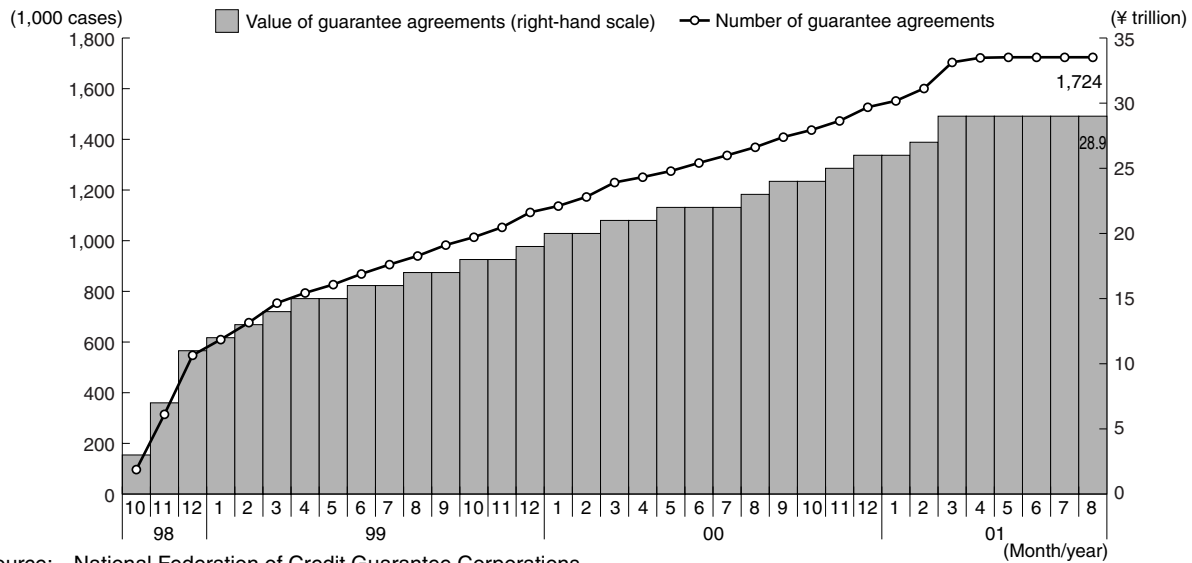
As we have seen, the “three excesses” that hobbled the Japanese economy from the 1990s are now at least being overcome through SMEs’ ceaseless management efforts.

During this period, the Government, too, has engaged in a variety of activities to help tackle the issues facing SMEs at the time.

Since 1992, when business confidence began to deteriorate with the collapse of the bubble, the

Government has worked to develop various schemes for lending by government-affiliated financial institutions as part of a succession of economic packages. One particular initiative designed to assist the stable supply of funds to SMEs was the Special Guarantee System for the Financial Stabilization of SMEs, which was established under the “Outline of Measures against Reluctance to Lend to SMEs” (August 1998) in the wake of the financial system

Fig. 1-1-39 Trends in number and value of special guarantee agreements
 Rise in use in both number (1,724,000) and value (¥28.9 trillion)



Source: National Federation of Credit Guarantee Corporations.
 Note: Cumulative figures.

uneasiness in autumn 1997 and the subsequent sudden credit crunch, to assist the SMEs that were the main victims. 1,723,873 loans worth a total of ¥28,943.7 billion were guaranteed under the scheme between its establishment in October 1998 and its termination in March 2001 (Fig. 1-1-39), and it is credited with staving off the bankruptcy of some 10,000 firms, the loss of around 100,000 jobs, and the loss of private enterprises worth a combined total of approximately ¥2,000 billion at the time of the financial crisis.¹⁰⁾

Amid concerns over the institutional fatigue and declining vitality of Japan’s social and economic systems, there has emerged a recognition of SMEs as not just the underdogs in a dual structure composed of large enterprises and SMEs, but also, through their role in innovation, as the source of the Japanese economy’s vitality.

In 1999, the Law on Supporting Business Innovation of Small and Medium Enterprises entered effect, and the Government set about providing comprehensive support to SMEs engaging in the development of new products and other forms of business innovation. As of November 2005, more than 20,000 approvals had been made since the system’s inception in July 1999, and around half of the enterprises that have completed business innovation plans (of three to five years in duration) under the system have achieved at least a 3% annual increase in value added, either in total value or per employee, which is regarded as the yardstick of success.

In December 1999, the Small and Medium Enterprise

Basic Law underwent its first radical overhaul in 36 years, expanding the range of SMEs eligible for support measures and enhancing support for startups and SMEs engaging in business innovation.

In 2002, legislation including the Law for Facilitating the Creation of New Business was amended under the Law for the Support of Small and Medium Enterprise Challenges to allow exemptions from the minimum capital requirements for corporations (dubbed the “One Yen Startup System”) in order to provide support for startups and new business ventures by SMEs.

At the same time, attention has come to focus on the problems of oversupply and excess debt on the side of industry as causes of Japan’s prolonged deflation alongside the problem of non-performing loans on the financial side, making the joint revival of both the industrial and financial sectors a key issue. Against this backdrop, the Law on Special Measures for Industrial Revitalization was amended in 2003 in order to assist the regeneration of diverse SMEs in the regions in particular. This resulted in the establishment of SME revitalization support councils in each prefecture,¹¹⁾ together with the implementation of measures such as the establishment of SME revitalization funds.

With this series of measures having a widening impact, the Law on Supporting Business Innovation of Small and Medium Enterprises was revised in April 2005 in order to establish the Law for Facilitating New Business Activities of Small and Medium Enterprises¹²⁾

10) According to estimates by the Council on Economic and Fiscal Policy in “On Small and Medium Business Finance” (submitted September 20, 2002).

11) See Part I, Chapter 2.

12) The Law for Facilitating New Business Activities of Small and Medium Enterprises entered effect in April 2005. Based on the Law on Supporting Business Innovation of Small and Medium Enterprises, this law integrated support schemes under the Temporary Law Concerning Measures for the Promotion of the Creative Business Activities of Small and Medium Enterprises and the Law for Facilitating the Creation of New Business. In parallel with this, a new scheme was established to support the development of ventures involving collaboration between businesses in different fields (“new partnerships”).

so as to further bring out the strengths of the SMEs that will fuel Japan's economic dynamism in the future, and support has started to be provided for "new partnerships" undertaken by businesses in different fields as a means of effectively combining their respective business resources. With the economy now enjoying a full-fledged recovery and domestic investment in

manufacturing expanding, the Draft Law concerning the Enhancement of the Fundamental Technologies for SME Creativity has been submitted to the 164th ordinary session of the Diet (in January 2006) in order to support the development of technologies by SMEs that underpin the core manufacturing technologies that are a strength of the Japanese economy.

Section 5 Regional differences in business conditions among SMEs

Having looked at the business conditions facing SMEs from a variety of perspectives, in this section we look at how and why conditions vary according to region.

If we examine business confidence among SMEs in each region using the business conditions DI according to the SMRJ's *Survey on SME Business Conditions*, we discover that whereas business confidence rapidly improved from mid-2003 in the Kanto, Chubu, and Kinki regions, improvement has been sluggish in Hokkaido, Tohoku, and Shikoku (Fig. 1-1-40). Regarding the situation in Hokkaido, while conditions in manufacturing in the south and middle of the island are comparatively buoyant, there has been no clear sign of improvement in non-manufacturing in Tokachi, Kushiro, and Nemuro, and in manufacturing in the north and Okhotsk, at least as far as the DI is concerned. And in Tohoku, the comparatively firm tone of confidence in manufacturing in the prefectures of Yamagata and Iwate contrasts with the rather weaker recovery trend in manufacturing in Akita and Fukushima, and in non-manufacturing in Iwate and Fukushima. In Shikoku, too, conditions are comparatively firm in manufacturing and non-manufacturing in Kagawa, but sluggish in both manufacturing and non-manufacturing in Kochi (Supplementary Statistical Data Table 18).

As in the case of the gap in business confidence between large enterprises and SMEs, this regional variation in the scale of the improvement in business confidence is a reflection in large part of each region's (prefecture's) industrial composition. For example, in prefectures in which manufacturing industry accounts for a large proportion of production, business confidence has improved considerably. Conversely, in industries in which the construction industry occupies a more important position, the recovery in business confidence tends to have been more subdued (Fig. 1-1-41). Fig. 1-1-42 shows a comparison of the industrial production indices for each region, from which it can be seen that while there is still no sign of improvement in Hokkaido, production has increased substantially in the Chubu region compared with during the trough in the business cycle. Hence as the present recovery was initially driven

by export growth, the industrial production indices in these regions reflected the extent to which export-related industries were concentrated in them, which has as a consequence considerably affected local business confidence. Fig. 1-1-43 illustrates the extent to which production activity in each region has been induced by which components of final demand. This shows that Hokkaido, for example, tends not to benefit from a rise in exports as such a rise does not generate much of an increase in production. In the Chubu region, on the other hand, an increase in exports tends to encourage more production.

The regional variation in business confidence is thus due largely to differences in the industrial composition of each region, and in particular to differences in the extent to which production in each region is induced by exports.

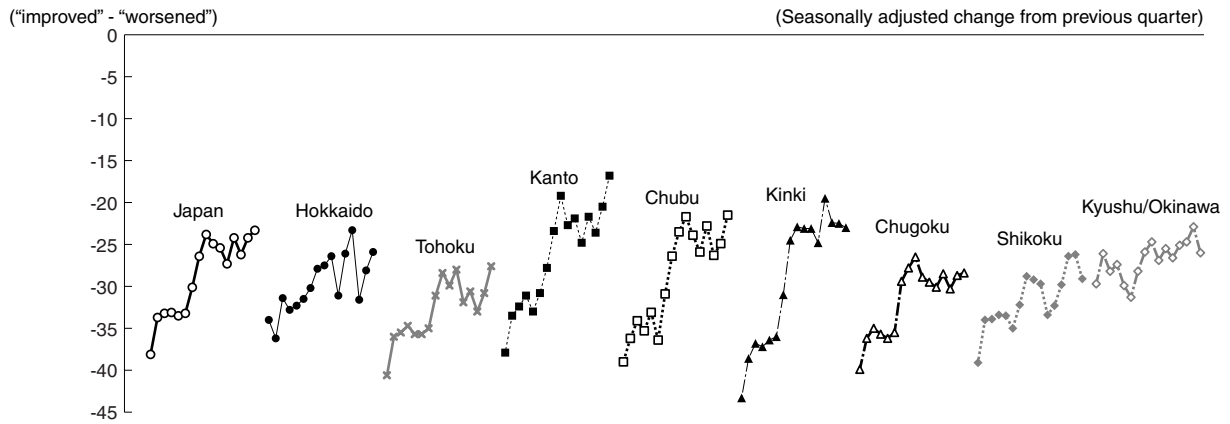
However, it is important to note that as domestic enterprises gradually respond to the shift from export to domestic demand-led recovery, they will increasingly move to tap into domestic demand by taking advantage of their local resources rather than simply relying on the external stimuli of exports and their production inducement effect. As we shall see in Part II, Japan's location just a few hours from the rapidly growing economies and cheap labor markets of East Asia means that the model of economic growth dependent on simply attracting enterprises from major cities and other regions within Japan is no longer applicable, making it necessary to develop a model of autonomous revitalization based on the effective use of "local resources," such as the human resources, skills, technologies, goods (including agricultural produce), and functions of industrial clusters found in each region.¹³⁾

13) See Part II, Chapter 4.

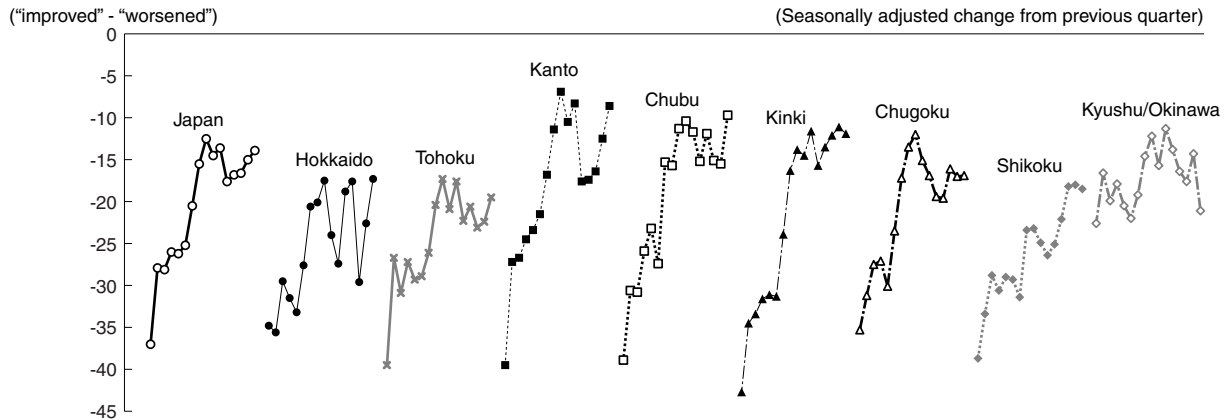
Fig. 1-1-40 Trends in business conditions DI among SMEs by region

Business conditions varies according to region, with conditions stagnating in Hokkaido, Tohoku, and Shikoku

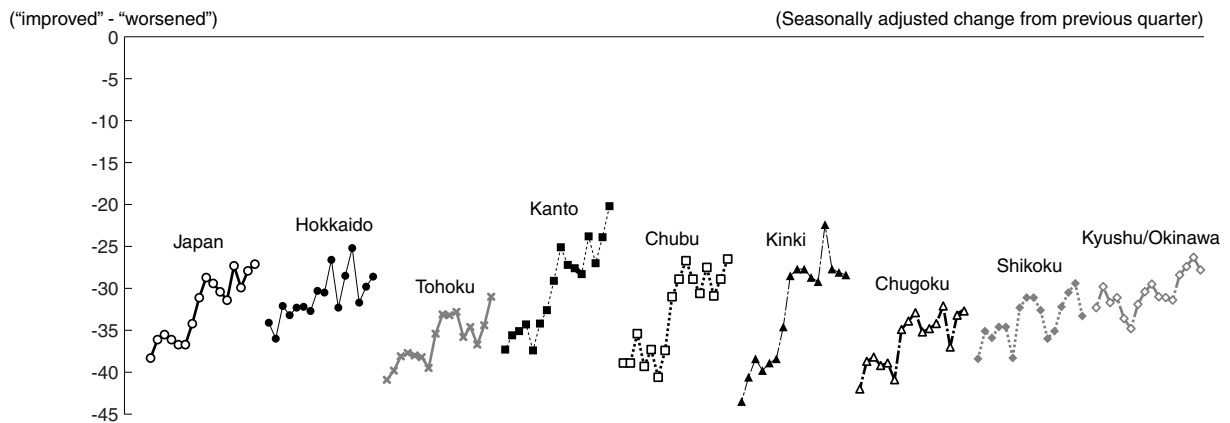
1) All industries



2) Manufacturing



3) Non-manufacturing



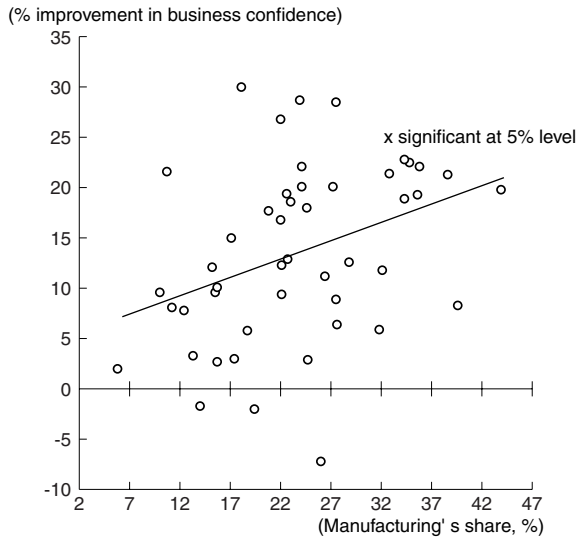
Source: SMRJ, *Survey on SME Business Conditions*.

- Notes:
1. Regions are classified according to the prefectures in the regions of jurisdiction of each bureau of economy, trade and industry.
 2. The Kanto region includes the prefectures of Niigata, Nagano, Yamanashi, and Shizuoka, the Chubu region includes of the prefectures of Ishikawa and Toyama, and the Kinki region includes the prefecture of Fukui. The Kyushu/Okinawa region is the total for the prefectures of Kyushu and Okinawa Prefecture.
 3. From 1Q 2002 to 4Q 2005.

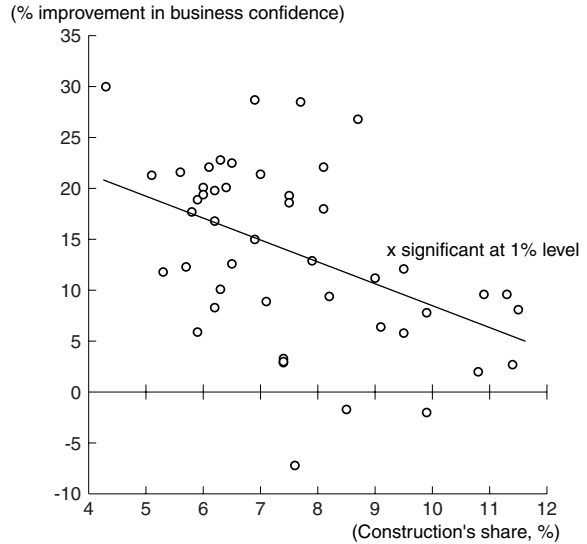
Fig. 1-1-41 Correlation between share of industrial production in each prefecture and scale of improvement in business conditions

Greater improvement in business conditions among SMEs in regions where manufacturing accounts for large proportion of output, and reverse trend in construction

1) Manufacturing



2) Construction

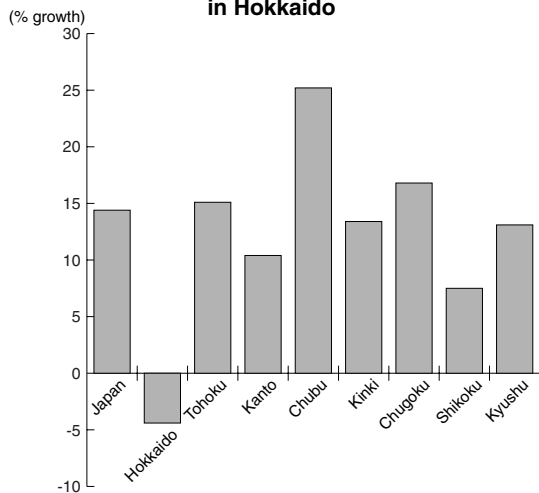


Sources: SMRJ, *Survey on SME Business Conditions*; Cabinet Office, *Report on Prefectural Accounts*.

- Notes: 1. The improvement in business conditions is the percentage point difference between 1Q 2002 (the trough of the business cycle) and 4Q 2005.
 2. Seasonally adjusted change from previous quarter (all industries).

Fig. 1-1-42 Comparison of industrial production indices

Considerable growth in Chubu region, but stagnation in Hokkaido



Source: METI and bureaus of economy, trade and industry, *Indices of Industrial Production*.

Note: Point difference in industrial production index between 1Q 2002 and 4Q 2005.

Fig. 1-1-43 Comparison of dependence on export-induced production by region

Buoyant growth in output in Chubu and Kanto regions when exports are growing strongly

	(Unit: %)		
	Consumption	Investment	Exports
Hokkaido	71.5	26.3	2.2
Tohoku	64.2	28.9	7.0
Kanto	59.7	29.3	11.0
Chubu	53.3	30.4	16.4
Kinki	59.9	29.8	10.3
Chugoku	57.6	29.4	13.0
Shikoku	64.5	26.5	9.0
Kyushu	65.8	25.9	8.3

Source: METI, *Input-Output Tables by Region*.

Column 1-1-1 Effect of rising crude oil prices on SMEs

One factor affecting confidence among SMEs in fiscal 2005 was rising crude oil prices.

West Texas Intermediate crude (WTI) was US\$40 a barrel early in fiscal 2005, before hitting a record high of almost \$70 at the end of August 2005. The rise was attributed to sharply increased worldwide demand, mainly in China, decreased surplus production capacity in OPEC, and structural factors, including a shortage of refining capacity in the United States and elsewhere - plus the effects of market speculation. Prices fluctuated but remained high, and as of March 2006 were still above \$60.

Rising oil prices put a squeeze on profits of SMEs that were large users of oil and petroleum products, directly and indirectly. That is, while the effects of higher crude prices were generally passed on by upstream companies (including major oil companies) to their customers downstream, many SMEs in the further downstream - closer to the final consumer - found it difficult to do so, and their profitability was squeezed quite hard.

Column Figs. 1-1-1-1 and 1-1-1-2 show the results of surveys on the "Effect of Rising Crude Oil Prices on Small and Medium Enterprises" carried out since July 2005 by SME-related organizations. Fig. 1-1-1-1 shows indeed that around 90% of the enterprises surveyed were able to pass on only 20% or less of their rising costs. Consequently, in the survey conducted at the end of October 2005 (Fig. 1-1-1-2), when the effect of the highest level of crude oil prices - as a result of Hurricane Katrina - could be seen, 60-70% of SMEs described their profitability as "somewhat squeezed" or "very squeezed."

Fig. 1-1-1-1 Percentage of rising costs of crude oil and petroleum products passed on

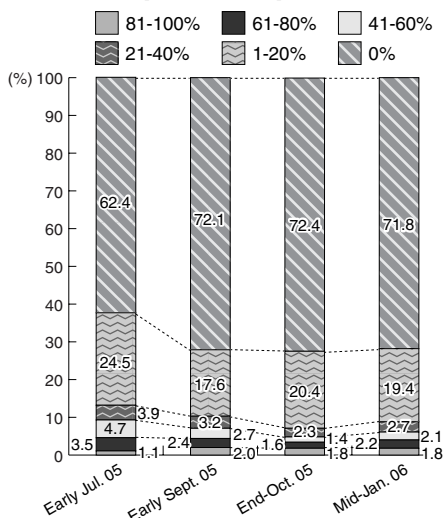
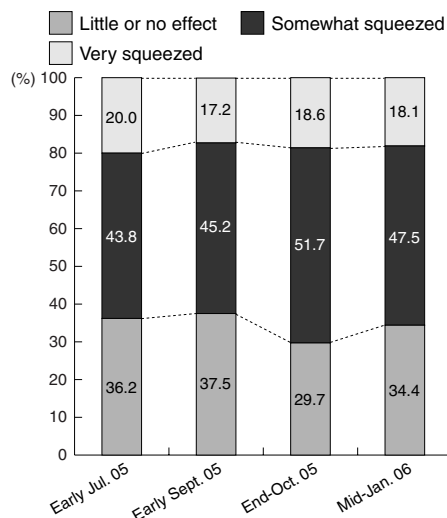


Fig. 1-1-1-2 Effect of rising oil prices on SME profits



Source: National Federation of Small Business Associations, Japan Finance for Small and Medium Enterprises (JASME), and National Association for Subcontracting Enterprises Promotion, *Surveys on the Effect of Rising Crude Oil Prices on Small and Medium Enterprises*.

Enterprises whose use of oil and petroleum products is high - fields that include petroleum product manufacturing, cleaning, transportation, fiber dyeing, and the chemical, plastics, rubber, and ceramic, stone and clay product industries - have been significantly affected, and between 80% and 90% of such SMEs reported that their profits were being squeezed.

On September 20, 2005, to help deal with the situation, the Small and Medium Enterprise Agency set up special consultation desks at government-affiliated SME financial institutions, credit guarantee corporations, major chambers of commerce and industry, societies of commerce and industry, and Bureaus of Economy, Trade and Industry under METI. It also put measures in place to assist SMEs finding themselves in difficulty, with "safety net" loans and guarantees provided by government-affiliated SME financial institutions, and others. On September 30, the agency also reminded companies ordering from or outsourcing to SMEs - which SMEs were finding their profitability squeezed as a result of difficulty in passing on oil-driven cost increases - of the "promotion standards" under the Law on the Subcontract Small and Medium Enterprises Promotion Law.

These were emergency actions in response to radical changes in the business environment. At the same time, various ministries and agencies were and are endeavoring to develop measures to help SMEs make constructive structural changes, including cutting their energy consumption and introducing new energies.

Chapter 2 Trends in entries, exits, bankruptcies, and business recoveries among SMEs

Section 1 Trends in entries and exits

1. Entries and exits of business establishments and enterprises

(1) Overview from 2001 to 2004

Let us examine recent trends in entries and exits of business establishments and enterprises in Japan using the MIC's *Establishment and Enterprise Census of Japan*.

The entry rate in Japan experienced a prolonged decline from the 1970s to the mid-1990s. Recently, however, the entry rate—whether calculated based on the number of business establishments or the number of enterprises—has bottomed out and is beginning to increase again, as can be seen in Figs. 1-2-2 1) and 2).

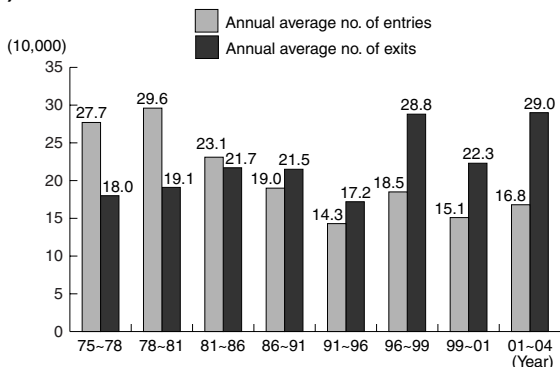
A major reason for the long-term decline in the entry rate until the mid-1990s was the decline in the entry rate for sole proprietorships, which has been ascribed to risk aversion among the young and middle-aged.¹⁾ Nevertheless, the signs now are brighter, and according to the most recently published data, the entry rate has started to rise again, if only by a little.

We look next at how the exit rate has changed. The exit rate in Japan has trended upward in recent years, and rose by a record annual average of 6.1% (based on the number of enterprises) between 2001 and 2004. As a consequence, the exit rate has considerably exceeded the entry rate despite the slight upward swing in the entry rate, and the gap has widened further to 2.2% in terms of number of establishments and 2.6% in terms of number of enterprises. In both cases, this is the largest gap on record since statistics were first compiled in 1947.

Let us consider these trends in the entry and exit rates in terms of the actual number of enterprises. The number of entries of enterprises began to increase again after declining to an annual average of 143,000 between 1991 and 1996, and reached an annual average of 168,000 between 2001 and 2004. The number of exits, on the other hand, increased from an annual average of 172,000 to 290,000 between 1991 and 1996, and the difference between the two averages over the 2001-2004 period had climbed to as much as 122,000 (Fig. 1-2-1). Consequently, the number of Japanese enterprises, which

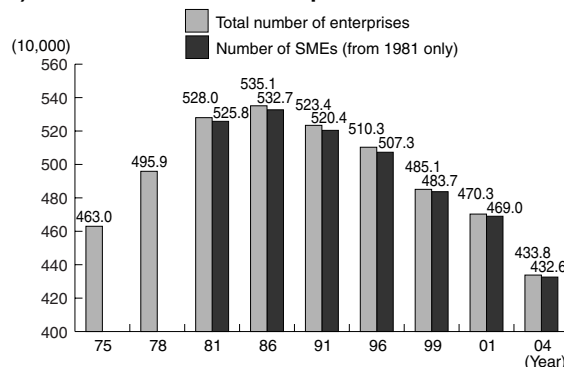
Fig. 1-2-1 Trends in number of entries and exits of enterprises (non-primary industry)
 Gap between annual average number of entries and exits grew to 122,000 between 2001 and 2004, and number of Japanese SMEs declined from a peak of 5,327,000 in 1986 to 4,326,000 in 2004

1) No. of entries and exits



Source: MIC, *Establishment and Enterprise Census of Japan*.

2) Trends in number of enterprises



Source: Recompiled from MIC, *Establishment and Enterprise Census of Japan*.

- Notes:
- Survey conducted as the *Establishment Census* until 1991, and the *Establishment Directory Maintenance Survey* in 1994.
 - Regarding the methods of calculation of the entry and exit rates, see the notes to Table 11 in the supplementary statistical data.
 - SMEs are defined here as follows.
 - Up to 1996: Enterprises with 300 or fewer regular employees (100 or fewer in wholesaling, and 50 or fewer in retailing, eating and drinking places, and services) or capital of ¥100 million or less (¥30 million or less in wholesaling, and ¥10 million or less in retailing, eating and drinking places, and services).
 - From 1999: Enterprises with 300 or fewer regular employees (100 or fewer in wholesaling and services, and 50 or fewer in retailing and eating and drinking places) or capital of ¥300 million or less (¥100 million or less in wholesaling, and ¥50 million or less in retailing, eating and drinking places, and services).

1) 2005 White Paper on Small and Medium Enterprises in Japan, p. 241.

had reached a peak of 5,351,000 in 1986 (based on the total number of enterprises), declined to 4,338,000 by 2004. Similarly, the number of SMEs declined from 5,327,000 to 4,326,000 between 1986 and 2004.

Breaking exits down according to type of business organization reveals that the majority (69.4%) are sole proprietorships,²⁾ which means that the rise in exits is heavily influenced by the rise in exits of sole proprietorships (Figs. 1-2-2 3), 4)). This is backed up by the fact that the rise in the exit rate according to the Ministry of Health, Labour and Welfare’s (MHLW) *Annual Report on Employment Insurance Programs* (Fig. 1-2-3),³⁾ which covers only business establishments that have employees (“employing establishments”), and the Ministry of Justice’s (MOJ) *Annual Report of Statistics on Civil Affairs, Litigation and Civil Liberties* and National Tax Agency’s *National Tax Agency Annual Statistics Report* (Fig. 1-2-4), which cover only incorporation registrations, entries, and exits of

companies, is lower than the rise in the exit rate according to the MIC’s *Establishment and Enterprise Census of Japan*, which covers both sole proprietorships and business corporations.

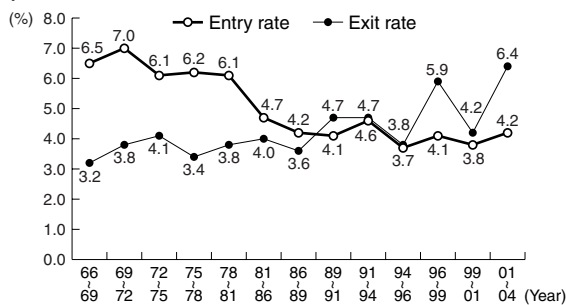
An examination of the age profile of exiting entrepreneurs (“exiters”) according to the MIC’s *Employment Status Survey*⁴⁾ reveals that as a result of the continued increase in exits of entrepreneurs aged 50 years or over since 1979, 43.0% of exiters were aged 60 years or over in 2002 (Fig. 1-2-5). A major cause of the increase in the exit rate in recent years is thus the retirement of entrepreneurs at sole proprietorships (i.e., the self-employed) due to aging.⁵⁾

The exit rate has greatly exceeded the entry rate since the late 1990s, and the gap has recently been widening. As described below, it is important that continued efforts be made to reduce the exit rate by assisting business successions between the generations. While the extensive support measures pursued to date appear to

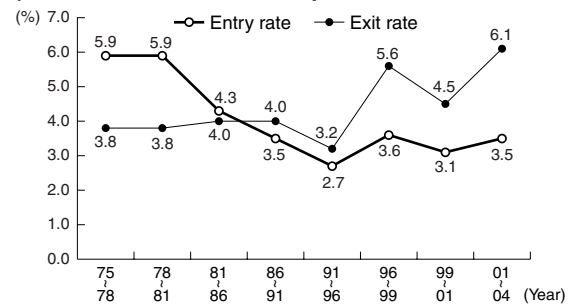
Fig. 1-2-2 Trends in entry and exit rates (annual averages for non-primary industry)

Entry rate exhibiting upward trend, but exit rate also rising

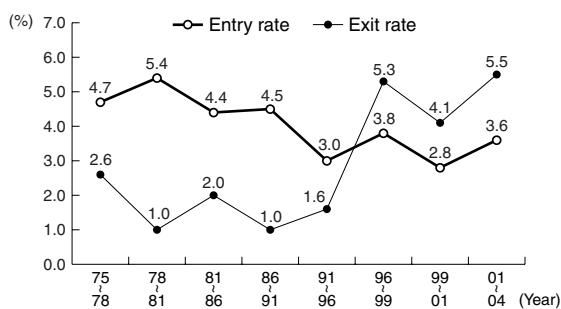
1) Based on number of business establishments



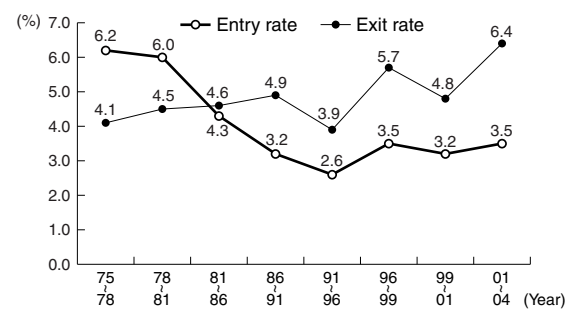
2) Based on number of enterprises



3) Based on number of enterprises (corporations only)



4) Based on number of enterprises (sole proprietorships only)



Source: MIC, *Establishment and Enterprise Census of Japan*.

- Notes:
1. Fig. 1) shows the entry and exit rates for business establishments, including the establishment and closure of branches and plants, and establishments and closures due to relocations.
 2. Survey conducted as the *Establishment Census* until 1991, and the *Establishment Directory Maintenance Survey* in 1994.
 3. Regarding the methods of calculation of the entry and exit rates, see the notes to Table 11 in the supplementary statistical data.

2) Regarding these data, see Table 11 in the supplementary statistical data.

3) One in two sole proprietorships does not employ any regular workers. Such establishments are not therefore covered by the MHLW’s *Annual Report on Employment Insurance Programs*.

4) As the MIC’s *Establishment and Enterprise Census of Japan* does not survey sole proprietors’ ages, the MIC’s *Employment Status Survey* was used here. The statistics from this survey give the employment status of the members of households surveyed, from which it is possible to observe movements in employment focusing on the age of the self-employed.

5) Naturally, even if a sole proprietor exits on the grounds of old age, his or her business is often succeeded to by relatives or employees. Consequently, not all the exits identified here necessarily represent the elimination of economic units from the real economy. However, the decline in the number of entrepreneurs in tandem with the aging of sole proprietors is something that cannot be ignored when considering the question of how to ensure smooth business successions, addressed in Part III, Chapter 2.

have borne fruit in the form of a long awaited upturn in the entry rate, it is crucial that efforts be made to ensure that this positive development is not a transitory one.

(2) Profile of founders from 2001 to 2004

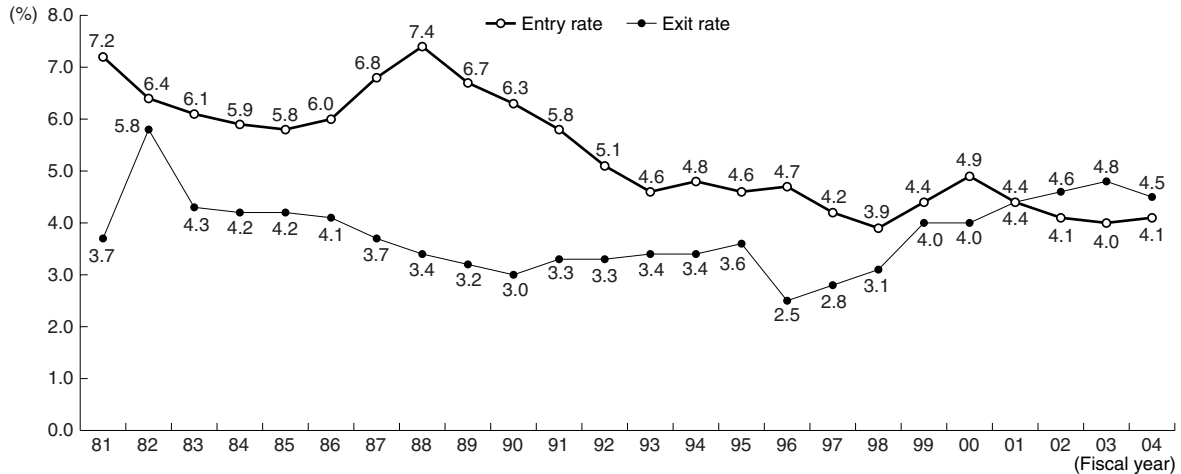
The preceding pages have examined overall trends in

entries and exits over time. Next, we look in detail at the profiles of entries of enterprises between 2001 and 2004.

1) Profile of entries by industry

Entry rates vary according to industry, as Fig. 1-2-6 demonstrates. It is highest in “information and

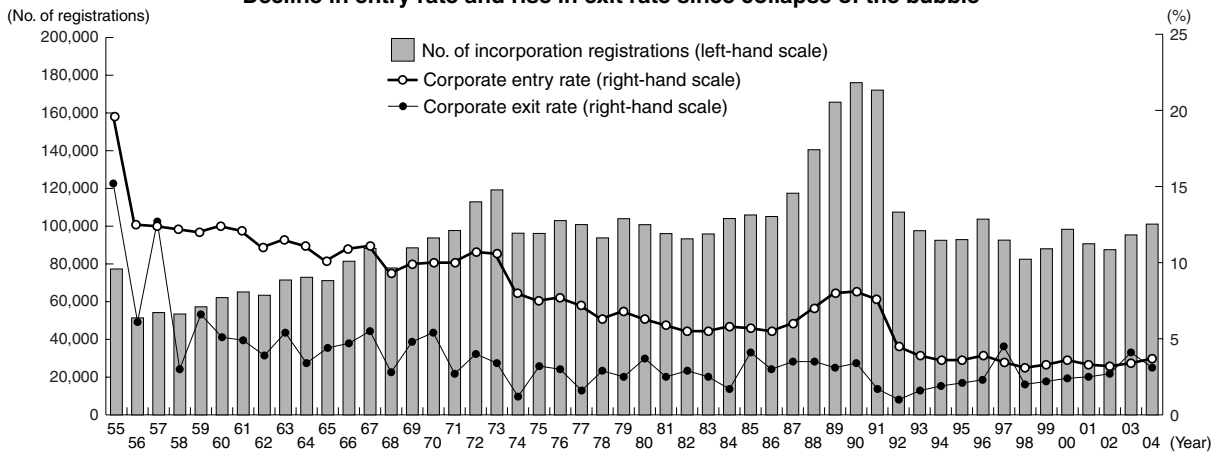
Fig. 1-2-3 Trends in entry and exit rates based on number of employing establishments
Exit rate continues to rise and exceed entry rate, but gap is now closing



Source: MHLW, *Annual Report on Employment Insurance Programs*.

- Notes:
1. Entry rate = number of business establishments newly covered by employment insurance in fiscal year concerned / number of business establishments covered by employment insurance at end of previous fiscal year x 100 (%)
 2. Exit rate = number of business establishments that cease to be covered by employment insurance in fiscal year concerned / number of business establishments covered by employment insurance at end of previous fiscal year x 100 (%)
 3. Business establishments covered by employment insurance are business establishments covered by Article 5 of the Employment Insurance Law and Article 4 of the Law on Collection of Labor Insurance Premiums.

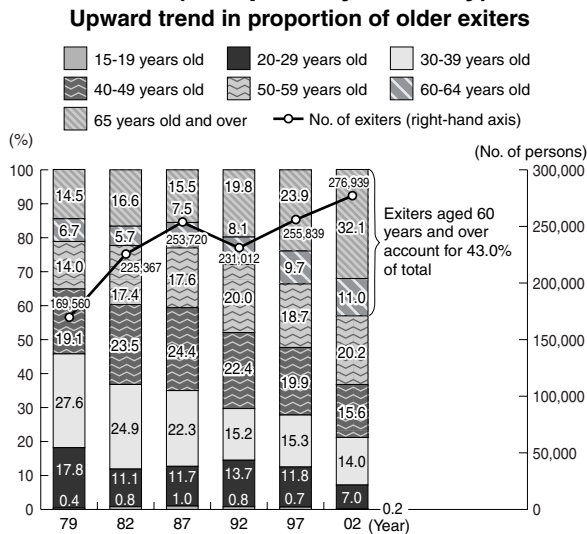
Fig. 1-2-4 Trends in number of incorporation registrations and corporate entry and exit rates
Decline in entry rate and rise in exit rate since collapse of the bubble



Sources: MOJ, *Annual Report of Statistics on Civil Affairs, Litigation and Civil Liberties*; National Tax Agency, *National Tax Agency Annual Statistics Report*.

- Notes:
1. The number of incorporation registrations is from *Annual Registration Statistics* from 1955 to 1960, *Annual Report of Statistics on Civil Affairs, Litigation and Civil Liberties* from 1961 to 1971, and *Annual Report of Statistics on Civil Affairs, Litigation and Civil Liberties* from 1972 onward.
 2. The numbers of companies in 1963 and 1964 are estimates based on the National Tax Agency's Results of the Corporation Sample Survey. The number of companies from 1967 includes cooperative associations.
 3. Corporate entry rate = number of incorporation registrations / number of companies in previous year x 100
 4. Corporate exit rate = corporate entry rate - rate of increase
 (= (number of companies in previous year + number of incorporation registrations in previous year - number of companies in current year) / number of companies in previous year x 100)

Fig. 1-2-5 Breakdown of exiters by age (non-primary industry)



Source: Recompiled from MIC, *Employment Status Survey*.
 Note: “Exiters” here means the combined total of 1) persons who normally work, are not presently engaged in the same work as one year ago, and were self-employed persons in non-primary industry (excluding homeworkers), and 2) persons who do not normally work, were working one year ago, and were self-employed persons in non-primary industry (excluding homeworkers).

communications” (9.9%), for example, followed by “medical, health care, and welfare” (6.4%), and “eating and drinking places, accommodation” and “education, learning support” (both 6.0%). At the other end of the scale, it is low in “mining” (1.7%) and “manufacturing” (2.2%).

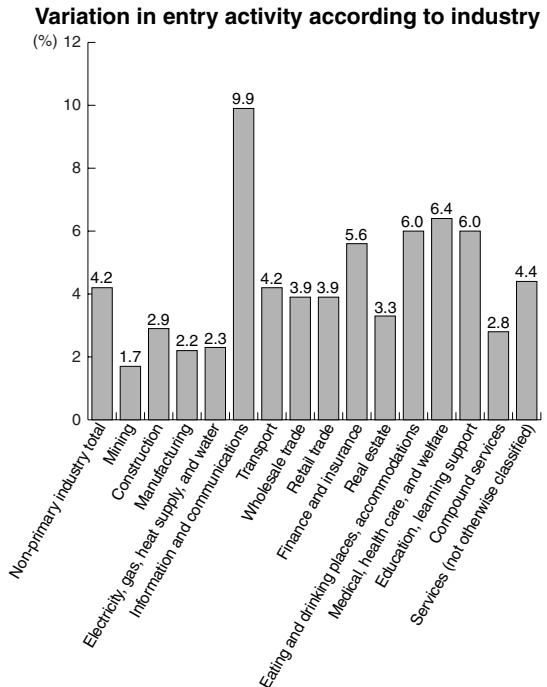
Examining entries in more detail by dividing industries into minor industry groups (Fig. 1-2-7), we find that the entry rate is highest in “internet based services” (51.7%), followed by “other social insurance services” (30.7%) and “other information processing and production based services” (29.5%). These industries with high entry rates tend to be those that cater to the growing use of information technology, the aging of the population, and the diversification of modes of employment, and their high level of startup activity is a reflection of contemporary social demands.

2) Profile of entries by region

Next, we look at entry rates by region.⁶⁾ Fig. 1-2-8 shows a breakdown of entry and exit rates by prefecture, from which it can be seen that entry rates are relatively higher in major urban areas such as Tokyo, Aichi, and Osaka. This tendency is nothing new, and can be

6) It should be noted that in analyzing entry and exit rates by region using the MIC’s *Establishment and Enterprise Census of Japan*, all movements across the approximately 250,000 districts into which the country was divided in order to survey business establishments are treated as entries or exits. Thus an enterprise that moves from district A to district B is counted as an exit in district A and an entry in district B. The smaller the districts into which the country is divided, the greater is the impact of this problem. Consequently, the results described here should be interpreted as representing general tendencies rather than the actual number of entries and exits, or prefectures’ rankings in relation to one another.

Fig. 1-2-6 Entry rates by industry (based on annual average number of business establishments in major industry groups, 2001-2004)



Source: MIC, *Establishment and Enterprise Census of Japan*.
 Notes: 1. Industries are categorized according to the classification described in MIC, *Japan Standard Industrial Classification* (March 2002 revision).
 2. Entry rate = annual average number of entering establishments / number of business establishments in 2001 x 100 (%)

observed during the 1999-2001 period as well. Generally, the exit rate too is higher in regions with high entry rates, suggesting that entries and exits function like economic metabolic processes (in regions with high metabolisms, both entry and exit rates are high).

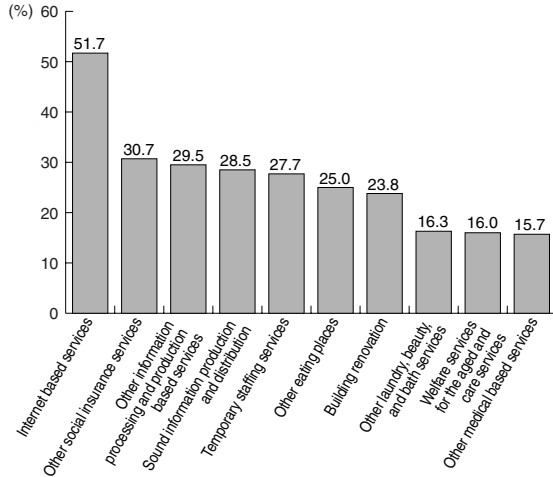
3) Profile of entries according to number of regular employees and business structure

Turning next to consider the size of entries’ workforces, we find that many entries are small in size: 34.7% of entries in non-primary industry have no regular employees at all, and 81.1% have five or fewer (Fig. 1-2-9).

Regarding business structure, the proportions of sole proprietorships, joint-stock companies, limited companies, and so on vary according to industry, with entries of sole proprietorships being particularly prevalent in industries such as retailing, eating/ drinking places and accommodations, medical services, welfare

Fig. 1-2-7 10 industries with highest entry rates (based on annual average number of business establishments in minor industry groups, 2001-2004)

Vigorous entry activity in fields meeting the needs of the times



Source: MIC, *Establishment and Enterprise Census of Japan*.

- Notes:
1. Industries are categorized according to the classification described in MIC, *Japan Standard Industrial Classification* (March 2002 revision).
 2. Entry rate = annual average number of entering establishments / number of business establishments in 2001 x 100 (%)

Classification of minor industry groups

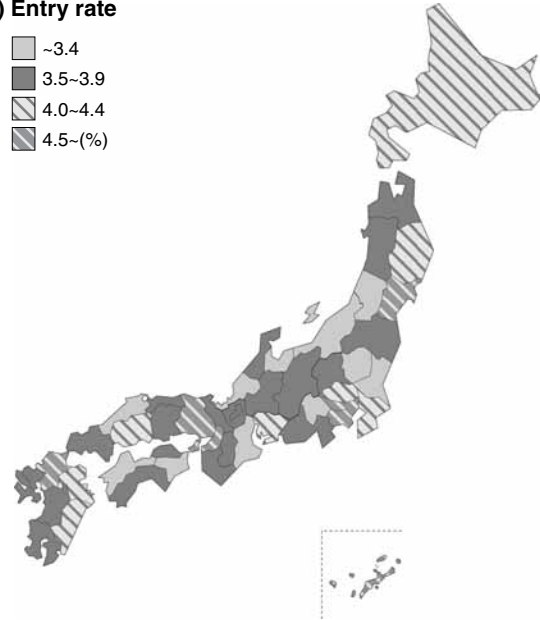
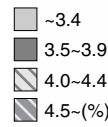
Internet based services	Server housing, application service providers (ASPs), electronic authentication, information network security services, portal site hosting, etc.
Other social insurance services	Halfway houses, rehabilitation aid associations, home-help centers, home-visit bathing centers, social welfare councils, community chests, zeni banks, sheltered workshops, pension investment funds, disability councils, welfare protection housing, Organization for Pharmaceutical Safety and Research, women's counseling centers, etc.
Other information processing and production based services	Film acting agencies, film photofinishing, film captioning, post production, studio rental (for filming and recording), recording studios, recording engineers, etc.
Sound information production and distribution	Recording companies, music publishers, radio program production, etc.
Temporary staffing services	Temporary staffing services, etc.
Other eating places	Korean restaurants, Indian restaurants, curry restaurants, beef barbecue restaurants, ethnic restaurants, fusion restaurants, etc.
Building renovation	Building renovation, home renovation, wooden building renovation, etc.
Other laundry, beauty, and bath services	Kimono cleaning, starching, drapery steam cleaning, stain removal, dyes, Kyozone dyeing, complete redyeing, partial redyeing, color restoring, dyed goods agents, beauty clinics, coin showers, bedding disinfection and drying, self-service laundries, manicure services, pedicure services, nail salons, etc.
Welfare services for the aged and care services	Special nursing homes for the elderly, care and welfare service facilities for the aged, care and health service facilities for the aged, day service centers for the aged, short-stay facilities for the aged, group homes for elderly with dementia, private nursing homes, homes for the aged, homes for the aged with moderate fees (including care houses), welfare centers for the aged, multipurpose senior centers, rest houses for the elderly, senior citizens' support center.
Other medical based services	Eye banks, kidney banks, bone marrow banks, health laboratories, sterilization services (of medical supplies), etc.

Source: MIC, *Japan Standard Industrial Classification* (March 2002 revision).

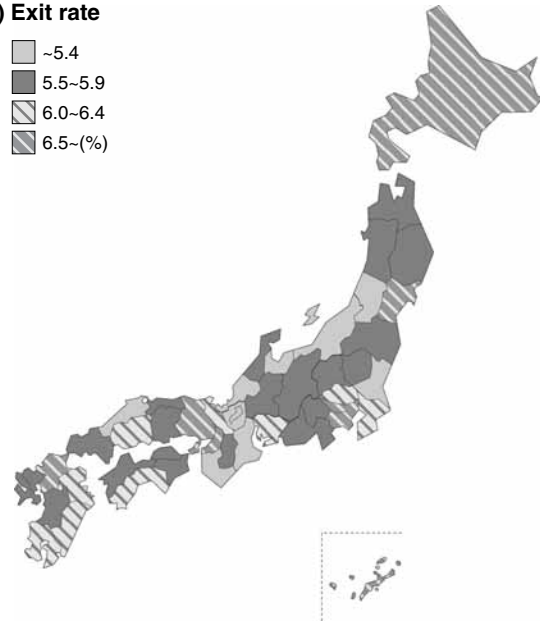
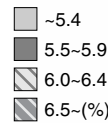
Fig. 1-2-8 Entry and exit rates by prefecture (annual averages for non-primary industry, 2001-2004)

High entry and exit rates in conurbations

1) Entry rate



2) Exit rate



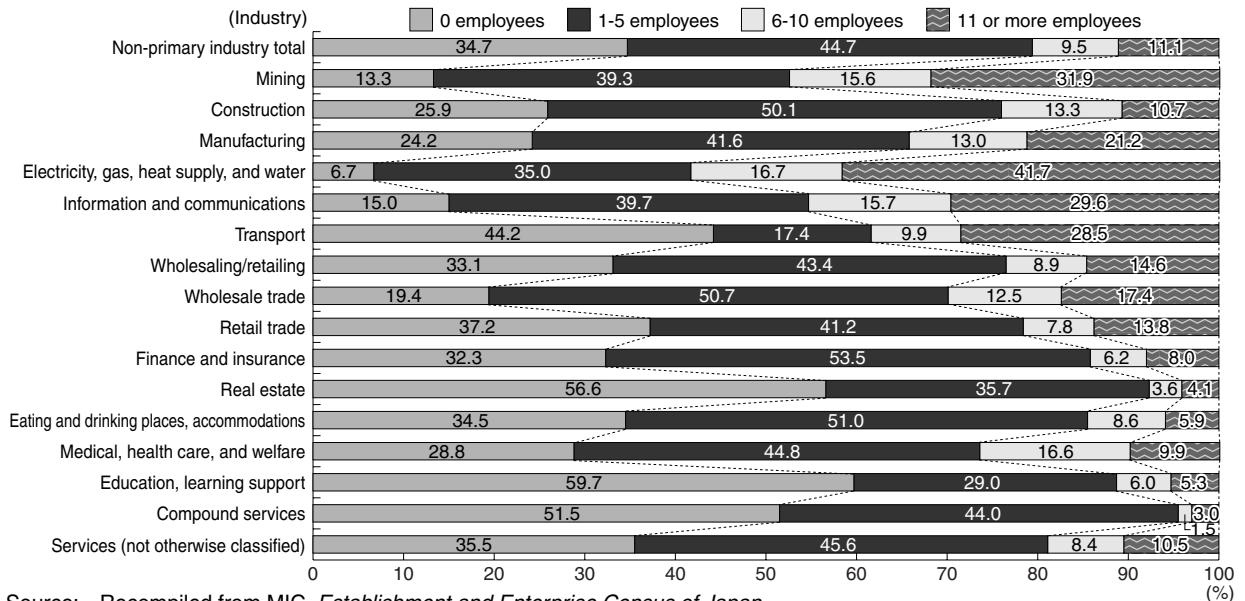
Source: MIC, *Establishment and Enterprise Census of Japan* (2004).

services, education, learning support, and compound services (Fig. 1-2-10).

In the case of business corporations broken down according to amount of capital (Fig. 1-2-11), entries tend to have more capital in information and communications, transport, and compound services, but a majority (55.5%) of all entries in non-primary industry are small enterprises with capital of less than ¥10 million.

These business corporations with capital of less than

Fig. 1-2-9 Profile of entries in terms of number of regular employees
Vast majority employ five or fewer regular employees

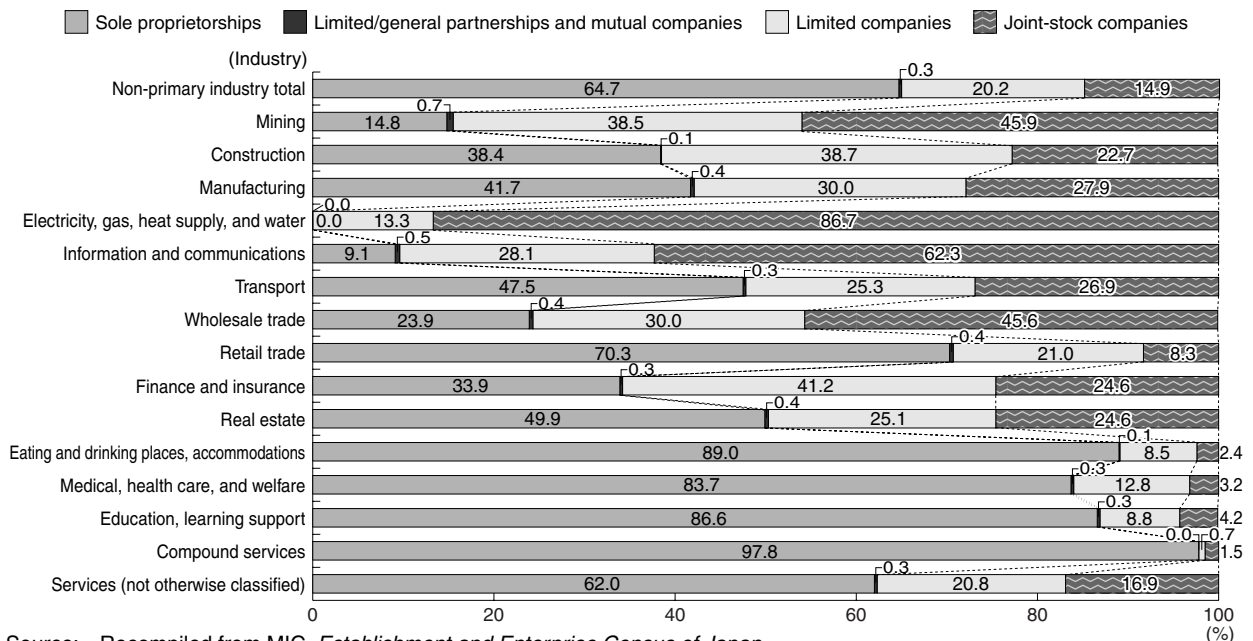


Source: Recompiled from MIC, *Establishment and Enterprise Census of Japan*.

- Notes:
1. "Entries" are here defined as sole proprietorships (including branches) and business corporations that were not in existence at the time of the October 2001 survey, but were in existence at the time of the June 2004 survey.
 2. As business establishments whose line of business was unknown at the time of the 2001 survey but was known in June 2004 are counted as entries, the above estimates may depart from actual trends.
 3. The number of regular employees is as of the June 2004 survey, and may not necessarily be the same as the number at the time of entry.
 4. Industries are categorized according to the classification described in MIC, *Japan Standard Industrial Classification* (March 2002 revision).

Fig. 1-2-10 Profile of new entries in terms of business structure

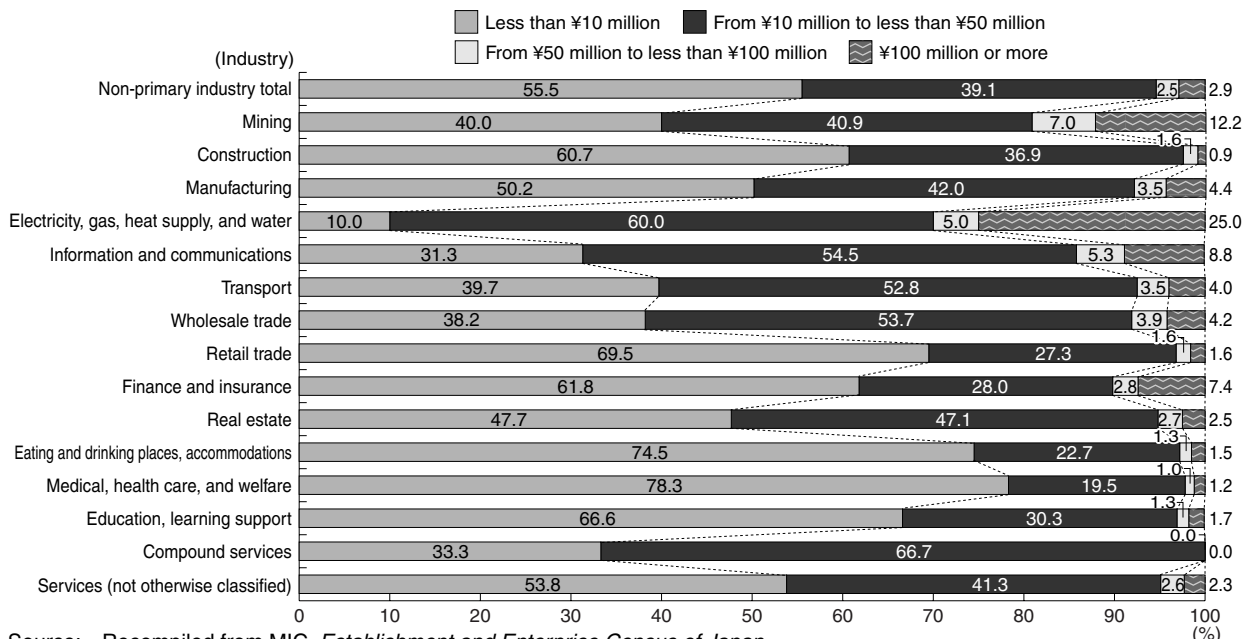
Large proportion of sole proprietorships businesses in industries such as retailing, eating and drinking places and accommodations, medical services, welfare services, education, learning support, and compound services



Source: Recompiled from MIC, *Establishment and Enterprise Census of Japan*.

- Notes:
1. "Entries" are here defined as sole proprietorships (including branches) and business corporations that were not in existence at the time of the October 2001 survey, but were in existence at the time of the June 2004 survey.
 2. As business establishments whose line of business was unknown at the time of the 2001 survey but was known in June 2004 are counted as entries, the above estimates may depart from actual trends.
 3. Business structures are as of the June 2004 survey, and may not necessarily be the same as at the time of entry.
 4. Industries are categorized according to the classification described in MIC, *Japan Standard Industrial Classification* (March 2002 revision).

Fig. 1-2-11 Profile of entries in terms of amount of capital (business corporations only)
Comparatively higher capital in information and communications, transport, wholesaling, and compound services



Source: Recompiled from MIC, *Establishment and Enterprise Census of Japan*.

- Notes:
1. “Entries” are here defined as business corporations that were not in existence at the time of the October 2001 survey, but were in existence at the time of the June 2004 survey.
 2. As business establishments whose line of business was unknown at the time of the 2001 survey but was known in June 2004 are counted as entries, the above estimates may depart from actual trends.
 3. The amount of capital is as of the June 2004 survey, and may not necessarily be the same as at the time of entry.
 4. Industries are categorized according to the classification described in MIC, *Japan Standard Industrial Classification* (March 2002 revision).

¥10 million include not only limited companies (with capital of at least ¥3 million and less than ¥10 million), but also enterprises that appear to have made use of the minimum capitalization exemption system under the Law for Facilitating the Creation of New Business,⁷⁾ which account for 0.9% (870 companies) of the total. Here it should be noted that as the *Establishment and Enterprise Census of Japan* only surveyed entries of enterprises between October 1, 2001 and June 1, 2004, and, moreover, small-scale entry activity, such as businesses established in just a single room of an apartment that display no sign of their presence, do not show up in the statistics, the stimulus to the entry rate given by use of the above exemption system, which entered force on February 1, 2003, is not properly reflected in the survey. Nevertheless, the upward trend since 2003 in the entry rate according to incorporation registrations shown in Fig. 1-2-4 and the fact that the total number of enterprises that had used the system between its launch and January 31, 2006 had come to 33,543 (of which 1,538 companies were “one yen companies,” i.e., companies established with capital of ¥1) are together indicative of the

substantial role that has been played by the system.

With the entry into effect of the Corporation Law in May 2006, the minimum capital system is to be abolished.

2. Startups by women and the elderly

Having looked at trends in entries and exits focusing on business establishments and enterprises, we focus next on the attributes of entry entrepreneurs in examining startups by women and the elderly.

We begin with an analysis focusing on the sex and age of entrepreneurs using the MIC’s *Employment Status Survey*.⁸⁾

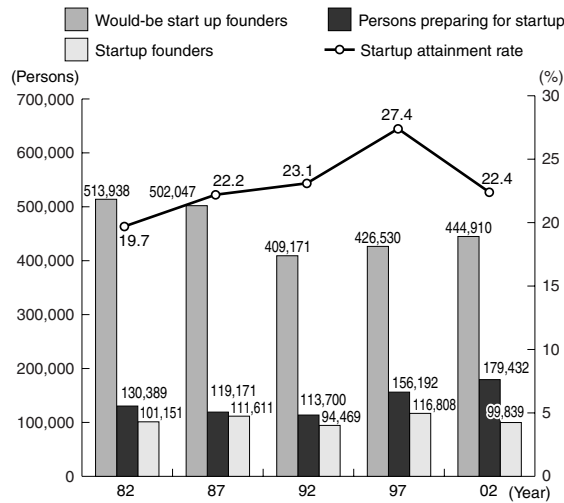
The number of female “would-be startup founders” was around 410,000 in 1992 following the collapse of the bubble, since when it has followed an upward trend. Also worth noting is that the number of women preparing for startup has recently exceeded the level during the bubble (Fig. 1-2-12).

At 31.6%, the proportion of “would-be startup founders” that are women is low. However, the

7) This is a scheme under which an individual establishing a company and not otherwise engaged in business may, with the confirmation of the Minister of Economy, Trade and Industry, be exempted for a period of five years from the date of incorporation from the minimum capitalization requirements under the Commercial Law and Private Limited Companies Law. As companies can be incorporated with capital of just ¥1, the scheme has been dubbed the “One Yen Startup System.”

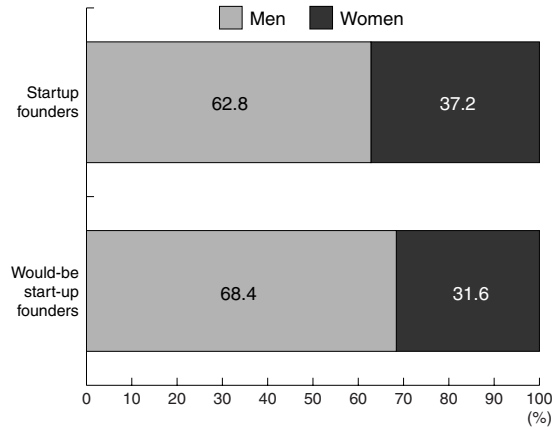
8) In this white paper, “startup founders” are defined as “persons who changed jobs or were newly employed in the past year and are presently self-employed in non-primary industry (excluding homeworkers).” In past white papers, data including homeworkers and persons engaged in agriculture, forestry or fisheries were used for some analyses, making direct comparisons difficult in some cases.

Fig. 1-2-12 Trend in startups by women
Reversal of post-bubble decline in would-be startup founders and persons preparing for startup



Source: Recompiled from MIC, *Employment Status Survey*.
 Notes: 1. "Would-be startup founders" are defined as prospective job-changers and job seekers who responded that they "want to work for themselves" (1979-1997) or "want to be self-employed" (2002).
 2. "Startup founders" are defined as presently self-employed persons in non-primary industry (excluding homeworkers) who changed jobs in the past year or were newly employed.
 3. Startup attainment rate = number of startup founders / number of would-be startup founders

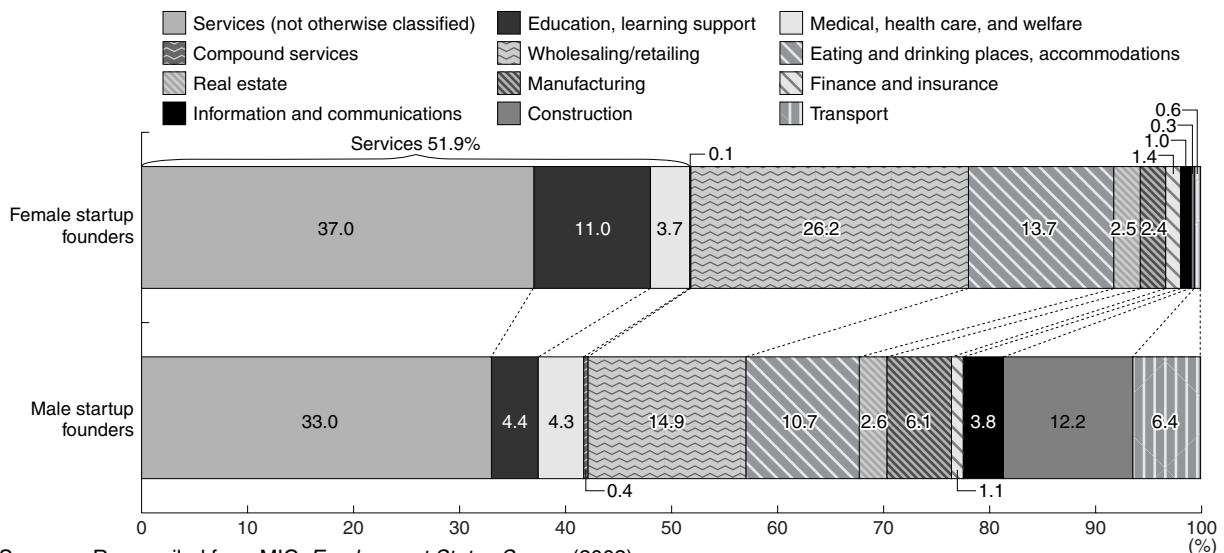
Fig. 1-2-13 Comparison of startup founders and would-be startup founders (by sex)
Higher proportion of women among actual startup founders than would-be startup founders



Source: Recompiled from MIC, *Employment Status Survey* (2002).
 Notes: 1. "Startup founders" are defined as presently self-employed persons in non-primary industry (excluding homeworkers) who changed jobs in the past year or were newly employed.
 2. "Would-be startup founders" are defined as prospective job-changers and job seekers who responded that they "want to be self-employed."

Fig. 1-2-14 Fields of startups by women

Greater concentration of startups in wholesaling/retailing and education/learning support than among men

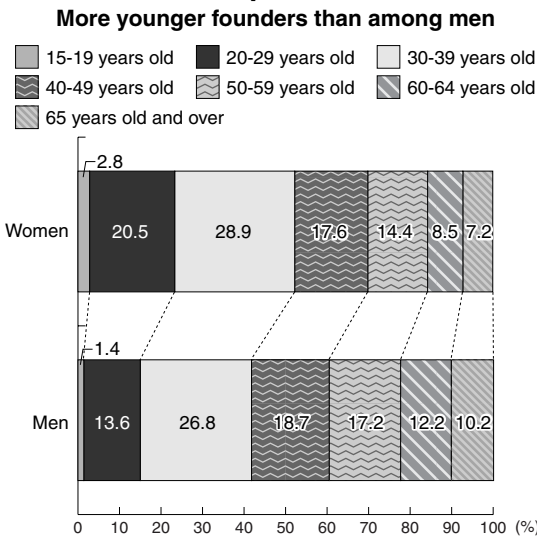


Source: Recompiled from MIC, *Employment Status Survey* (2002).
 Notes: 1. "Startup founders" are defined as presently self-employed persons in non-primary industry (excluding homeworkers) who changed jobs in the past year or were newly employed.
 2. "Services (not otherwise classified)" includes business establishments that provide services to individuals or business establishments that do not fall into any other major industry group, such as providers of mainly residential skills and technologies or services that provide facilities (e.g., laundry, beauty, and bath services).

proportion of actual "startup founders" that are women is 37.2%, which means that the startup attainment rate is higher for female would-be startup founders than male would-be startup founders (Fig. 1-2-13).

Looking at the fields in which women establish startups by industry, women tend to concentrate more in certain fields than men. Thus while a majority are concentrated in services, there are few startups by

Fig. 1-2-15 Age composition of female startup founders



Source: Recompiled from MIC, *Employment Status Survey* (2002).
 Note: “Startup founders” are defined as presently self-employed persons in non-primary industry (excluding homeworkers) who changed jobs in the past year or were newly employed.

women in construction and transport (Fig. 1-2-14).
 If we consider next the age profile of female startup founders (Fig. 1-2-15), we find that many are comparatively young, with over one in two (52.2%) being aged less than 40 years.

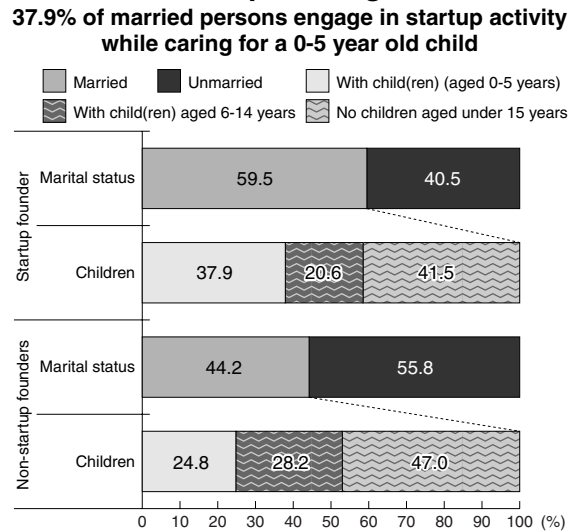
With the Japanese population projected to decline, women’s participation in the labor force will assume even greater significance than in the past if Japan is to maintain its economic growth. Balancing the demands of work and parenting will consequently become an issue, but can startup activity and parenting be successfully combined?

Fig. 1-2-16 shows that 59.5% of startup founders have spouses, of which 37.9% establish startups while caring for children aged 0-5 years. Even for those without children, starting up in business is no easy matter. It is possible, however, that the relative control that one has over working conditions and the distance between “work” and “home” helps sustain startup activity by women with young children. If this is so, then although there may not presently be many women with young children who choose to start up in business as a means of gainful employment, startups will be well worth considering in the future as one avenue that allows people to balance parenting with work.

Next, we consider trends in startups by the elderly.
 Elderly “startup founders” are consistently increasing, both in number and as a proportion of all startup founders (Fig. 1-2-17). Recent years have also seen a sharp rise in elderly “would-be startup founders,” which should in the future translate into increased actual startups by the elderly (Fig. 1-2-18).

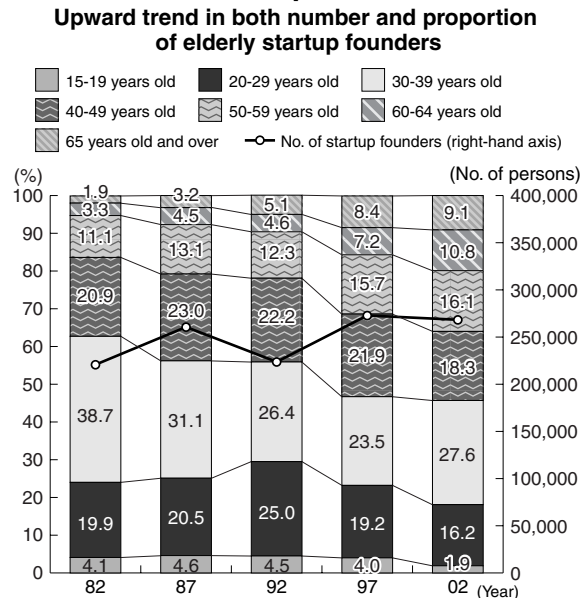
While the age profiles of elderly “would-be startup founders” and actual “startup founders” according to

Fig. 1-2-16 Women’s startup activities and parenting



Source: Recompiled from MIC, *Employment Status Survey* (2002).
 Notes: 1. Percentages regarding children are for married persons only.
 2. “Startup founders” are defined as presently self-employed persons in non-primary industry (excluding homeworkers) who changed jobs in the past year or were newly employed.
 3. “Non-startup founders” are defined as persons other than startup founders who changed jobs in the past year or were newly employed.

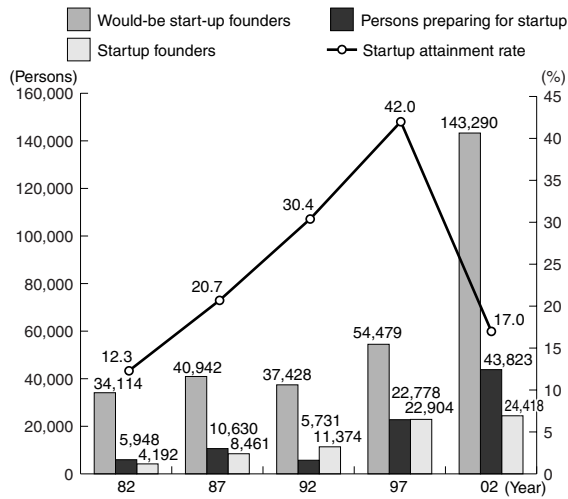
Fig. 1-2-17 Trends in age composition of startup founders



Source: Recompiled from MIC, *Employment Status Survey*.
 Note: “Startup founders” are defined as presently self-employed persons in non-primary industry (excluding homeworkers) who changed jobs in the past year or were newly employed.

data for the latest year available (2002) are almost the same, there is a slightly higher proportion of actual startup founders than would-be startup founders aged 39 years or under and 60 years or over (Fig. 1-2-19).

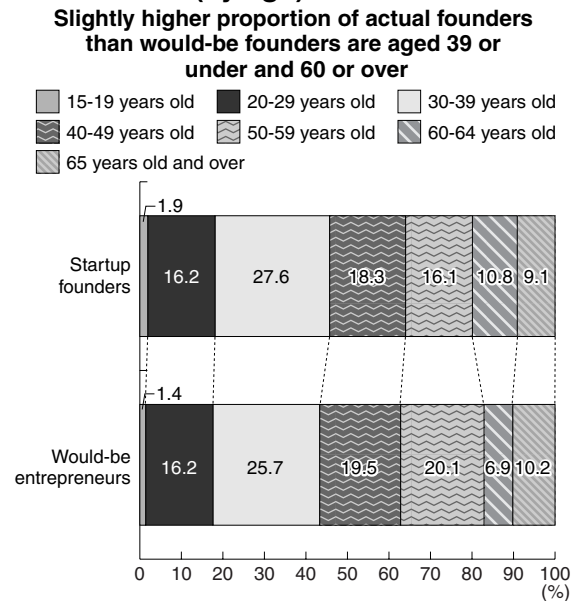
Fig. 1-2-18 Trends in startups by the elderly
Increase in elderly would-be startup founders and persons preparing for startup



Source: Recompiled from MIC, *Employment Status Survey*.

- Notes:
1. "Would-be startup founders" are defined as prospective job-changers and job seekers who responded that they "want to work for themselves" (1979-1997) or "want to be self-employed" (2002).
 2. "Startup founders" are defined as presently self-employed persons in non-primary industry (excluding homeworkers) who changed jobs in the past year or were newly employed.
 3. Startup attainment rate = number of startup founders / number of would-be startup founders
 4. "Elderly" here refers to persons aged 65 years or over.

Fig. 1-2-19 Comparison of actual and would-be startup founders (by age)
Slightly higher proportion of actual founders than would-be founders are aged 39 or under and 60 or over

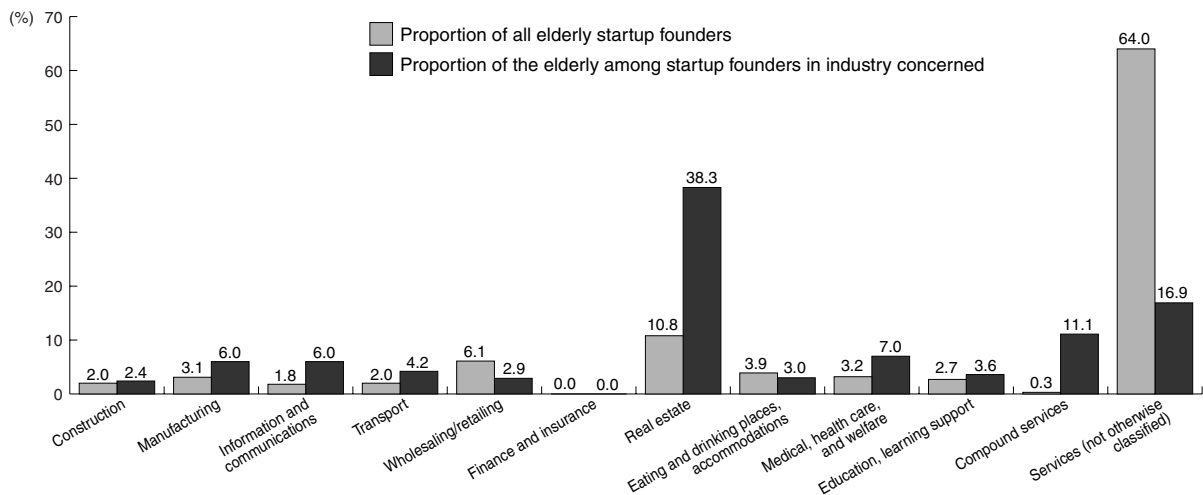


Source: Recompiled from MIC, *Employment Status Survey* (2002).

- Notes:
1. "Startup founders" are defined as presently self-employed persons in non-primary industry (excluding homeworkers) who changed jobs in the past year or were newly employed.
 2. "Would-be startup founders" are defined as prospective job-changers and job seekers who responded that they "want to be self-employed."

Fig. 1-2-20 Startup fields of elderly startup founders

More startup founders in services among the elderly, and more elderly founders in real estate among founders in general



Source: Recompiled from MIC, *Employment Status Survey* (2002).

- Notes:
1. "Startup founders" are defined as presently self-employed persons in non-primary industry (excluding homeworkers) who changed jobs in the past year or were newly employed.
 2. "Elderly" here refers to persons aged 65 years or over.

Regarding the fields in which the elderly tend to establish startups, Fig. 1-2-20 reveals a preponderance of startup founders in the service sector, which accounts for around two thirds of all startups by elderly startup founders. But since the service sector may require less initial investment and know-how than industries such as

manufacturing, making it comparatively easier to enter, this applies not only to the elderly.

Broken down by industry, 65.2% of startup founders in the real estate industry are aged 60 years or over, revealing a large proportion of elderly founders compared with in other industries (Fig. 1-2-20). One possible reason for this

is that elderly entrepreneurs may have accumulated more assets, enabling them to rent out land and buildings that they own and so start up in business as landlords.

The coming years will see the members of the baby-boom generation, who have until now worked as employees of enterprises, reach retirement age. But if Japan is to maintain its economic growth potential in the face of demographic decline, older people's participation

in employment will grow even more important. As described in Part III, Chapter 2, the employment of people who have reached mandatory retirement age needs to be encouraged through reemployment. At the same time, however, vigorous startup activity among the elderly should have a role to play in maintaining social vitality and metabolism in Japan's aged society of the future by generating new business in society.

Section 2 Continuation, bankruptcy, and recovery of businesses

1. Trends in continuation in business and bankruptcy after entry

As observed in Section 1, the rate of entry of both business establishments and enterprises in Japan has bottomed out in recent years, and is now starting to rise.

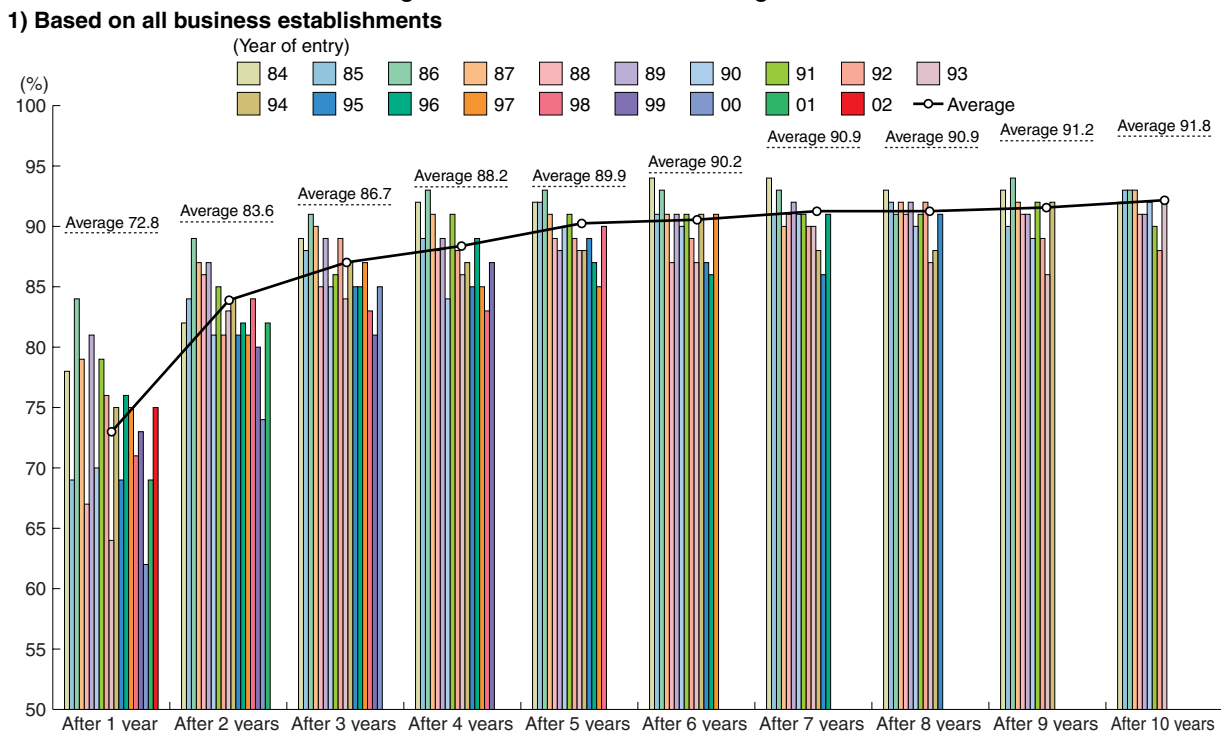
Next, therefore, we examine the situation regarding the continuation in business of enterprises after entry.

Fig. 1-2-21 1) shows the survival rate from the previous year of business establishments during their

first 10 years following entry.⁹⁾ From this, it is apparent that the survival rate of business establishments immediately after entry is low, and gradually stabilizes over the next few years.

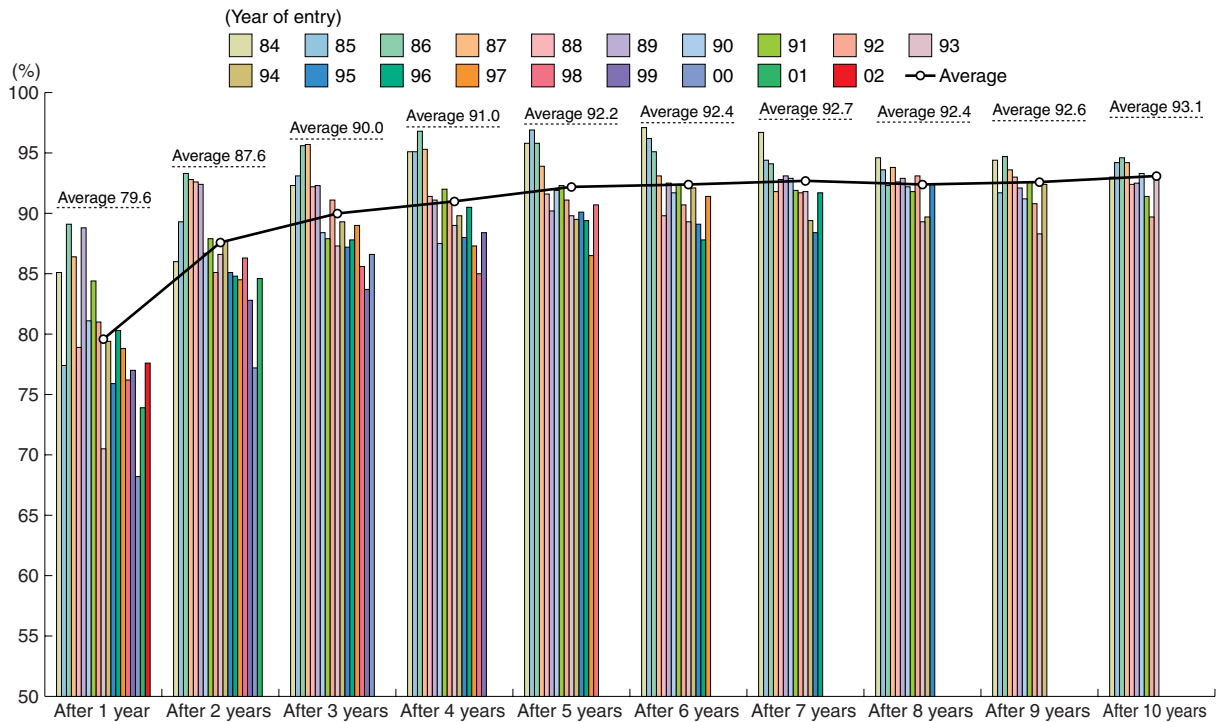
It is likely that the low survival rate for enterprises soon after entry is due to their lack of the various knowledge and know-how required to manage a business, such as knowledge about fund management, management of labor and human resources, products and technologies, and approaches to the market. In terms of

Fig. 1-2-21 Survival rates by year of entry and age of business establishment
Enterprise survival rates gradually stabilize after entry, but survival rates lower among SOHO businesses and take longer to stabilize

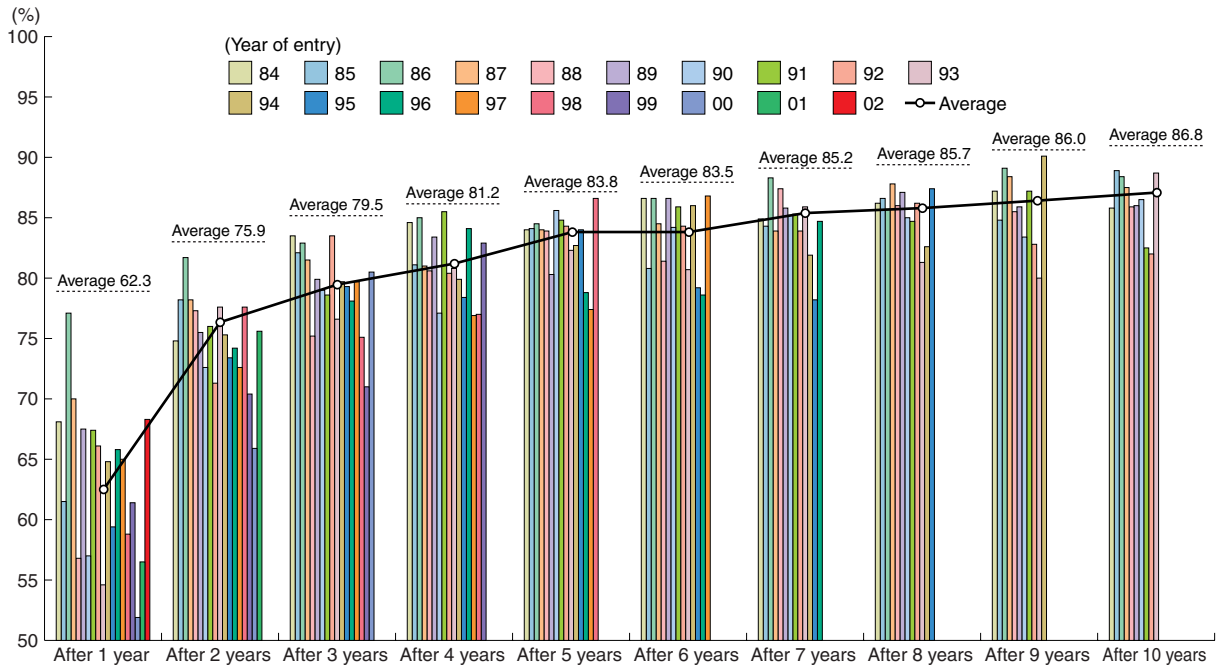


9) Determining the survival rate requires panel data (i.e., statistical data that allow individual survey subjects to be traced over time). Annual surveys should also ideally be used so that years of entry can be identified and survival rates observed year by year after entry. METI's *Census of Manufactures* meets these conditions. However, it needs to be remembered that this survey covers only manufacturing, and it is also limited to business establishments with four or more workers. In order to analyze survival rates in other industries, such as commerce or services, one possibility would be to use METI's *Basic Survey of Japanese Business Structure and Activities*, as this is a complete annual census. The drawback is that it covers only business corporations with at least 50 workers and capital (or capital subscriptions) worth at least ¥30 million, making it unsuitable for determining the survival rate in each year of new entries, given their predominantly small size. (Hardly any enterprises have 50 or more workers when they are established.) Given the statistics presently available, therefore, it is only possible to analyze the survival rates of founders in manufacturing.

2) Based on corporations



3) Based on sole proprietorships



Source: Recompiled from METI, *Census of Manufactures*.

Note: The survival rate indicates the proportion of business establishments surviving each year after entry considering the number in the previous year to be 100.

scale as well, the fact that the majority of entries are below the minimum optimal scale¹⁰⁾ is also no doubt a major factor.¹¹⁾

Next, we break survival rates down according to type of business organization, which reveals that the survival

rate for corporate establishments stabilizes in three to four years, and thereafter stays at around 93% compared to the previous year (Fig. 1-2-21 2)). On the other hand, the survival rate for sole proprietorships immediately after startup is considerably lower than that for corporate

10)The minimum optimal scale is defined as the “minimum scale of production needed to minimize the average cost of production (cost of production / volume of production).”

11)2002 *White Paper on Small and Medium Enterprises in Japan*.

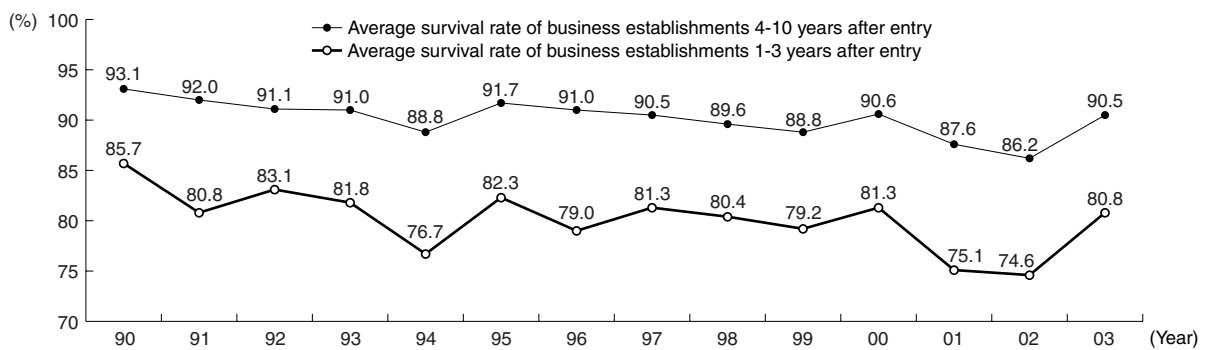
establishments, and takes longer (five to seven years) to stabilize. Even after stabilizing, moreover, the survival rate remains persistently lower than that for corporate establishments at between 85-89% compared to the previous year (Fig. 1-2-21 3)).

Nevertheless, despite differences according to business organization and length of time after entry, survival rates for business establishments do appear to be in decline. This is thought to be a reflection of the increasingly severe survival environment faced by entries (Fig. 1-2-21 2, 3)).¹²⁾

If we look at the situation over time, we discover that although the survival rate declined continuously following the collapse of the bubble, there are signs that it bottomed out in 2002 and began to rise in 2003 (Fig. 1-2-22).

The actual number of bankruptcies¹³⁾ has continued to decline since peaking at 19,164 in 2001, and had declined considerably to 12,998 in 2005, the lowest level since the collapse of the bubble (Fig. 1-2-23). In terms of type, there has been a large decline in recent years in the number of bankruptcies due to suspensions of bank

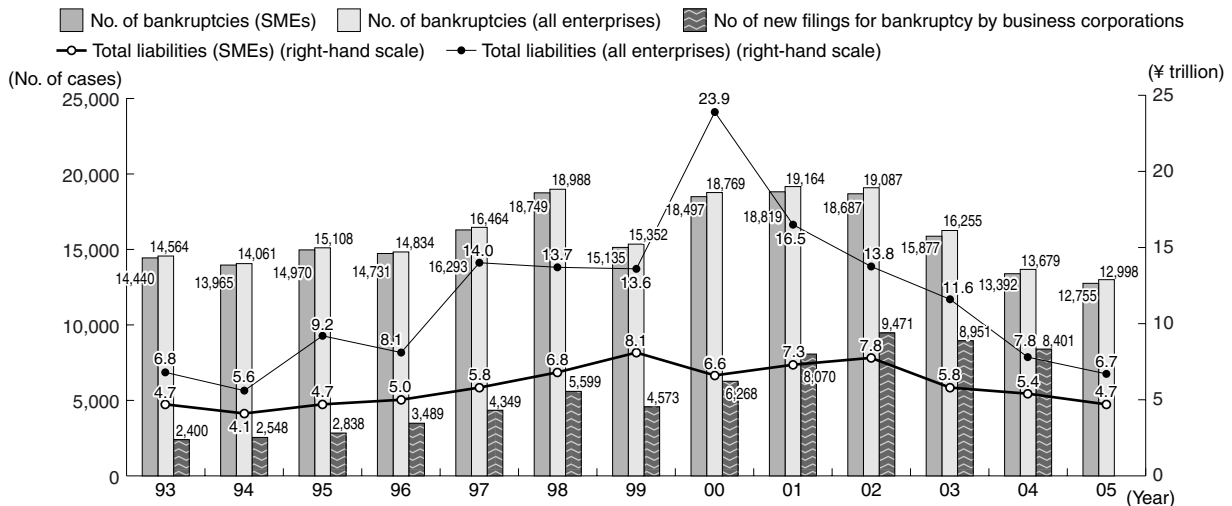
Fig. 1-2-22 Number of years after entry and survival rates of business establishments
Signs that the post-bubble decline in survival rates bottomed out in 2002, with rates now heading up



Source: Recompiled from METI, *Census of Manufactures*.

Note: The survival rate indicates the proportion of business establishments surviving each year after entry considering the number in the previous year to be 100.

Fig. 1-2-23 Trends in number of bankruptcies and total liabilities
Number of bankruptcies now declining after peaking in 2001



Sources: Tokyo Shoko Research, Ltd., *Bankruptcy White Paper*; Supreme Court General Secretariat, *Annual Report of Judicial Statistics*.

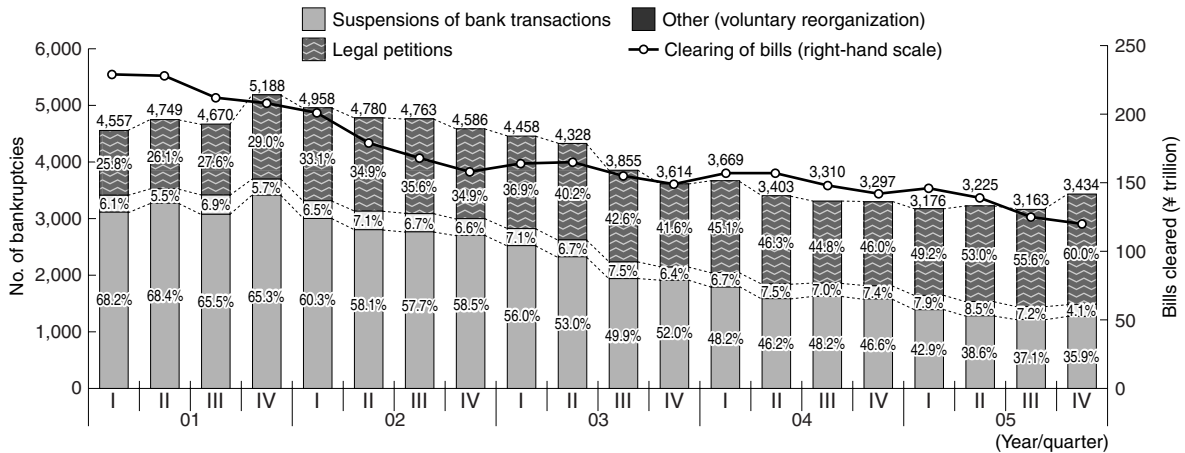
Notes: 1. Number of bankruptcies of enterprises with liabilities of at least ¥10 million. SMEs are corporations with capital of less than ¥100 million and sole proprietorships.

2. The latest year for which data on new filings for bankruptcy by business corporations are available is 2004.

12) In Fig 1-2-21, the thin bars in each "After xx years" category on the horizontal axis indicate the survival rate in each entry period. For example, the values for "entry in 1984" in the "After 3 years" category indicates the proportion of business establishments entering in 1984 that survived one year from 1986 (two years after entry) to 1987 (three years after entry at the time of the survey).

13) "Bankruptcy" is here used as a translation of the word *tosan* in Japanese, which is a popularly used term with no unambiguous legal definition. In this section, use is made of statistics compiled by Tokyo Shoko Research, Ltd., which defines bankruptcies as "a state of being unable to repay debts in general (rather than specific debts), and consequently being unable to continue to engage in economic activity unless some kind of action is taken" (from Tokyo Shoko Research's website). In concrete terms, bankruptcy takes the form of suspension of bank transactions, corporate reorganization, corporate arrangement under Article 381 of the Commercial Law, civil rehabilitation, formal bankruptcy, special liquidation, and voluntary reorganization.

Fig. 1-2-24 Trends in bankruptcies by type and clearing of bills
Decline in suspensions of bank transactions with decline in clearing of bills



Sources: Tokyo Shoko Research, Ltd., *Business Failure News (Monthly)*; BOJ, *Monthly Financial and Economic Statistics*.
 Note: Number of bankruptcies of enterprises with liabilities of at least ¥10 million.

Column 1-2-1 Business Support Libraries

People preparing to set up businesses, as well as managers of newly launched businesses, need ready access to information on business models and how to put them into practice, management techniques, and so on. For those in particular with limited contacts, networks and sources, the activities of public libraries – called "business support libraries" – are attracting considerable attention.

Regional libraries possess a wealth of information and, with the skills of their reference librarians, are well placed to deliver it to entrepreneurs and others in support of starting and operating SMEs in their communities. From only four libraries nationwide involved in business support activities in fiscal 2001, the number grew to more than 30 by July 2005*. Many others are now in the process of developing programs.

Although assistance differs with the individual library, they typically:

- (1) Gather large volumes of printed material (publications, pamphlets, etc.) in a wide range of business areas, organize them into appropriate business categories and topics, and make the available to the public, including via electronic media, in databases and on the Internet – all free of charge;
- (2) Offer the services of reference librarians skilled in finding desired information, for those not yet experienced enough to do so themselves;
- (3) Are open on Saturdays and Sundays, in addition to weekdays, allowing all members of the public, including those employed full-time, to use their facilities free of charge;
- (4) Cooperate with organizations with professional know-how and functions, including governmental bodies at all levels, Chamber of Commerce and Industry and universities; some libraries serve as one-stop access to information from multiple organizations; and
- (5) Proactively disseminate information by sponsoring seminars and the like on starting new businesses, etc.

The Shinagawa Osaki Library, to take a specific example, has more than 4,000 professional books and business books mainly focusing on *monozukuri* (manufacturing), eight categories of on-line databases, and about 80 business magazines and newspapers. It also works in concert with various other organizations – e.g., arranging visits by coordinators from the Industry Promotion Department of the Shinagawa Ward Office, hosting consultation meetings by NPOs on all manner of business matters, and staging social get-togethers for groups of managers or engineers. By cooperating with outside experts in these ways, the library is able to provide more information and more thorough support, meeting the needs of its users more effectively.

As the number of such libraries increases, the stimulation of activities toward the creation of more new businesses, and, equally important, improved survival rates among new enterprises, can surely be expected.

* According to an investigation by the Business Library Association.

transactions (Fig. 1-2-24), possibly owing to a decline in enterprises whose bank transactions had been suspended after dishonoring bills amid the overall decline in use of bills and inter-enterprise credit in general. While the number of bankruptcies appears to have stabilized overall, the increasing number of bankruptcies due to legal bankruptcy petitions (primarily formal bankruptcies) means that it is too early to judge whether the present decline in bankruptcies observed above will translate directly to an improvement in the actual number of bankruptcies.

2. Business recovery

Next, we turn to consider trends in business recovery.

Three factors are typically identified as being necessary to an enterprise in business: people (organizational functions), goods (distribution and production functions), and money (financial functions). Rather than existing in isolation, though, each of these factors affects the others; even should an enterprise suffer a deterioration in its financial health or fall into insolvency, one would expect there to exist fundamental problems with its management of things such as industry trends, changes in consumer demand, business policy, state of sales and distribution, capital investment, capacity utilization, inventory control, labor management cost control, and so on before it reaches that stage (Fig. 1-2-25).

In order to turn a business around, therefore, temporary financial support is not in itself sufficient.

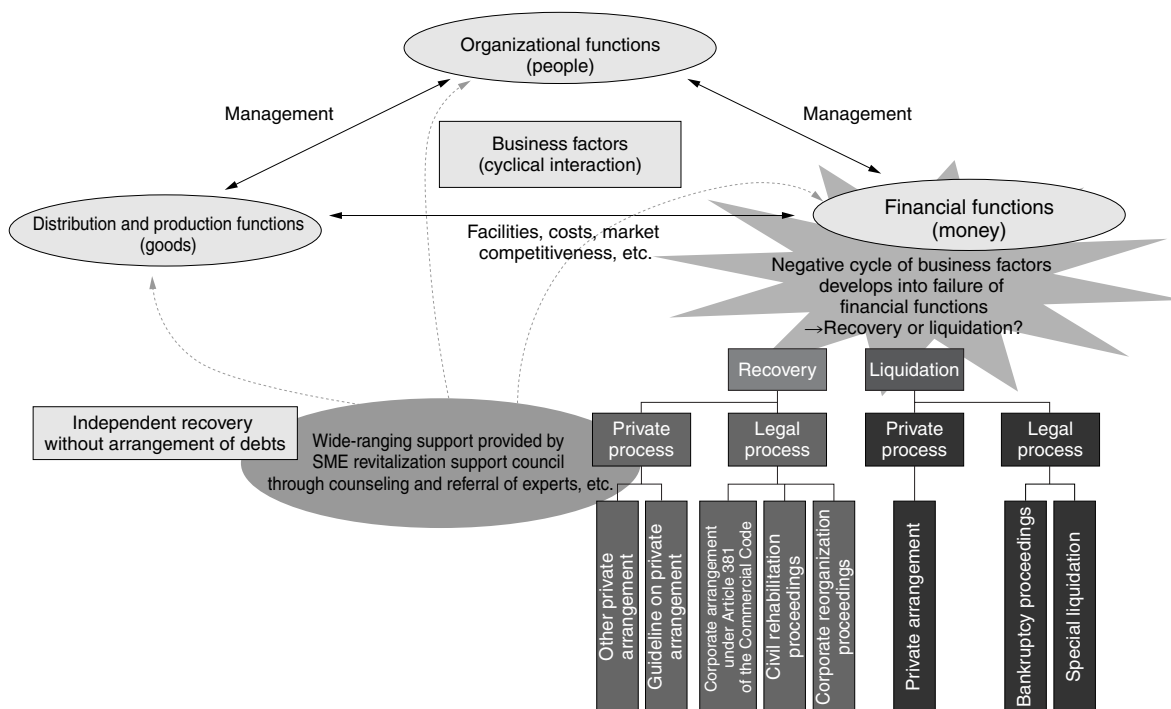
What is needed is a cyclical recovery in all three factors achieved by identifying the causes leading to the enterprise having entered financial difficulties, and a simultaneous rethink of the organizational functions and distribution and production functions.

Following such a recovery course necessitates not only vigorous internal action by managers and employees, but also the cooperation of stakeholders such as suppliers, distributors, and creditors. Management reconstruction is meaningless unless supplies and sales too can be ensured, and an enterprise’s business foundations, such as goods and facilities, and even corporate status can be at risk depending on how creditors act.

As turning a business around thus requires that each business factor be properly balanced, and that action be taken with the understanding of numerous interested parties, steps need to be taken in accordance with the scheme best suited to each enterprise.

In the case that recovery is pursued by legal process, the process is as a rule binding on all creditors, and the loss of business assets is prevented, such as by a preservation order prohibiting the repayment of debts arising from grounds prior to a specified date. The use of private process, on the other hand, enables financial costs and time requirements to be kept down, avoids triggering credit unease among suppliers and distributors, and allows more flexible recovery measures to be implemented. Legal processes tend to take a considerable time, and the negative image associated with “bankruptcy” arising from filing for commencement of

Fig. 1-2-25 Schematic of business factors, bankruptcy, and recovery



Source: Compiled by the SME Agency based on Saburo Ota, *Kigyō no Tosan to Saisei* [Bankruptcy and Recovery of Enterprises], 2004.

proceedings risks handicapping the maintenance and expansion of an enterprise's business dealings.

In view of this, SME revitalization support councils (referred to below simply as "councils") have been established in each prefecture since February 2003 under the Law on Special Measures for Industrial Revitalization. The purpose of these councils is to provide broad-ranging support, such as advice on business in general (including revamping organizational, distribution, and production functions as well as financial functions) and referral of experts, to enterprises, including those that are not yet facing collapse, and they function as neutral intermediaries between enterprises and their stakeholders. They also contribute to preventing enterprises' circumstances from deteriorating in the first place, as well as to recovery from near collapse. Below, then, we briefly describe these councils' performance to date.

(1) State of councils' activities

Since their establishment in February 2003, councils have served a steadily increasing number of enterprises, and the sum total of consultations had reached 8,338 as of the end of January 2006 (Fig. 1-2-26). Although the number of new consultations fell in fiscal 2004 compared with fiscal 2003, they began to climb again in fiscal 2005, reflecting a continued need for their services.

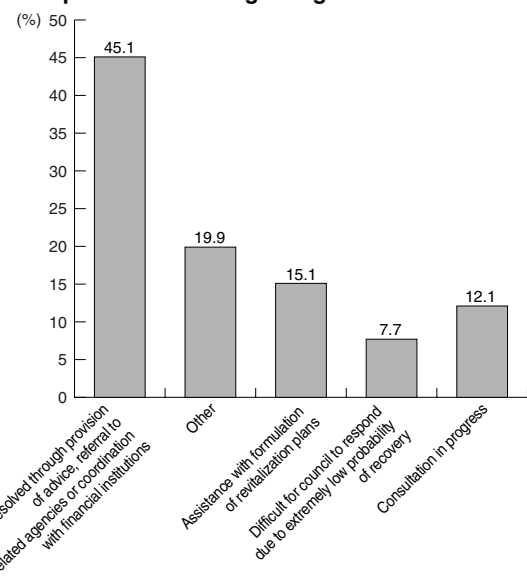
Looking at how councils responded to requests, 44.5% of enterprises received advice on improving their management and/or finances, were referred to appropriate agencies, or became able to raise fresh operating funds from financial institutions through councils' intervention. In a large proportion of cases, therefore, enterprises' problems were resolved at the

consultation stage (Fig. 1-2-27).

As the health of an enterprise deteriorates, its chances of recovery decline. Successful recovery also takes longer and involves more interested parties. Councils thus serve to head off many SMEs' problems before they reach that stage through the provision of simple consultations.

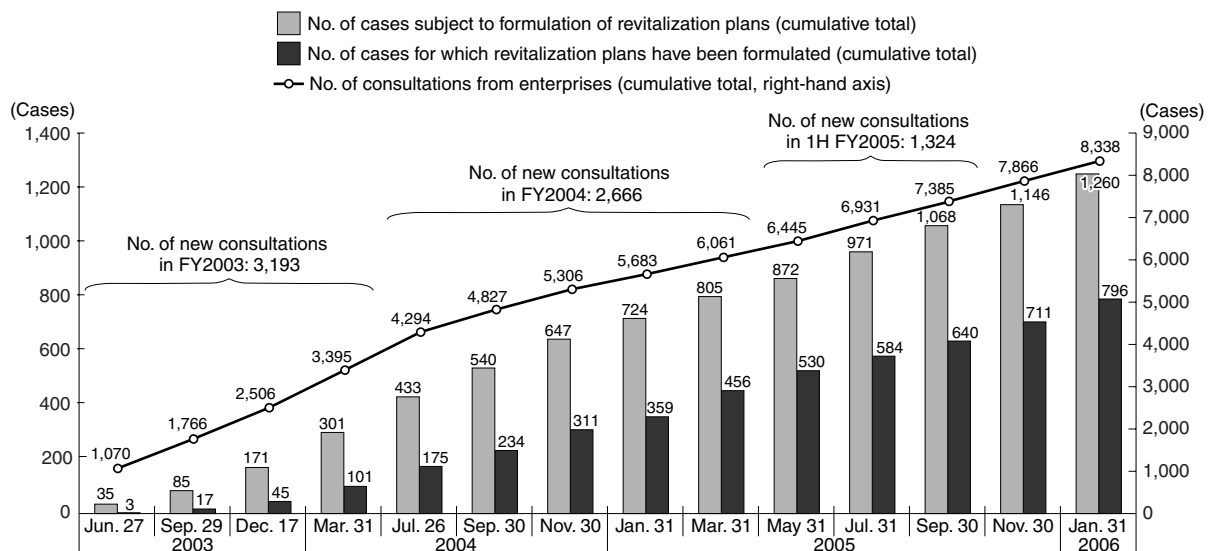
Fig. 1-2-27 Responses to enterprises consulting SME revitalization support councils

High proportion of problems resolved at the consultation stage, indicating that councils are making a valuable contribution to preventing enterprises from falling into greater difficulties



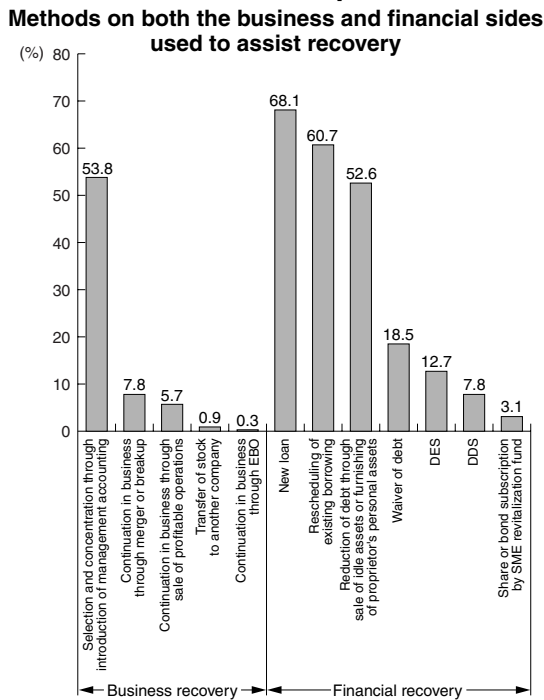
Source: Compiled by the SME Agency (as of January 31, 2006).

Fig. 1-2-26 Performance of SME revitalization support councils



Source: Compiled by the SME Agency.
 Note: There were 202 new consultations in fiscal 2002.

Fig. 1-2-28 Specific methods employed in revitalization plans



Source: Compiled by the SME Agency (as of January 31, 2006).

- Notes:
- As some plans employ more than one method, the totals exceed 100.
 - EBO: Employee Buy Out, i.e., the sale of an enterprise's business to its employees.
 - DDS: Debt-for-Debt Swap, i.e. the conversion of a portion of the lending held by a financial institution to subordinated loan capital under a rational and highly realistic business improvement plan.
 - DES: Debt-for-Equity Swap, i.e. the exchange of an enterprise's debt for equity as a means of reducing its debt.

(2) Formulation and performance of revitalization plans

Let us look at the specific methods employed to date in revitalization plans produced with councils' assistance (Fig. 1-2-28).

Regarding recovery on the business side, the commonest method is the introduction of management accounting by type of product and business partner. Management accounting enables enterprises to keep track of their situation, leading to reduced manufacturing costs and sales and general administrative expenses, and

helps SMEs in particular to concentrate their relatively sparse business resources on more profitable fields.

On the financial side, the most commonly used methods of recovery are "new loans" and "rescheduling of existing borrowing." These are both employed in over 90% of cases, most of which result in either new loans or rescheduling of existing borrowing. Although these include cases in which support cannot easily be provided by private financial institutions acting alone, new loans and rescheduling are arranged by government-affiliated financial institutions in approximately 50% of cases, suggesting that these institutions complement private financial institutions and encourage them to provide support.

In addition to use of the new financing methods of DES¹⁴⁾ and DDS,¹⁵⁾ there has also recently emerged a trend toward the use of methods that cannot easily be implemented without cooperation and coordination among numerous interested parties, such as business reorganization and waiving of debts.

This is a result of the development of conditions for the provision of a variety of forms of support, with the lead role being played by support councils. This includes the development of support schemes by government-affiliated financial institutions and local governments, collaboration with regional financial institutions, clarification of the treatment of recovery plans formulated with councils' assistance in *The Supplement to the Financial Inspection Manual: Treatment of Classifications Regarding Credits to Small and Medium-Sized Enterprises*, and clarification of the tax treatment of debt write-offs.

Accordingly, councils' activities have evolved not only quantitatively in terms of growth in the number of cases handled, but also qualitatively in that they are tackling increasingly tricky recovery cases (Fig. 1-2-29).

Regarding the state of implementation of business recovery plans formulated with councils' assistance, 76.5% of enterprises are largely making smooth progress, including 6.8% that have already returned to a state of normality by, for example, eliminating excess liabilities, while 1.9% have switched to legal liquidation¹⁶⁾ (Fig. 1-2-30).

The bankruptcy of an enterprise is not just a problem for that enterprise, but also creates a risk of secondary bankruptcies among business partners, extending the negative chain of effects. By assisting recovery on both

14)Debt-for-Equity Swap, i.e., the conversion of debt for equity. For an enterprise seeking to turn its business around, this eliminates interest expenses and improves financial health. From the point of view of financial institutions, equity gives them an interest in a borrower's business, which should contribute to putting the business back on a sound footing.

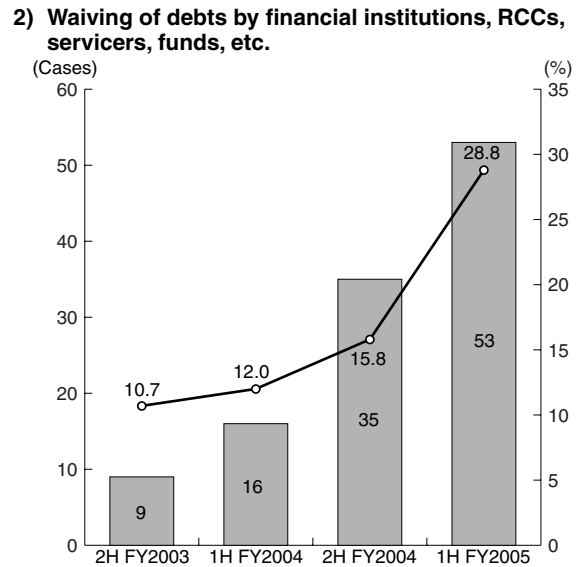
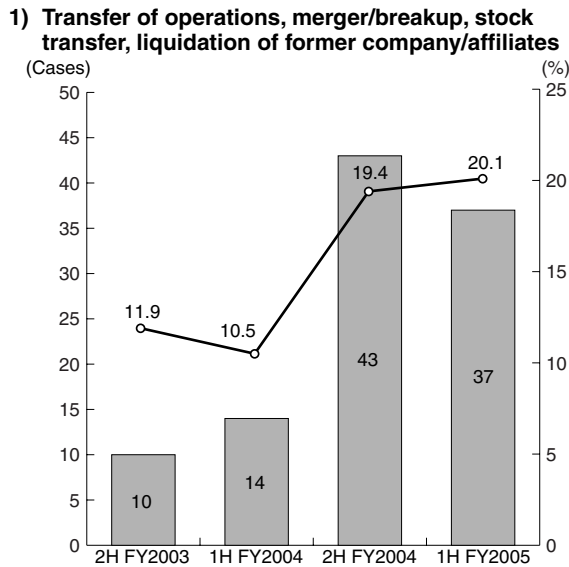
15)Debt-for-Debt Swap, i.e., the conversion of borrowing to a subordinated loan (a low ranking loan that is repayable after other debts with higher claims have been satisfied). *The Supplement to the Financial Inspection Manual: Treatment of Classifications Regarding Credits to Small and Medium-Sized Enterprises* (February 2004) states that in the case that assets requiring caution (including substandard assets) are converted to loans meeting all necessary conditions, financial institutions may treat such subordinated loan capital as equity when determining the category of a borrower. This allows the borrower category of enterprises engaging in recovery to be raised, thereby hopefully stabilizing fund procurement.

16)According to research by Tokyo Shoko Research, Ltd., decisions were made to commence civil rehabilitation proceedings in 4,033 cases between April 2000 and December 2005, and annulment decisions were made in respect of 852 of these cases. Thus in 21.1% of cases, there was no prospect of recovery and a switch was made to formal bankruptcy proceedings or similar procedures instead.

the business and financial sides from a neutral standpoint before enterprises reach the stage at which they meet the conditions for commencing legal proceedings, councils

have a considerable role to play in avoiding the negative impact—direct and latent—of business failures.

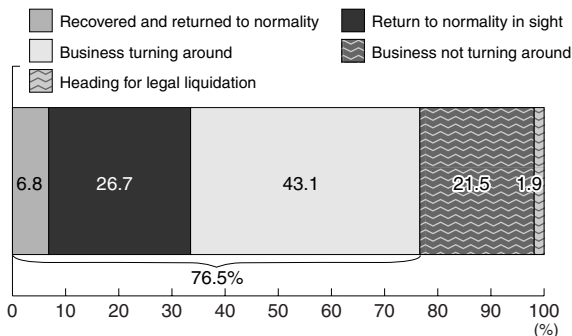
Fig. 1-2-29 Cooperation in business reorganization and waiving of debts
 Increase in essential, serious cooperation by interested parties in business reorganization and waiving of debts, etc.



Source: Compiled by the SME Agency.

Fig. 1-2-30 Business situation after formulation of plan

76.5% of enterprises in relatively favorable position



Source: Compiled by the SME Agency (May 2005).

- Notes:
1. Based on a survey of 311 enterprises that finished formulating revitalization plans by November 30, 2004.
 2. The 43.1% of enterprises that responded “business turning around” are those whose business situation was improving but, because they were in the early stages of plan implementation, were unable to say that a return to normality was in sight.

Chapter 3 Trends in SME finance

Section 1 Financial environment of SMEs

1. Improving SME financing environment

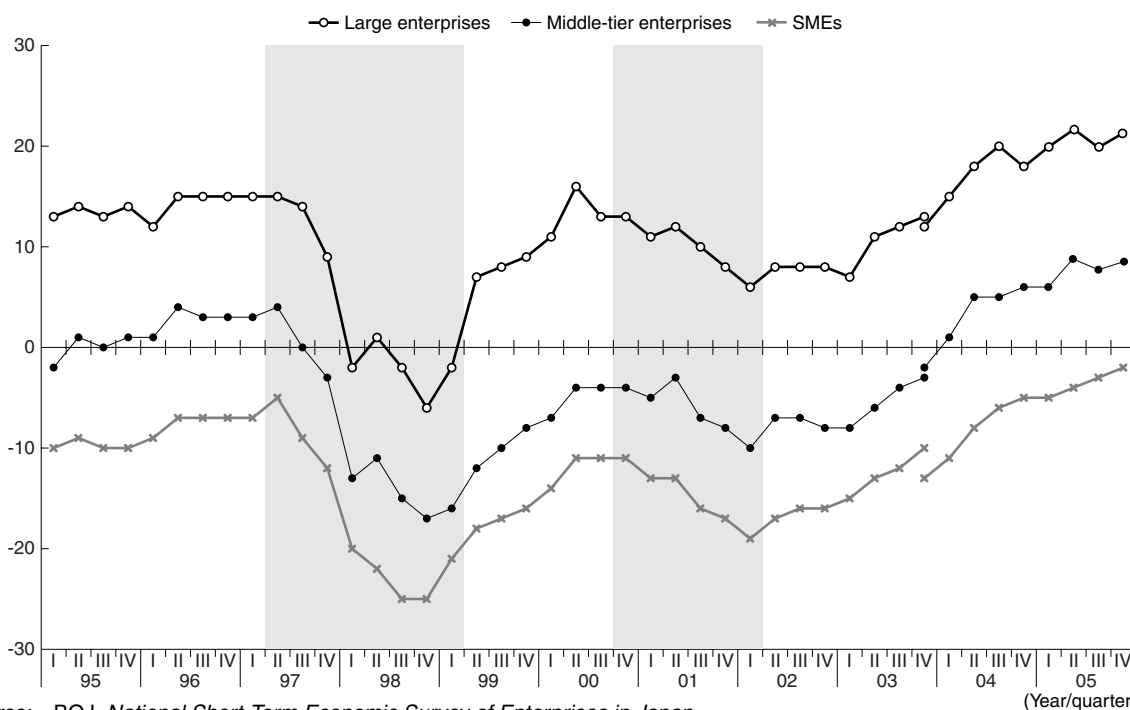
Amid the overall improvement in business conditions facing SMEs, the SME financing environment, too, is generally brightening. As observed in Chapter 1, SMEs are continuing to act to reduce their debts and enhance their equity capital, strengthening their financial position in recent years. Against this background, SMEs' cash flows have also continued to steadily improve since the first quarter of 2002 (Fig. 1-3-1).

Let us examine these developments using the results of RIETI's *Survey of the Financial Environment of Small and Medium Enterprises* conducted by Tokyo Shoko Research, Ltd. According to this survey, which polled SMEs on the micro and macro financial environment that they faced, 46.4%, or a little less than one in two, reported that their revenue/expenditure and financial status had "improved" compared with the past three years (Fig. 1-3-2). The commonest specific reason given for an improvement in revenue/expenditure and financial

status, chosen by 71.3% of enterprises, was "ordinary profit increased," followed by "sales increased" (61.0%), "overall borrowing decreased" (48.7%), and "equity ratio improved" (47.2%) (Fig. 1-3-3). This survey also shows that SMEs are making progress in eliminating the "three excesses," as described in Chapter 1, thus developing a structure that is more profitable overall. In fact, SMEs are in their best position since the collapse of the bubble, with the breakeven point ratio declining and the ordinary profit ratio increasing, creating the conditions for sales growth to translate easily into profit.

Next, we look at the revenue/expenditure and financial status of SMEs according to enterprises' own attributes. Considering firstly trends by industry, it can be seen that whereas more than 50% of enterprises in manufacturing and transport/communications responded that their revenue/expenditure and financial status had improved, the proportion in construction was just 29.7% (Fig. 1-3-4). Broken down by number of employees, the improvement is on the whole more sluggish at smaller enterprises (Fig. 1-3-5). Thus while the situation is

Fig. 1-3-1 Financial position DI (by size of enterprise)
Gradual improvement in financial position of SMEs



Source: BOJ, *National Short-Term Economic Survey of Enterprises in Japan*.

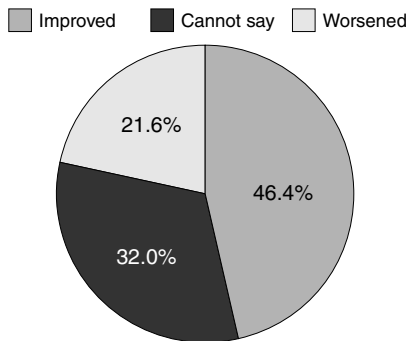
Notes: 1. Financial position DI = "easy" - "tight"
2. The survey has been conducted using revised size and industry categories since March 2004.

improving, the still severe financing environment in certain industries (such as construction) and among smaller enterprises in particular cannot be ignored.

Looking next at the revenue/expenditure and financial environment by region, we find that while there have been conspicuous improvements in some prefectures, such as Saitama, Aichi, and Osaka, the situation remains severe in other regions, such as Aomori, Iwate, and

Fig. 1-3-2 Revenue/expenditure and financial status compared with three years ago

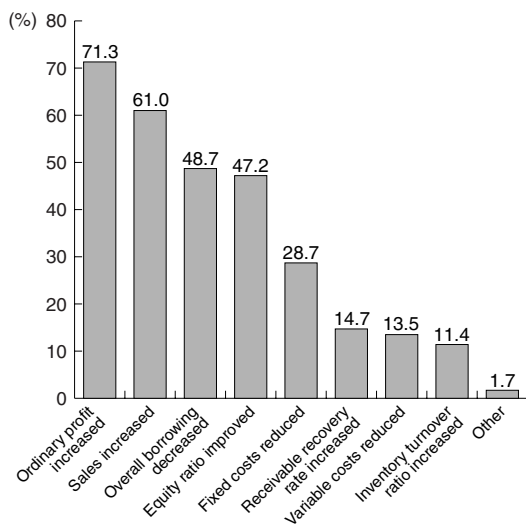
46.4% of enterprises answered that their revenue/expenditure and financial status has "improved" compared with three years ago



Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

Fig. 1-3-3 Specific areas of improvement in revenue/expenditure

Main specific areas of improvement include growth in ordinary profit and growth in sales



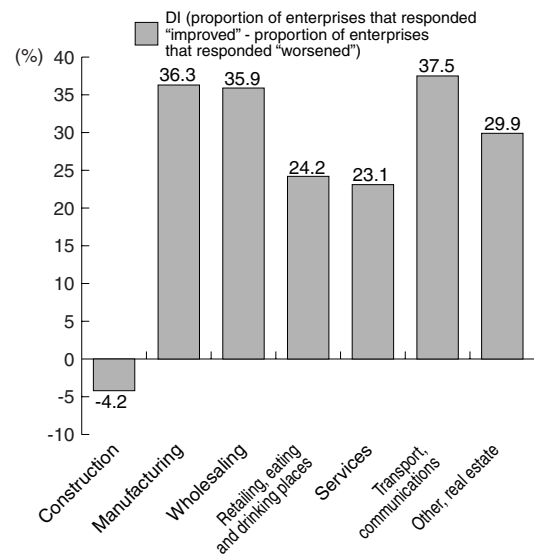
Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

Notes: 1. Totals exceed 100 due to multiple responses.
2. Only enterprises that responded that their revenue/expenditure and financial status had improved compared with three years ago are included.

Shimane (Fig. 1-3-6). Overlaying trends in revenue / expenditure status and manufacturing clustering by region (Fig. 1-3-7) reveals a certain correlation, confirming that, as in the case of the trends in business conditions and production observed in Chapter 1, there is

Fig. 1-3-4 Revenue/expenditure and financial status compared with three years ago (DI by industry)

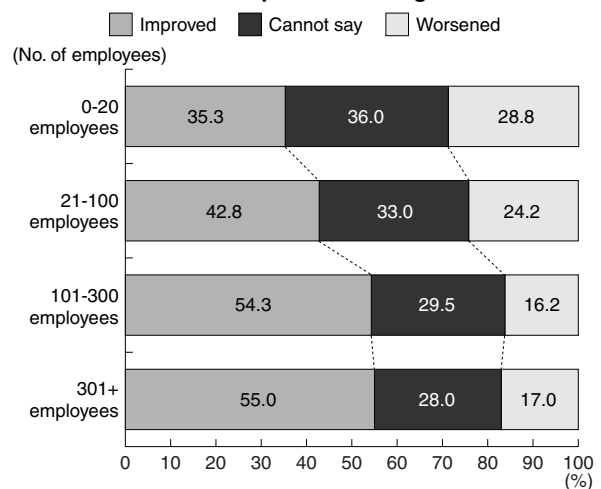
No discernible improvement in construction despite recovery trend in other industries



Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

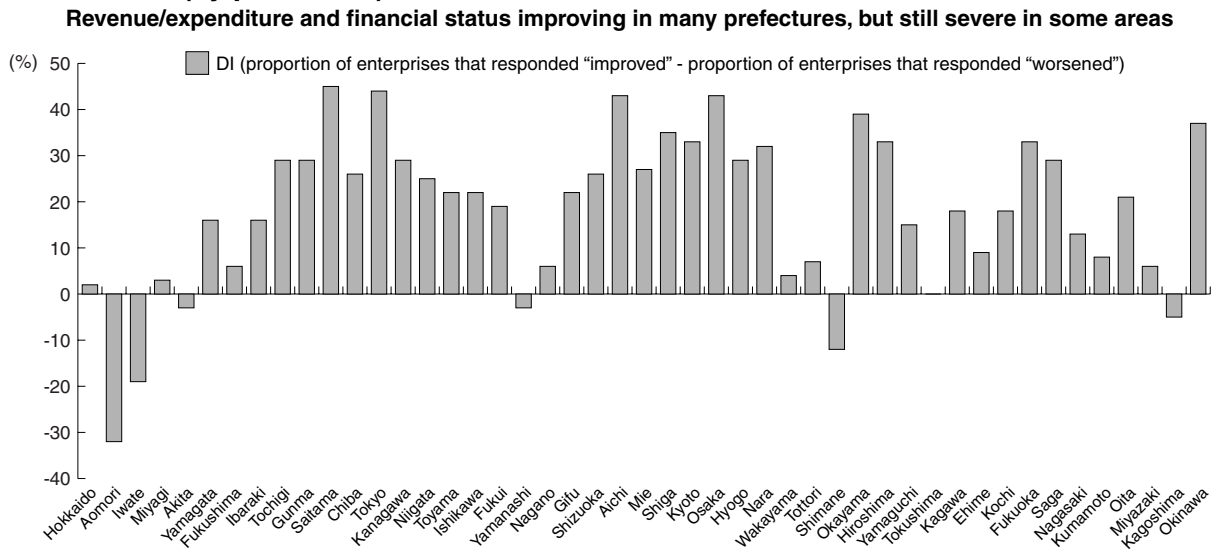
Fig. 1-3-5 Revenue/expenditure and financial status compared with three years ago (by number of employees)

More marked improvement in revenue/expenditure and finances at enterprises with larger workforces



Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

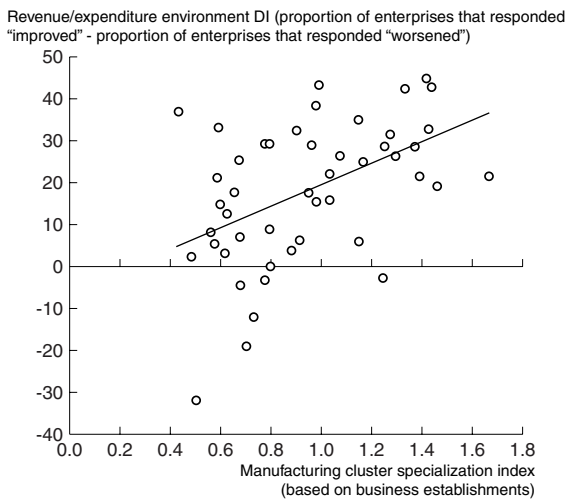
Fig. 1-3-6 Revenue/expenditure and financial status compared with three years ago (by prefecture)



Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

Fig. 1-3-7 Manufacturing clusters and improvement in revenue/expenditure environment

Improvement in revenue/expenditure and financial status tends to be concentrated in regions with comparatively large manufacturing clusters



Sources: MIC, *Establishment and Enterprise Census of Japan* (2004); RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

a pronounced tendency for the revenue/expenditure environment of SMEs to improve in regions with manufacturing clusters.

2. Financial institutions becoming more positive

Next, let us consider lending attitudes toward SMEs from the side of financial institutions.

According to the BOJ's *Tankan*, the SME lending attitude of financial institutions DI ("accommodative" minus "severe") improved after bottoming out at -10 in the fourth quarter in 2002, and has been positive since the second quarter of 2004, with the proportion of "accommodative" responses exceeding "severe" responses (Fig. 1-3-8). The *Survey of the Financial Environment of Small and Medium Enterprises* similarly shows that many enterprises are meeting with a favorable response from financial institutions – according to its findings, 44.8% of SMEs reported that the commonest response received when applying for borrowing from a main bank¹⁾ was "amount applied for received," followed by "bank suggests increasing loan" (29.1%) (Fig. 1-3-9). Similarly, 71.2% of SMEs said that they were approached by a financial institution with which they had not previously done business (Fig. 1-3-10), which provides further evidence of financial institutions' positive stance toward lending to SMEs.

With the financing environment of SMEs thus improving and financial institutions becoming positive about lending to them, what is the actual situation like regarding outstanding lending to SMEs?

As Fig. 1-3-11 illustrates, financial institutions' outstanding lending to SMEs followed a long-term downward trend after the financial crisis in 1997, but

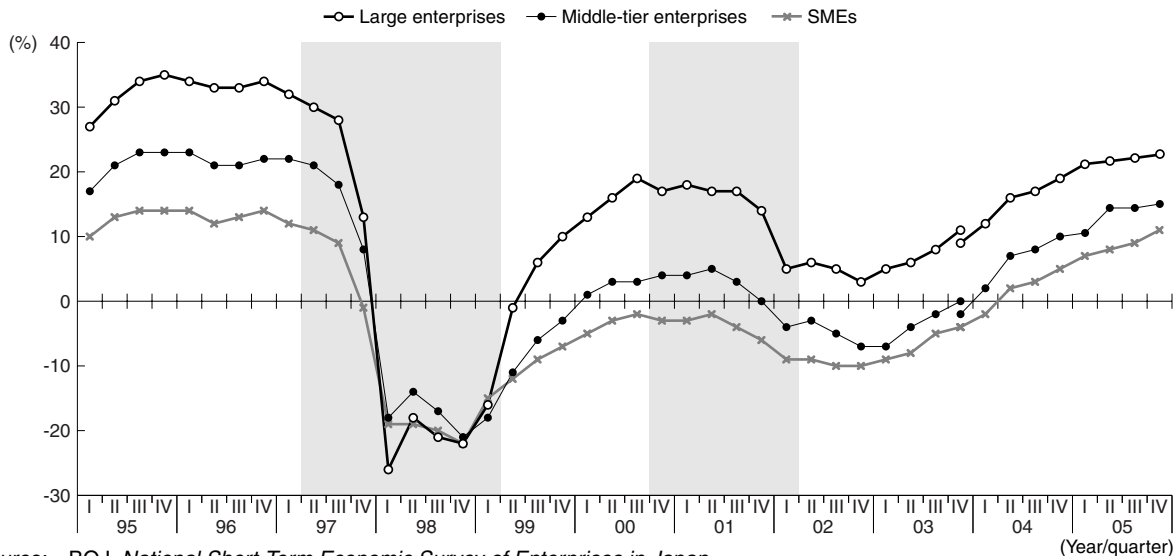
1) A "main bank" is here defined as the financial institution considered by an enterprise to be its main bank regardless of what proportion of its outstanding borrowing is from that institution.

appeared at last to be bottoming out at the beginning of 2005. Particularly noteworthy is the fact that lending to SMEs by domestic private banks, which had been in decline until now, began to climb last summer. This change is due in large part to capital investment demand among SMEs moving into full swing as the recovery in

business conditions generated demand for loans, though the impact of increased lending for real estate in certain regions also played a part (see Fig. 1-1-28).²⁾

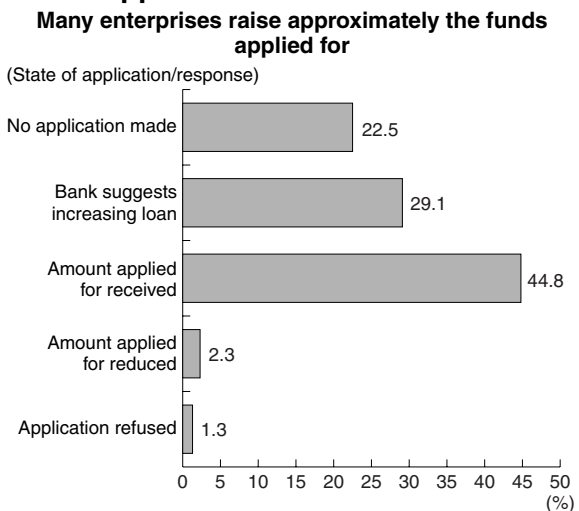
The *Survey of the Financial Environment of Small and Medium Enterprises* also shows that approximately one in two enterprises plans to implement capital

Fig. 1-3-8 Lending attitude of financial institutions DI (by enterprise size)
Modest improvement in financial institutions' lending attitude to middle-tier enterprises and SMEs too



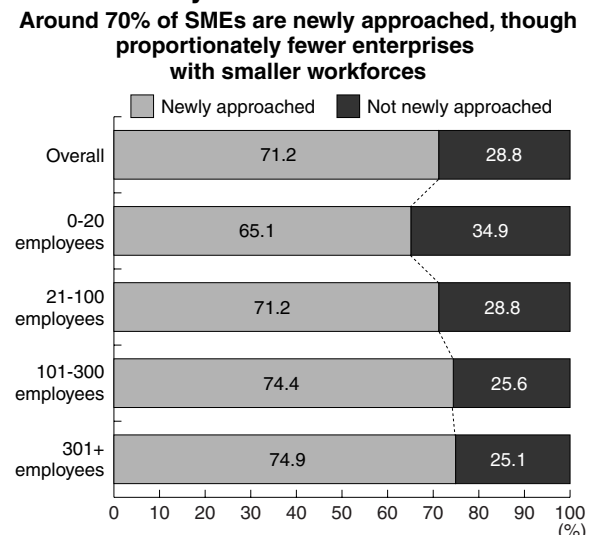
Source: BOJ, *National Short-Term Economic Survey of Enterprises in Japan*.
 Notes: 1. Lending attitude of financial institutions DI = “accommodative” - “severe”
 2. The survey has been conducted using revised size and industry categories since March 2004.

Fig. 1-3-9 Commonest responses to loan applications to main banks



Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

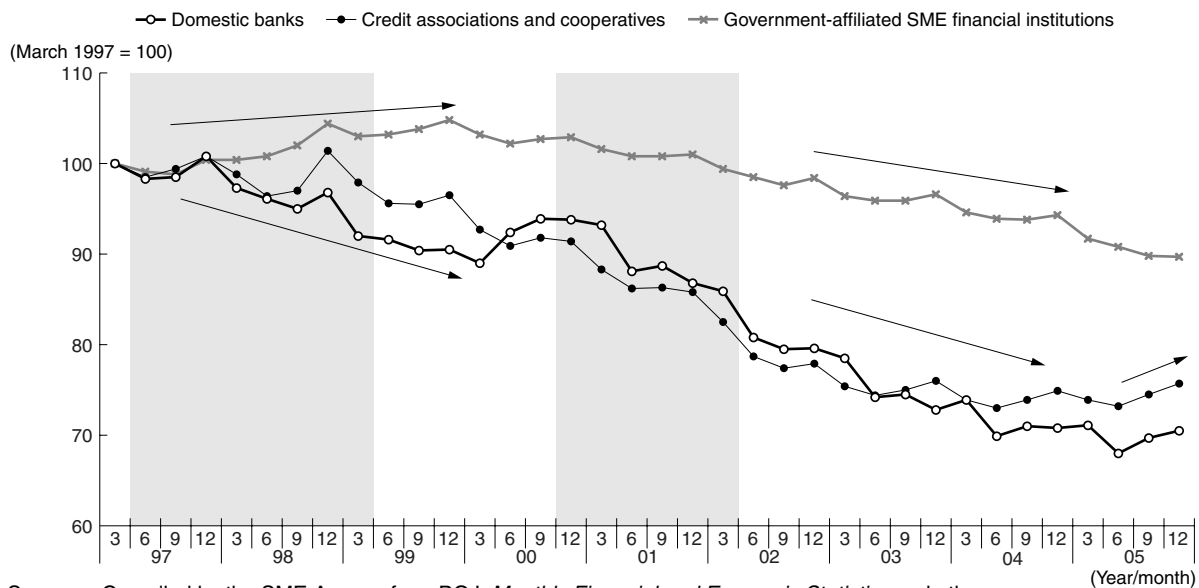
Fig. 1-3-10 Proportion newly approached by financial institution



Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

2) Regarding trends in land prices and mortgage-backed lending, and trends in land prices and total outstanding lending by private financial institutions to SMEs, see Appended Notes 1-3-1 and 1-3-2.

Fig. 1-3-11 Trends in outstanding lending to SMEs (by type of financial institution)
Comparatively stable lending by government-affiliated SME financial institutions, credit associations, and credit cooperatives, but lending by domestic banks too has recovered from June 2005

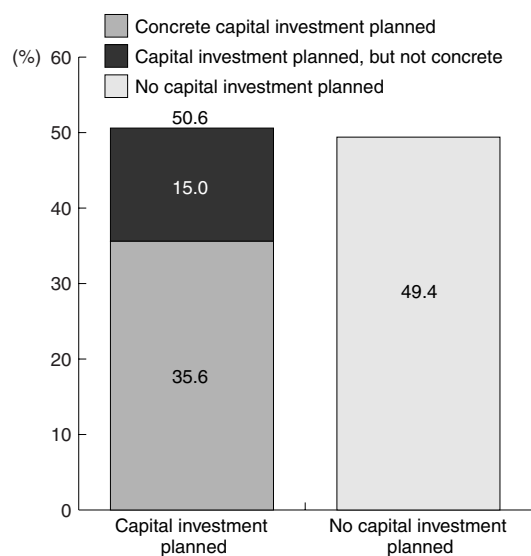


Source: Compiled by the SME Agency from BOJ, *Monthly Financial and Economic Statistics* and other sources.
 Notes: 1. The figures for “domestic banks” indicate the combined lending of domestic banks (excluding credit associations and credit cooperatives), domestic trust banks, and overseas branch accounts of domestically licensed banks.
 2. Government-affiliated SME financial institutions are the Shoko Chukin Bank, Japan Finance Corporation for Small and Medium Enterprise (JASME), and National Life Finance Corporation.
 3. The shaded sections indicate economic contraction (from the peak to the trough in the business cycle).

investment within the next year. A high proportion of SMEs anticipate making capital investment plans, particularly those with larger workforces (Fig. 1-3-12), and 50.8% said that they would raise the funds to do so by “borrowing from main bank.” This is more than the 26.7% that said that they fund investment through “use of internal reserves.” In Chapter 1, it was described how SMEs have cut back on capital investment and practiced “restrained management” relying on internal funding in the face of the decreasingly accommodative lending attitude of domestic private banks following the financial crisis in 1997. Looking ahead, however, it can be seen that as the lending attitude of financial institutions improves as noted above, many SMEs are actively considering raising funds by borrowing (Fig. 1-3-13).

Nevertheless, a breakdown of trends in outstanding lending by prefecture reveals that outstanding lending is still not growing in one in three prefectures,³⁾ and the switch to more “aggressive management” tends to be concentrated, as in the case of the improvement in revenue/expenditure status observed above, in regions with dense manufacturing clusters (Fig. 1-3-14). Regarding lending rates as well, a similar gap in regional trends⁴⁾ needs to be noted (Fig. 1-3-15).

Fig. 1-3-12 Proportion of enterprises planning capital investment within the next year
Around one in two enterprises plan to invest in plant and equipment within the next year

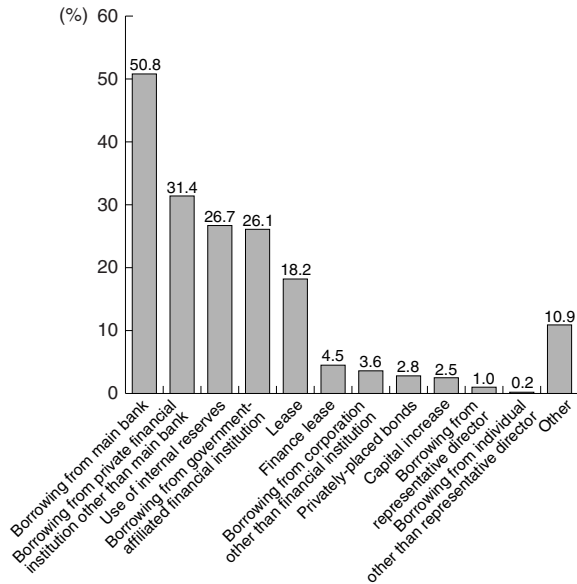


Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

3) Outstanding borrowing, including bills discounted, according to the BOJ’s *Loans by Prefecture*. Regarding the proportions of outstanding lending by prefecture as of December 2005, see Appended Note 1-3-3.
 4) Regarding the upper 25th percentile, median, lower 25th percentile, and mean of concrete short-term borrowing rates by prefecture, see Appended Note 1-3-4.

Fig. 1-3-13 Methods of financing capital investment

Many enterprises plan to borrow from financial institutions in order to finance capital investment

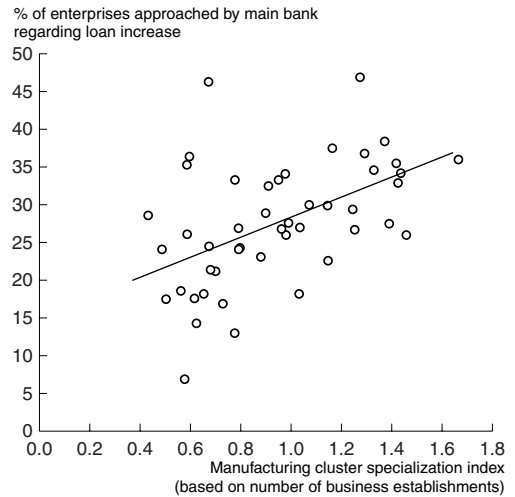


Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

- Notes:
1. Only enterprises that responded that they had "concrete capital investment planned within the next year" are included.
 2. Totals exceed 100 due to multiple responses.

Fig. 1-3-14 Enterprises approached by main bank regarding loan increase and manufacturing clusters

Lending attitude of main bank tends to be more positive in regions with dense manufacturing clusters

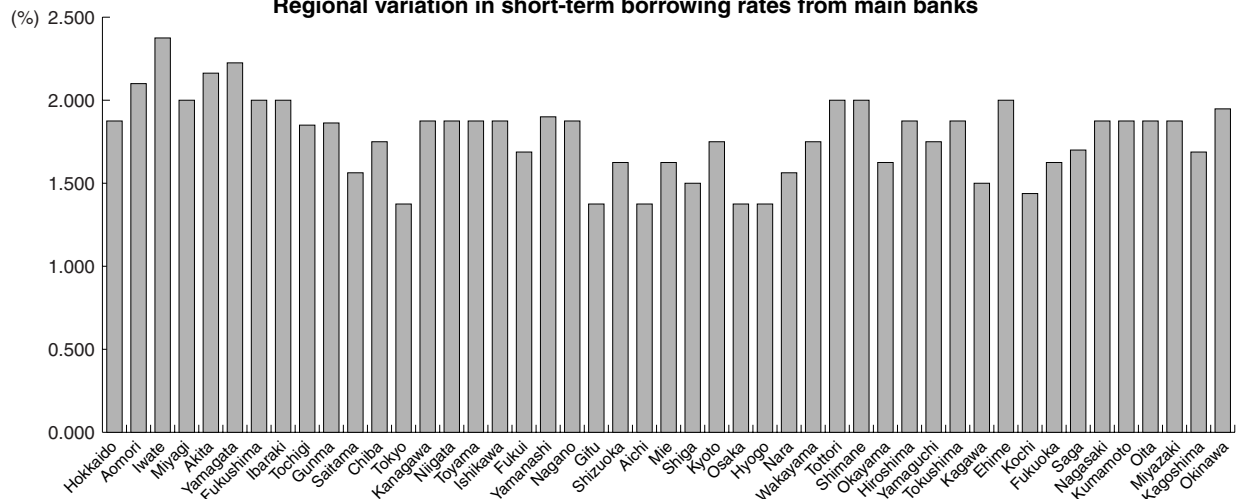


Sources: MIC, *Establishment and Enterprise Census of Japan* (2004); RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

Note: Only enterprises that responded that were "approached regarding increase of loan" in response to borrowing applications made to main banks are included.

Fig. 1-3-15 Short-term borrowing rates from main banks (by prefecture)

Regional variation in short-term borrowing rates from main banks



Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

- Notes:
1. Short-term borrowing rate from main bank as of end October 2005 (median for each prefecture).
 2. Where there was no short-term borrowing as of end October 2005, the latest known short-term borrowing rate was used. Where there were multiple rates, the highest was used.

Section 2 New developments in SME finance

So far we have considered the financial environment facing SMEs. In this section, we turn our attention to specific methods of finance, and consider the penetration of credit scoring finance (quick loans), use of which is now spreading rapidly, and direct finance among SMEs.

1. Rapid spread of credit scoring finance (quick loans)

Conventional lending to SMEs normally requires that assets, such as real estate owned by the proprietor, be pledged as security or that third-party guarantees be provided. In recent years, however, there have developed greater options for unsecured and unguaranteed borrowing paying interest rates of a level commensurate with risk, rather than relying excessively on real estate collateral or third-party guarantees. Of particular note is the recent rapid spread of unsecured and unguaranteed loans based on such an approach, known as “quick loans,” led by leading city banks.

We begin by outlining the distinguishing features of quick loans. As observed in the *2005 White Paper on Small and Medium Enterprises in Japan*, the characteristics of quick loans include the following:⁵⁾

- 1) Screening of loan applications based on, among other things, the probability of bankruptcy calculated statistically from data on the parent population.
- 2) Risk management of loans in a portfolio as a whole based on the law of large numbers, rather than management of risks on a per-loan basis.
- 3) Rapid processing of loans.
- 4) Capping of the maximum value of loans.
- 5) Reduction of screening costs through automation of much of the screening process.

This method of lending was developed in the U.S. in the 1990s, and is thought to have been first offered in Japan by the Tokyo Tomin Bank, Ltd. in December 1998. Since then, use has spread, and quick loans are now offered not only by the leading city banks listed in the introduction, but also local financial institutions such as regional banks. Fig. 1-3-16 confirms the extent of adoption of quick loans by financial institutions. This illustrates the stress placed on quick loans by financial institutions, with around 60% of the total showing a positive interest: as well as 34.1% that are ready for their introduction, 23.6% say that introduction of quick loans is “under consideration.”⁶⁾

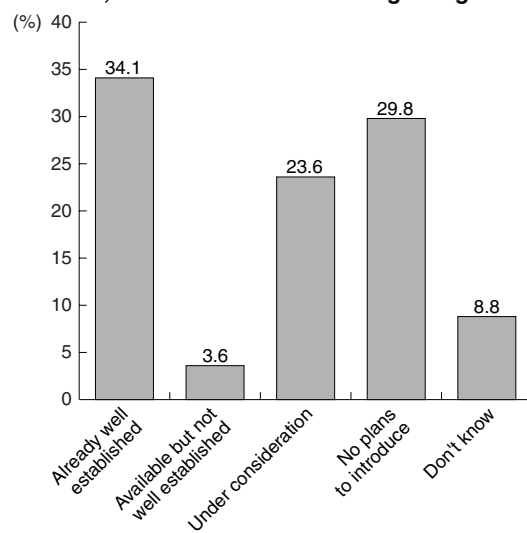
So what kinds of SMEs tend to use quick loans? Using the results of the *Survey of the Financial Environment of Small and Medium Enterprises*, let us examine the attributes of enterprises that responded that they used quick loans.

Breaking the results down firstly by number of employees, 40.8% of enterprises that said that they used quick loans were small enterprises with fewer than 20 employees, and 77.6% had fewer than 100. Given that enterprises with fewer than 20 employees and 100 employees respectively made up 25.2% and 54.1% of the survey population, it is evident that quick loans are particularly widely used by small enterprises with few employees (Fig. 1-3-17).

If we consider next use of quick loans according to equity ratio, we find that they are most used by enterprises with an equity ratio of over 10% to 20%, in

Fig. 1-3-16 Quick loans becoming an established product offered by financial institutions

34.1% of financial institutions already offer quick loans, and 61.3% are considering doing so



Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

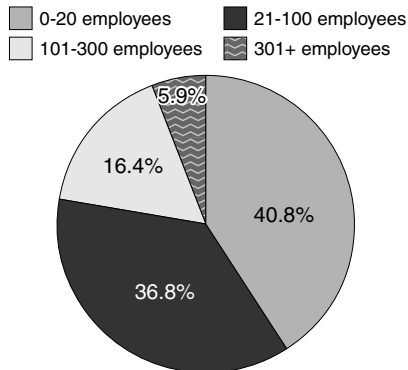
Note: Financial institutions here include city banks, trust banks, former long-term credit banks, regional banks, second-tier regional banks, credit associations, credit cooperatives and commercial moneylenders.

5) *2005 White Paper on Small and Medium Enterprises in Japan*, p. 102.

6) In the case of the “Business Select Loan” offered by Sumitomo Mitsui Banking Corporation to corporations with an annual turnover of not more than ¥1 billion, for example, around 141,000 loans had been made as of the end of September 2005 worth a combined total of approximately ¥3.4 trillion (http://www.smfg.co.jp/challenge/category2_2.html).

Fig. 1-3-17 Enterprises using quick loans (by number of employees)

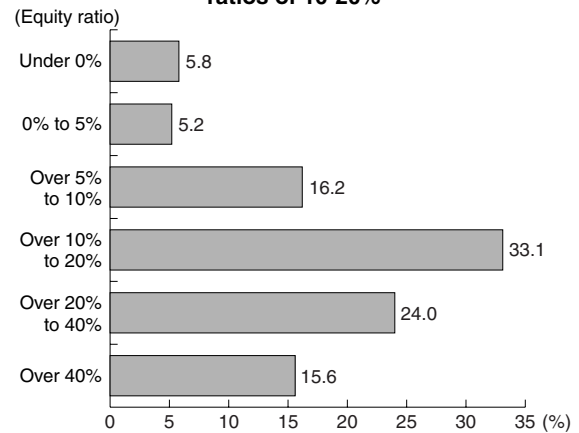
Greater use of quick loans with comparatively fewer employees



Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

Fig. 1-3-18 Enterprises using quick loans (by equity ratio)

Quick loans used most by enterprises with equity ratios of 10-20%



Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

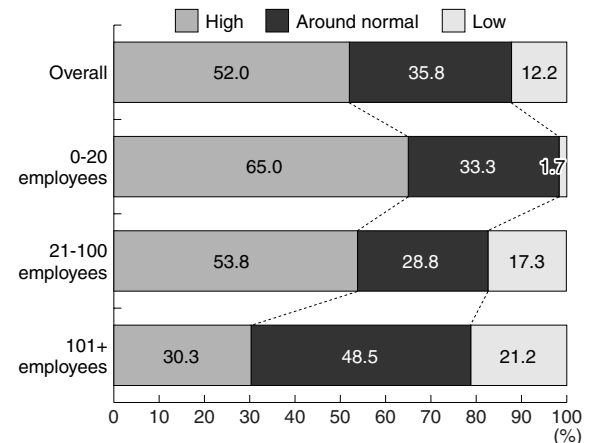
Note: Only enterprises that responded that they are “using quick loans” as of the end of October 2005 are included.

which category 33.1% of enterprises said that they used quick loans. Combined with enterprises with an equity ratio of over 5% to 10%, 49.3% said that they used quick loans. Considering that these enterprises made up only 31.0% of the survey population, use of quick loans is clearly widespread among enterprises with comparatively low equity ratios (Fig. 1-3-18).

Quick loans thus tend to be used more by comparatively small enterprises with low equity ratios. Regarding quick loan interest rates, lenders seek to set rates according to borrower risk, which is reflected by the fact that 52.0% of respondents that say that they are charged “higher than normal” interest rates (Fig. 1-3-19). Nevertheless, the evidence suggests that quick loans play a supplementary financing role of some importance, particularly among enterprises with few employees and low equity ratios, and enterprises in fields where conditions are comparatively difficult, such as construction (Fig. 1-3-20).

Fig. 1-3-19 Interest rates for quick loans (by number of employees)

Quick loan interest rates tend to be comparatively high



Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

Notes: 1. Only enterprises that responded that they are “using quick loans” as of the end of October 2005 are included.
2. Enterprises with 301 or more employees are grouped with enterprises with 101 or more employees.
3. “High” consists of enterprises that answered that borrowing rates are “high” or “comparatively high.” “Low” consists of enterprises that answered “comparatively low” or “low.”

2. Diversification of direct finance, particularly among comparatively large SMEs

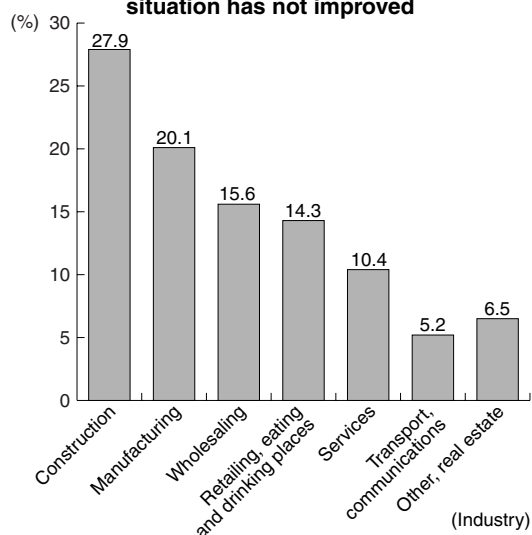
Indirect finance plays an overwhelming role in SME finance. As also noted in the *2005 White Paper on Small and Medium Enterprises in Japan*, however, direct financing methods have been diversifying in recent years, and their use among SMEs, especially comparatively larger ones, is growing.

Fig. 1-3-21 depicts the financing patterns of large enterprises and SMEs from a macro perspective. The trend among large enterprises and SMEs is similar in that both have in recent years reduced their ratio of borrowing from financial institutions, and increased their

equity and bond ratios. However, the borrowing ratio remains high among SMEs compared with large enterprises. Against this backdrop, an increasing number

Fig. 1-3-20 Enterprises using quick loans (by industry)

Proportionately greater use of quick loans in construction industry, in which revenue/expenditure situation has not improved



Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

Note: Only enterprises that responded that they are “using quick loans” as of the end of October 2005 are included.

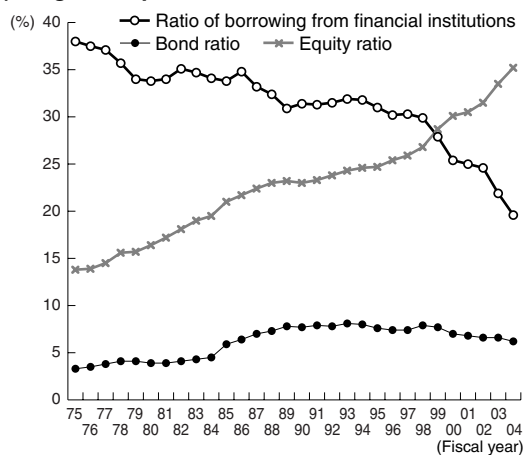
of SMEs – particularly those engaged in expensive R&D or rapid growth—are using direct finance.⁷⁾ While the hurdles to listing on venture markets are not easily overcome, those enterprises that can satisfy the requirements for direct finance not only necessarily have more ample equity capital, but are also targeted by financial institutions offering loans. For those SMEs that can take full advantage of this tool, therefore, direct finance can greatly expand their financing options. In other words, using direct finance generates synergies – as well as being able to raise funds just by combining loans and direct finance, an enterprise with access to direct finance can negotiate terms regarding, for example, interest rates and security requirements from a more advantageous position, and gains access to a larger number of financial institutions. Fig. 1-3-22 shows the sources of funding used by enterprises considering borrowing from financial institutions to fund capital investment according to whether they are publicly traded or have no intention of going public. While no marked difference is apparent between the two regarding borrowing from main banks, the proportion of enterprises borrowing from financial institutions other than their main bank is comparatively higher (38.0%) among publicly traded enterprises, confirming that such enterprises have access to a broader range of indirect

7) Yabushita and Bushimata (2002).

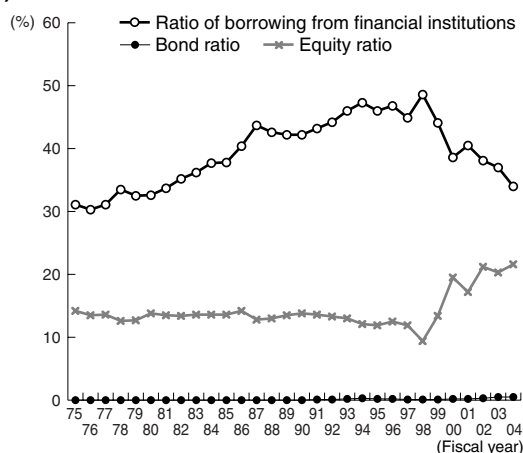
Fig. 1-3-21 Trends in financing patterns among enterprises

Upward trend in equity ratio and downward trend in borrowing ratio at both large enterprises and SMEs, but borrowing ratio still higher at SMEs

1) Large enterprises



2) SMEs



Source: MOF, *Financial Statements Statistics of Corporations by Industry (Annual)*.

- Notes:
1. Large enterprises are enterprises with capital of ¥100 million or more, and SMEs are enterprises with capital of less than ¥100 million.
 2. Ratio of borrowing from financial institutions = short-term and long-term borrowing from financial institutions / total assets
 3. Bond ratio = bonds / total assets
 4. Equity ratio = equity capital / total assets

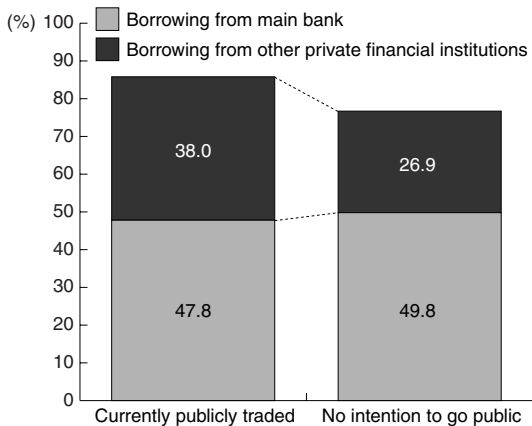
financing options.

Regarding the future, 79.4% of the enterprises polled said that they had “no intention to go public.” On the other hand, 12.7% said that they “planned to go public” or “wanted to go public at some point” (Fig. 1-3-23), and the proportion was particularly large among enterprises with more than 100 employees. As seeking to go public leads to improved manager and employee motivation as

well as diversification of financing methods, increasing numbers of enterprises are likely to consider going

Fig. 1-3-22 Methods of raising funds from private financial institutions for capital investment (according to publicly traded status)

Little difference in proportion of borrowing from main bank, but greater borrowing from other sources among publicly traded enterprises

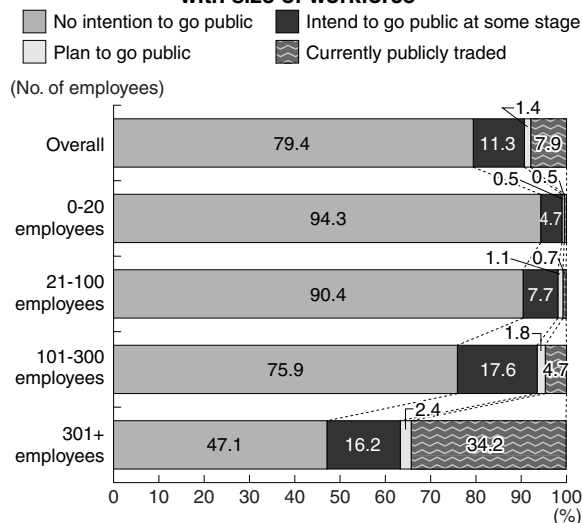


Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

Note: Only enterprises that responded regarding planned capital investment that they had “concrete capital investment plans” that they intended to fund by borrowing from financial institutions.

Fig. 1-3-23 Interest in going public (by number of employees)

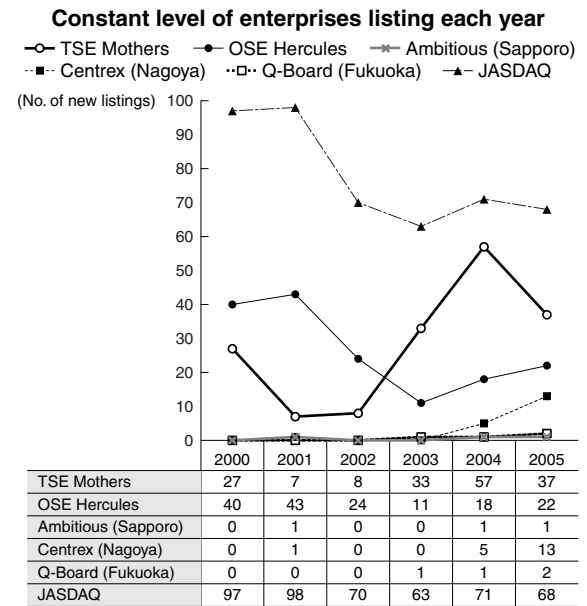
Interest in going public in some way increases with size of workforce



Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

public in the future. Looking at actual trends in the number of listings (IPOs)⁸⁾ on venture markets since 2000 and the number of registrations on unlisted stock markets (commonly called “Green Sheet Market”) (Figs. 1-3-24, 1-3-25), too, it is evident that a considerable number of SMEs list on venture markets each year.

Fig. 1-3-24 Trends in listing of enterprises on venture markets

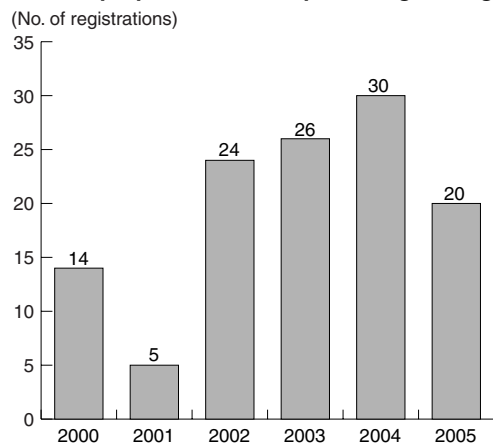


Source: Compiled by Mitsubishi UFJ Research and Consulting Co., Ltd. from each market's website, interviews, and other sources.

Note: The above figures do not match present listings due to transfer to other markets and delistings.

Fig. 1-3-25 Number of enterprises registered on the Green Sheet Market

Certain proportion of enterprises registering



Source: Mitsubishi UFJ Research and Consulting Co., Ltd.

8) Initial Public Offering. The offering to the public of new shares when an enterprise goes public. Here, however, IPOs are defined as initial offerings and over-the-counter registrations with the Japan Securities Dealers Association (JSDA).

Fig. 1-3-26 Requirements for use of bond guarantees (privately-placed bonds) by credit guarantee corporations

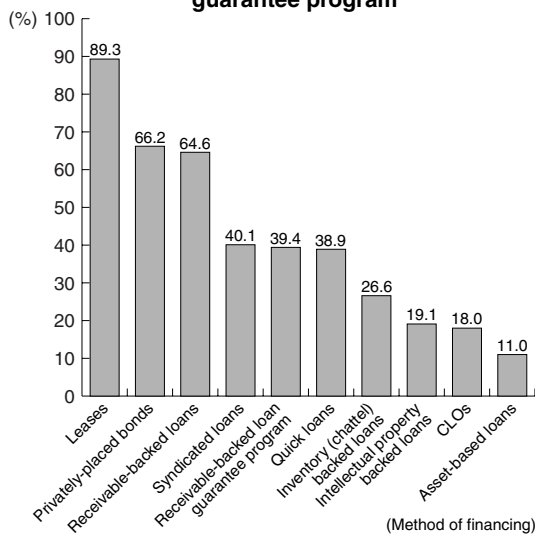
SMEs meet either (a) or (b), and (c) or (d) in net assets category 1) (at least ¥500 million), 2) (at least ¥300 million and less than ¥500 million) or 3) (at least ¥100 million and less than ¥300 million)

Category		Category 1)	Category 2)	Category 3)
Financial requirements	Net assets	¥500 million and over	From ¥300 million to under ¥500 million	From ¥100 million to under ¥300 million
	(a) Equity ratio	15% and above	20% and above	20% and above
	(b) Price book-value ratio	1.5 times and above	1.5 times and above	2.0 times and above
	(c) Return on capital employed	5% and above	10% and above	10% and above
	(d) Interest coverage ratio	1.0 times and above	1.5 times and above	2.0 times and above

Source: SME Agency.

- Notes:
1. Net assets = amount of capital (including stock capitalization)
 2. Equity ratio = amount of capital (including stock capitalization) / total assets x 100
 3. Price book-value ratio = amount of capital (including stock capitalization) / stock capitalization
 4. Return on capital employed = (operating income + interest and dividends received) / amount of capital x 100
 5. Interest coverage ratio = (operating income + interest and dividends received) / (interest expenses and discount charges)
 6. Enterprises that meet the above requirements are also subject to investigation by a credit guarantee corporation.

Fig. 1-3-27 Recognition of financing methods
More than one in two enterprises is aware of leases, privately-placed bonds, and receivable-backed loan guarantee program



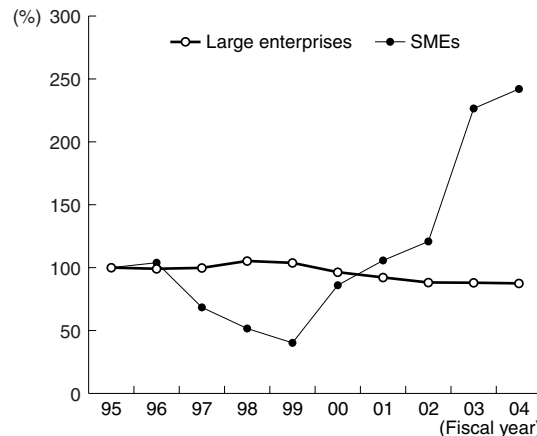
Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

Note: Totals exceed 100 due to multiple responses.

Next, let us examine bond (privately-placed bond) issues. The amendment of ministerial ordinances in 2002 and 2005 expanded the range of SMEs qualifying for the privately-placed bond guarantee system run by the National Federation of Credit Guarantee Corporations, the conditions of which had previously been hard for SMEs to meet (Fig. 1-3-26), and a growing number of financial institutions are acting as commissioned banks for privately-placed bond issues by SMEs, indicating

Fig. 1-3-28 Trends in outstanding bonds of large enterprises and SMEs in Japan

Though still low, sharp increase in outstanding bonds as a proportion of financing at SMEs since fiscal 2002



Source: MOF, *Financial Statements Statistics of Corporations by Industry (Annual)*.

- Notes:
1. Large enterprises are enterprises with capital of ¥100 million or more, and SMEs are enterprises with capital of less than ¥100 million.
 2. Fiscal 1995 = 100

that recognition of bond issues of this kind is steadily rising (Fig. 1-3-27). Although the proportion of total financing accounted for by bond issues is still small, Fig. 1-3-28 demonstrates that the proportion of outstanding issues has surged since around fiscal 2002.⁹⁾ Unlike in the case of share flotations, bonds are, like bank borrowing, liabilities – they incur interest expenses, and the rise in the value of outstanding SME issues in the past few years has probably been prompted by factors

9) Regarding specific trends in the value of bond issues, see Appended Note 1-3-5.

such as the following:

- 1) Being able to raise comparatively long-term funds at fixed interest rates fixes the cost of raising funds for capital investment and other purposes, and so makes it easier to formulate investment and business plans.
- 2) Privately-placed bonds are placed and underwritten from an investor perspective, ensuring that only prime enterprises can issue bonds. Accordingly, issuing privately-placed bonds not only improves an SME's image and strengthens its position when negotiating interest rates and loan terms with a financial institution, but can also contribute to improving creditworthiness as an enterprise, and

assist in improving an enterprise's appeal to business partners and attracting human resources. (Some pre-listed enterprises issue privately-placed bonds to assist in investor relations.)

- 3) As they can charge fees for bond issues, financial institutions, too, are focusing on such issues as a means of increasing revenues from non-interest sources.

At any rate, the diversification and expansion of use of methods of direct finance brings with it both merits and demerits for SMEs,¹⁰⁾ and it goes without saying that full and careful consideration is required when taking advantage of their merits as well.

Section 3 Demands of SME finance

Thus far, we have looked at new developments in SME finance, such as quick loans and direct finance. Taking into account these developments, we consider lastly what is sought from SME finance.

The preceding section considered the subject of quick loans, but how are these viewed by the SMEs that use them? According to the *Survey of the Financial Environment of Small and Medium Enterprises*, the commonest reason for use of quick loans by SMEs is "ease of borrowing process," given by 53.5% of respondents, followed by "short screening period," given by 33.5%. Overall, then, the results give some indication of the value attached to ease of use. A considerable number of enterprises are also attracted by the lack of security and guarantee requirements, with 32.3% giving "unsecured" and 25.8% giving "no third-party guarantee required" as their reasons (Fig. 1-3-29).

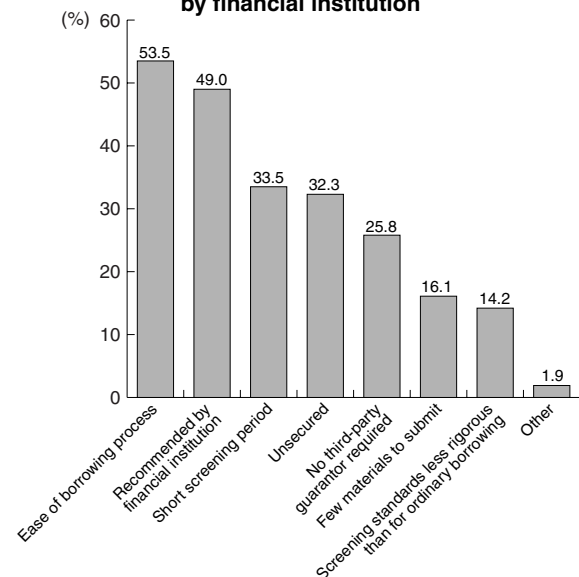
If we look, on the other hand, at those enterprises that do not currently use quick loans, one's attention is drawn to the fact that as many as 94.7% have "no intention to use in the future either" or "would prefer not to use" them in the future (Fig. 1-3-30). Below, therefore, we seek to identify what elements are most required of SME finance.

Fig. 1-3-31 shows the results of asking SMEs what factors they considered most important when dealing with financial institutions. As is immediately apparent, the largest proportion of enterprises gave "stable provision of funds," exceeding the proportion that said "interest rates," and the third commonest response, which was "understanding of potential and enterprise's business," highlighting just how important the stable furnishing of funds based on future business growth is considered to be by SMEs.

As the amounts, terms, and interest rates of quick loans and similar forms of lending are determined based

on past financial data such as statements of accounts, they are recognized as a somewhat convenient source of short-term operating funds, as previously observed. However, this also makes them difficult to use during the startup period when enterprises do not have any past statements of accounts to draw upon, in addition to which no consideration is given to future potential or

Fig. 1-3-29 Reasons for using quick loans
Common reasons for use of quick loans include ease of borrowing process and recommendation by financial institution



Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

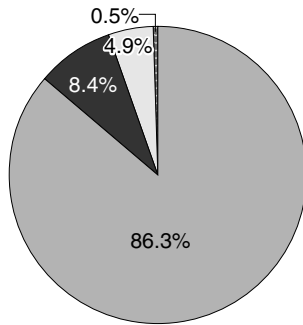
- Notes:
1. Only enterprises that responded that they are "using quick loans" as of the end of October 2005 are included.
 2. Totals exceed 100 due to multiple responses.

10) Possible demerits of the growth in direct finance include the increased burden of disclosure pursuant to the Securities and Exchange Law and accounts auditing, and the increased cost of development and maintenance of internal corporate structures.

Fig. 1-3-30 Future intentions of non-users of quick loans

Large proportion have no intention to use quick loans

No intention to use in future either
 Would prefer not to use
 Would not mind using
 Want to use

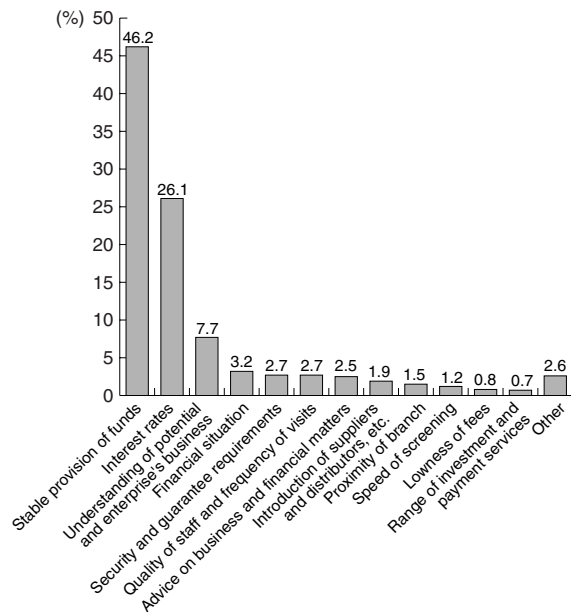


Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

Note: Only enterprises that responded that they were not using quick loans as of the end of October 2005 are included.

Fig. 1-3-31 Most emphasized factor when dealing with financial institutions

SMEs place most emphasis on stable provision of funds when dealing with financial institutions

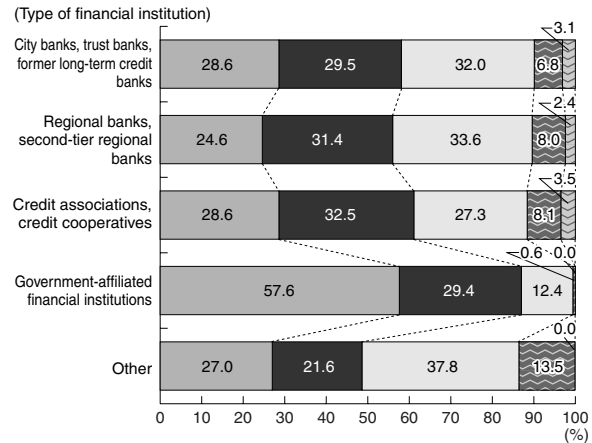


Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

Fig. 1-3-32 Satisfaction with main bank (by type of financial institution)

High level of satisfaction with government-affiliated financial institutions as main banks

Satisfied
 Somewhat satisfied
 Average
 Somewhat dissatisfied
 Dissatisfied



Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

understanding of an enterprise's business. Moreover, once an enterprise's business position deteriorates, it becomes difficult to make repeated use of quick loans, which cannot then serve the need for "stability" most sought by SMEs when dealing with financial institutions. Thus while quick loans may be regarded as convenient, they are not products that SMEs seeking stable sources of funding want to actively use in the future.

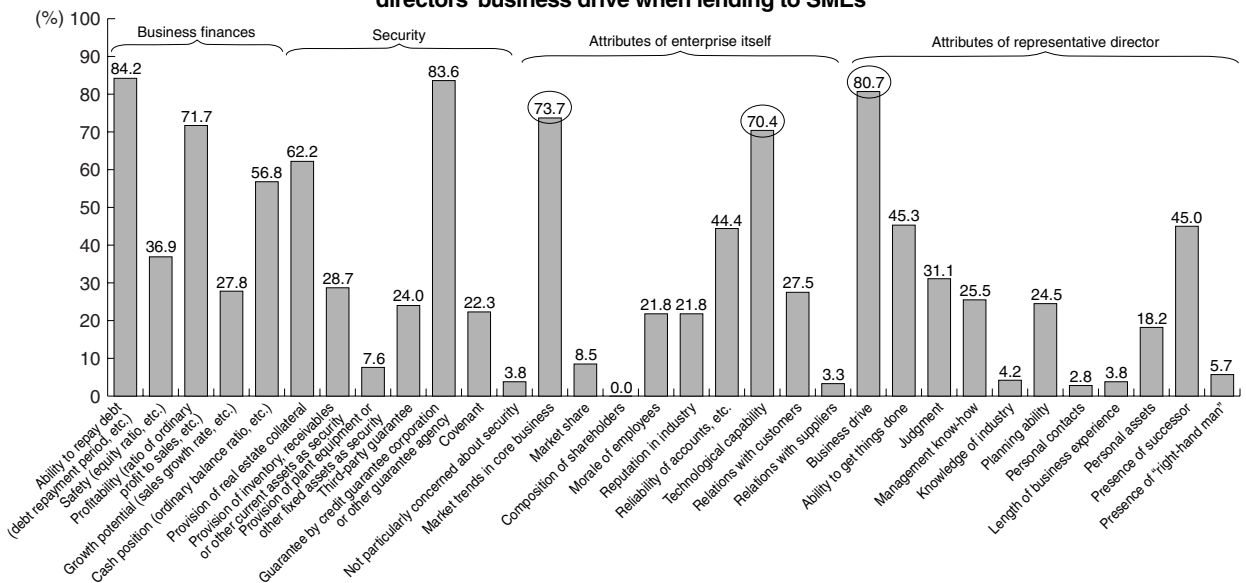
Regarding SMEs' satisfaction with their main banks broken down according to type of lending institution, generally around 60% were "satisfied" or "somewhat satisfied" with private-sector financial institutions (58.1% with city banks, 56.0% with regional and second-tier regional banks, and 61.1% with credit associations and cooperatives), compared with 87.0% in the case of government-affiliated SME financial institutions¹¹⁾ (Fig. 1-3-32). Government-affiliated financial institutions also served as a comparatively stable source of funds in the period after the financial crisis in 1997, when domestic private-sector financial institutions drastically reduced lending to SMEs, creating a credit crunch (Fig. 1-3-11), and these findings confirm that SMEs, given their strong desire for stable sources of funds in their dealings with financial institutions, rate their presence quite highly.¹²⁾

Now considering things from the point of view of SMEs, what points do enterprises pay particular regard to in order to obtain stable funding from financial

11) Government-affiliated SME financial institutions consist of the Shoko Chukin Bank, Japan Finance Corporation for Small and Medium Enterprise (JASME), and National Life Finance Corporation.

12) Breaking down the merits of doing business with each type of government-affiliated SME financial institution, the proportion of enterprises citing "stability of relationship" is comparatively high in regard to the Shoko Chukin Bank. Regarding dealings with JASME and the National Life Finance Corporation, a high proportion cite "long borrowing term" and "low interest rates" as merits.

Fig. 1-3-33 Factors emphasized by financial institutions when lending to SMEs
Financial institutions place stress on market trends and assessment of technological capabilities and representative directors' business drive when lending to SMEs



Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

- Notes: 1. Factors that financial institutions said that had "increased markedly in importance compared with in the past" when screening loan applications by SMEs.
 2. Totals exceed 100 due to multiple responses.

institutions?

Let us first consider what financial enterprises emphasize when investigating the creditworthiness of SMEs. As Fig. 1-3-33 indicates, stress tends to be placed on ability to repay debt in regard to business finances, guarantees by credit guarantee agencies such as guarantee corporations in regard to security, market trends in an enterprise's core business and technological capability in regard to an enterprise's own attributes, and business drive in regard to the attributes of the proprietor. The point worth noting here is that 70.4% of financial institutions said that they emphasize the technological capability of an enterprise. When we looked earlier at SMEs' expectations of financial institutions (Fig. 1-3-31), it was observed that SMEs want financial institutions to understand their own businesses, and the above findings show that financial institutions do in fact pay particular attention to SMEs' technological capabilities and other aspects of their business and future potential.

The Financial Services Agency's *The Supplement to the Financial Inspection Manual: Treatment of Classifications Regarding Credits to Small and Medium-*

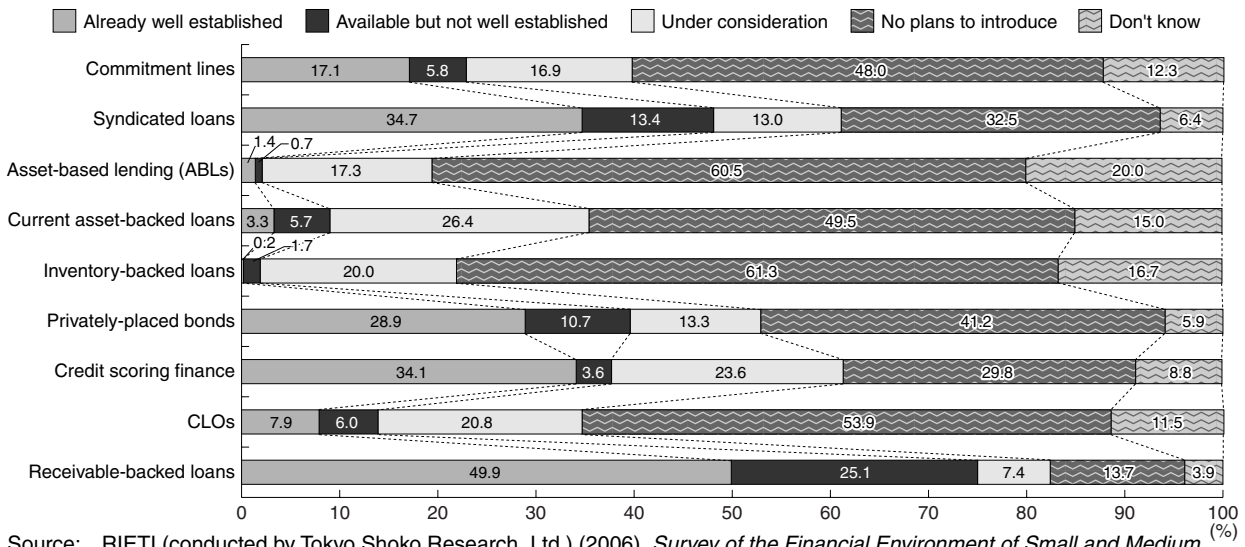
Sized Enterprises revised in February 2004 also explicitly states that financial institutions should "strive to properly manage loans and monitor the business situation of enterprises, including qualitative information regarding, for example, their technological capabilities, sales strengths, and proprietors' qualities, through continued visits to enterprises and similar methods,"¹³⁾ and in recent years, community-based finance of this kind – i.e., relationship banking¹⁴⁾ – has really begun to get off the ground at financial institutions (see Case 1-3-1).

Amid these developments, financial institutions have been actively developing new financial products to more broadly meet SMEs' various funding needs (Fig. 1-3-34), and some are also starting to offer new financing methods that do not depend on real estate collateral, such as loans secured by goods, trademarks, and receivables, and securitization services (see Cases 1-3-2 and 1-3-3). As well as just lending funds, some are also organizing business exchange forums, referring enterprises to potential new business partners, and providing other business matchmaking services, thus by extension supporting startups (Fig. 1-3-35) (see Case 1-3-4).

13) Financial Services Agency, *The Supplement to the Financial Inspection Manual: Treatment of Classifications Regarding Credits to Small and Medium-Sized Enterprises* (February 2004), p. 2.

14) According to the basic approach outlined in the Financial Services Agency's "Action Plan to Strengthen the Functions of Community-Based Finance" (Fiscal 2005-2006), community-based finance requires that "financial institutions accurately ascertain the business situation of borrower enterprises using information obtained through long-term relations and through high-quality information, including face-to-face negotiations, and also work to improve their own earnings."

Fig. 1-3-34 New methods of financing and extent of use
New lending products being developed by financial institutions too



Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

Case 1-3-1

Financial institution improves loan screening abilities of staff through own education program

Amagasaki Shinkin Bank (based in Hyogo Prefecture with 1,761 staff) has established its own program to train "industry-specific screening specialists" in order to raise the loan screening abilities of its staff.

Background to establishment of program

In order to promote lending without relying excessively on security or guarantees, staff have to have the ability to accurately assess the value of an enterprise in terms of its line of business, growth potential, technological capabilities, profitability, and so on. The bank therefore decided to start training industry-specific screening specialists from July 2001.

Details of industry-specific screening specialists

"Industry-specific screening specialists" are accrediting in the six main industries with which the bank does business (construction, distribution, iron/steel, machinery manufacturing, services, and wholesaling/retailing), and are drawn from staff that are in at least their fifth year with the bank; as of October 2005, 160 staff had been accredited. In order to be accredited, staff are sent to two enterprises with which the bank does business in

the relevant industry. They spend a week at each enterprise, after which they must complete all units of the bank's internal training program. This consists of training in financial analysis and marketing, placement in the credit department as trainees, and writing of research reports by industry.

Results of introduction of program

The presence in branches and head office of "industry-specific screening specialists" among staff routinely engaged in credit screening procedures has strengthened the bank's relations with its customers, which have commented that these specialists are capable of seeing things from their own perspective and discussing products, machinery, management issues and similar subjects as well as just sales and financial matters.

The system has also served to motivate and contribute to staff's self-development. Accredited staff have independently set about qualifying as SME management consultants and younger staff that will later qualify for the program are voluntarily striving to emulate their seniors. The program has thus also had a positive impact on the organization as a whole.

Case 1-3-2

Enterprise raises funds using assets other than real estate (merchandise)

Katsunuma Winery Co., Ltd. is a winemaker with 20 employees established in 1937, and located in Yamanashi Prefecture, that is working to facilitate financing by using its merchandise (wine) as security under a system of security based on assignment of current aggregated assets.

Immediately after the establishment of the "wine industry promotion zone" in the first round of approvals for the Special Zone Plan in April 2003, Katsunuma Winery started making plans to use the system in order to expand its business. It was considering concrete plans for shifting more from the production of cheap wine, which is normally sold in one year, to high-end wine that requires several years to mature. However, although the company had managed to put the necessary plant and equipment in place by renting land for grape cultivation and acquiring storage facilities, its plans

required that funds be left idle for a considerable period—from the input of the raw materials to sale—in order to ferment high-quality wine, making the acquisition of operating funds a problem. The company therefore consulted the Kofu branch of the Shoko Chukin Bank, with which it did business, which suggested that it make use of a system of security based on assignment of current aggregated assets, in this case wine. Katsunuma Winery's loan would therefore be secured against the wine itself. From the point of view of Shoko Chukin Bank, the attraction lay not only in the company's forward-thinking business policy and the quality of its wine, but also in the potential contribution to revitalization of the regional economy through the use of the "wine industry promotion zone." In February 2005, therefore it furnished a loan of ¥20 million for operating funds.

Case 1-3-3

Enterprise raises funds in the form of a syndicated ABL using the movable asset assignment registration system

Saikon Co., Ltd. is a seafood processor and wholesaler with 50 employees established in 1939, and located in Fukuoka Prefecture, that has raised funds secured against the "business lifecycle" scheme.

Background to raising of funds

When the company was considering how to raise the funds required to develop new products, it was introduced by two banks with which it did business—the Bank of Fukuoka, Ltd. and the Shoko Chukin Bank—to an asset-based loan scheme for establishing revolving lines of credit. This worked by taking the "business lifecycle" by which inventory is sold and become receivables, and receivables are recovered and become current assets, and securing loans against these inventories, receivables, and current deposits as a single package. Using this scheme, the company took out syndicated loans in October 2005 from the two banks worth a maximum of ¥25 million each.

These loans carry covenants,* which are intended to ensure that the loans are recovered premised on the borrower's continuation in business by ascertaining changes in the borrower's business situation at an early stage and assisting rapid recovery in the event that business conditions deteriorate. Provided that the representative director is deemed to be engaging in business in good faith and endeavoring to repay borrowing, no joint and several liability on guarantee is imposed even if the company's business and financial situation deteriorates. These loans are the first to use the movable asset assignment registration system in Japan, and the company had previously strongly associated the

use of inventory as security with the deterioration in performance of SMEs with no real estate collateral to date and the preservation of property. Now, however, it has a more positive view, as its use of the system has allowed it to create new enterprise value and broaden the range of financing methods available to it as an SME.

What is the movable asset assignment registration system?

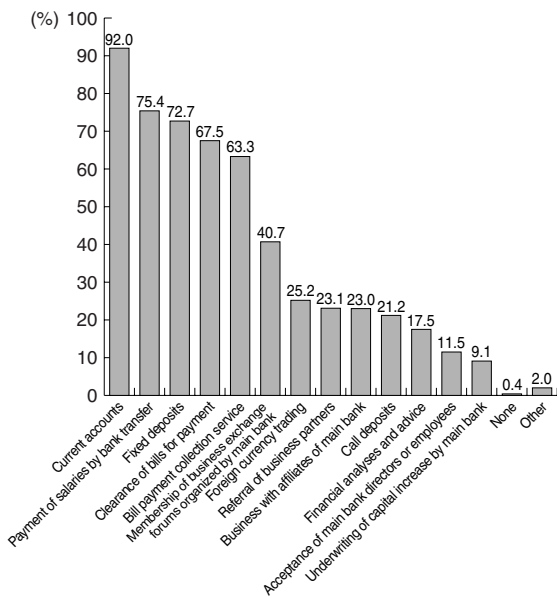
This is a system for satisfying the conditions for assertion of assignment of movable assets to a third party by registering the transfer of such assets (principally by depositing as collateral). It is expected to be used for loans secured against movable assets and financing by securitizing movable assets, and is characterized by the fact that 1) the assignor can only be a corporation, 2) individual movable assets and aggregated movable assets such as raw materials and inventories can be registered, 3) the validity of registration stems from recognition as a delivery pursuant to Article 178 of the Civil Code, allowing the assertion of assignment to a third party, and 4) registered matters may be disclosed in outline to anyone (though disclosure of detailed information is restricted).

*The term "covenant" is often used in the sense of a restrictive financial covenant. However, covenants are actually defined as pledges by debtors to creditors regarding certain acts and omissions during the term of a loan. Typical covenants include covenants requiring the provision of reports and information, covenants restricting provision of security, and covenants restricting assignment of assets.

There is thus occurring a shift in relations between financial institutions and SMEs away from the traditional one-way relationship of dependency (of SMEs upon financial institutions) to a relationship in which “information asymmetry” is eliminated through high-quality communication, and funds and business guidance are provided swiftly based on mutual understanding between SMEs and financial institutions, and this trend is expected to progress further in the future. Relationships are also strengthening as they evolve from one-off contact at the time of borrowing to broader use of a range of business services, such as assistance at the startup stage and help in developing more business contacts.

Fig. 1-3-35 Use of main bank services other than borrowing for more than five years

Commonly used services apart from deposit accounts include business exchange forums organized by main banks and referral of potential business partners



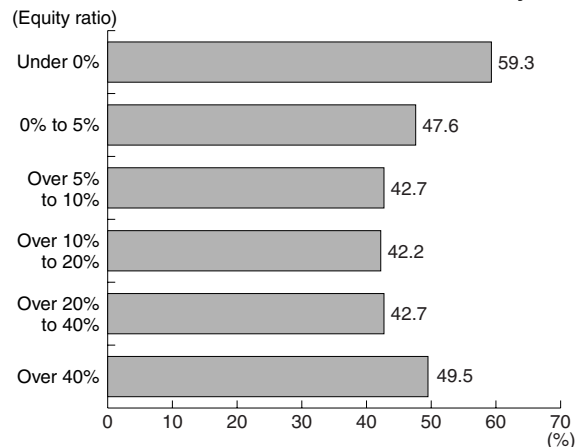
Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

Note: Totals exceed 100 due to multiple responses.

In view of these changes, it is clear what is required of SMEs if they are to gain stable access to funds. As is evident from Fig. 1-3-36, SMEs that are in a stronger financial situation tend to be more likely to actively provide more information to financial institutions. The accurate and swift disclosure of information on subjects such as an enterprise’s technological capabilities and the future potential of its business, as well as of course its business and financial situation, to financial institutions and other third parties not only contributes to SMEs’ management, but also makes a major contribution to the development of trusting relations between financial institutions and SMEs (see Column 1-3-1).

Fig. 1-3-36 Proportion of enterprises submitting materials after request by financial institution (by equity ratio)

Small proportion of insolvent enterprises submit materials to financial institutions voluntarily



Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

Note: Only enterprises that responded regarding submission of statements of accounts and other materials that they “submitted in accordance with request from financial institution.”

Case 1-3-4

Financial institution supports the growth of local SMEs through the provision of startup support

Seibu Shinkin Bank is a Tokyo-based financial institution with 936 staff that has opened its own incubation offices in order to provide support for local SME startups.

Background to establishment of incubation offices

Seibu Shinkin Bank has worked in collaboration with the TAMA Industrial Vitalization Association Inc.,* whose purpose is to promote regional economic growth and regional development, by adding a "financial" element to industrial, academic, and government collaboration so as to strengthen the business assistance provided to local SMEs.

As part of these activities, Seibu Shinkin Bank formed a venture capital company (Seibu Shinkin Capital Corporation) in February 2003 and established a fund called the "TAMA Fund" in April 2003 to commence investment in ventures. At the same time, unused employee accommodation adjacent to its Yakushi-Ekimae branch was renovated and opened in July 2003 to serve as incubation office space to assist the development of ventures. Potential tenants are screened and incubation services provided by Seibu Shinkin Capital.

Outline of incubation offices

Incubation office tenants must be corporations established within the past three years or individuals aiming to establish a corporation within the next year, and be engaged in manufacturing, services, IT, biotechnology, or similar industries and seeking to undertake R&D or enter new fields.

Prospective tenants go through two screenings: a primary screening based on written documents, and a second screening involving a presentation. The tenancy period is for two years, but can be extended for a maximum of two more years. As this facility is intended to support ventures and make use of the bank's idle assets, the rent is about half the market rate in the area, and around 80% of the offices are presently occupied on average.

The first four tenants, which moved in during July 2003, all moved out in June 2005 having reached the stage of being able to develop their businesses unassisted. One of the tenants was also the recipient of investment from the TAMA Fund in March 2005. Even where investment is not provided, the aim is

for enterprises to mature to a level at which they can engage in ordinary transactions with private financial institutions after two years as tenants.

The menu of business support services provided at the incubation offices is based on three pillars: firstly, "business support" consisting of 1) assistance and development support provided by permanent incubation managers, 2) outsourcing of financial, personnel, and labor-related needs in partnership with an accountancy firm located beneath the offices, and 3) assistance provided by Seibu Shinkin Capital and Seibu Shinkin Bank to help tenants to resolve their business problems; secondly, "financial support" consisting of 1) direct investment by the TAMA fund and Shopping District Fund to meet funding needs at startup, 2) startup loans based on assessments of tenants' technological capabilities, the marketability of their goods, and their market potential rather than collateral, and 3) the provision of financial data and information on financial trends; and thirdly, "coordinating support" consisting of 1) assistance with acquisition of grants and development of outlets in collaboration with the TAMA Industrial Vitalization Association Inc., 2) expert assistance with technical and business management issues, and 3) support for the development and commercialization of new products through coordination of technology seeds and tenant enterprises' technologies in collaboration with TAMA-TLO.

While tenant enterprises have indicated that they have benefited considerably from support regarding, for example, grant applications, financing methods, business planning, and business matchmaking, some have indicated a desire for longer tenancies and assistance with human resources, and the bank is looking into ways of enabling the facility to meet these demands.

*Known in full as the Technology Advanced Metropolitan Area Industrial Vitalization Association Inc. Established to implement the industry cluster plans being pursued by METI, it provides various forms of support to SMEs, including support regarding technology R&D, expansion into new business, new startups, expansion of business outlets, and recruitment of human resources.

Column 1-3-1 Mutual understanding between SMEs and financial institutions

1. What SMEs want to convey; what financial institutions want to know

As discussed in Section 3 of this chapter, when an SME wants to borrow money from a financial institution, it seeks stable availability of funds, a low interest rate, and that the institution has an accurate understanding of the company's business and prospects. Then, in order that the financial institution may properly understand and evaluate the company, now and for the future, so that the company may obtain the loan on the terms and conditions it desires, what points should the SME seek to convey to the financial institution, and how?

Financial institutions, similarly, want to make their loans to SMEs based on each company's actual condition and prospects. For that, they must deepen their understanding of the companies, beyond purely financial information, statements of accounts, etc., and take into consideration non-financial factors as well – what is known as "relationship banking."

The practice of loaning at preferential interest rates to SMEs adhering to the principles of "Corporate Social Responsibility (CSR)" is a specific example of incorporating non-financial information into the loan process. The idea is not only that financial institutions are taking a position on CSR per se, but also that CSR as demonstrated by the company reflects the strength of its own foundations and, in turn, the likelihood of its future profitability.

In this sense, any evidence in support of a company's vitality and profitability allows a financial institution to loan the money more confidently.

It is thus important for a company to explain its intangible assets (intellectual assets) – information not shown in its financial statements – to financial institutions; specifically, (1) what makes it different from other companies; and (2) how those differences contribute to its positive prospects. The affirmative awareness and use of the intangible assets (intellectual assets) particular to an individual company is called "intellectual-assets management."

(1) Intellectual assets as a source of differentiation from other companies

In the era of mass production and mass consumption, goods and money were sources of differentiation. These days, human resources, technology, know-how, speed, organizational strength, connections with customers, regions, suppliers, etc., along with reliability, tradition, brand identity, etc. – intangible assets (intellectual assets) – work to the same end.

<Examples of Intellectual Assets>

Willingness to integrate detailed requests at the production stage; a level of technology that makes that possible; the ability to work with customers to solve problems; prompt development of services and the organizational strength and systems to implement them; high-quality networking among regions and consumers; quality and stability over the medium- and long term; a strong brand identity, and products and services backed by trust based on medium-term trading relationships; highly motivated employees; etc. – each of these is an intellectual asset.

(2) Future profits from management of intellectual assets

Intellectual assets alone create no value. They are nevertheless real assets, accumulating in companies and people as a result of a long continuation of business activities, and many cannot be simply imitated by other companies overnight. Thus, if profits to come in the future through intellectual-asset management can be convincingly explained, financial institutions and so on are more likely to have a positive view of the company's prospects for growth, etc.

2. Presentations to Financial Institutions

How, specifically, should SMEs seek to present such information to financial institutions? Even if a manager thoroughly understands the strengths and managerial resources of the company, and actually carries out intellectual-asset management and achieves differentiation, insofar as the various elements remain only "in the mind," unspecified, not clarified, they can scarcely be appreciated by others. But when those same strengths and resources are spelled out clearly, managers are able to be better public advocates for their companies. They may even, in the process, become more cognizant themselves of their company's real strengths, which would enable them to manage more effectively.

It must be emphasized, however, that, because the significance of intellectual-asset management varies among companies, explaining the fruits of it is not a matter of specific indicators or simple comparisons. How future profits will grow out of intellectual-asset management should be shown through a story-like narrative, i.e., qualitatively, with quantitative information included to support the scenario. That is, quantitative data should be used to add credibility to arguments on the feasibility and sustainability of growth (see Fig. A).

Intellectual-asset management differs from company to company, and so do the indicators that will effectively bolster the story. Indicators demonstrating the existence of intellectual assets – a source of differentiation – are particularly useful (see Fig. B: Example of supporting indicators).

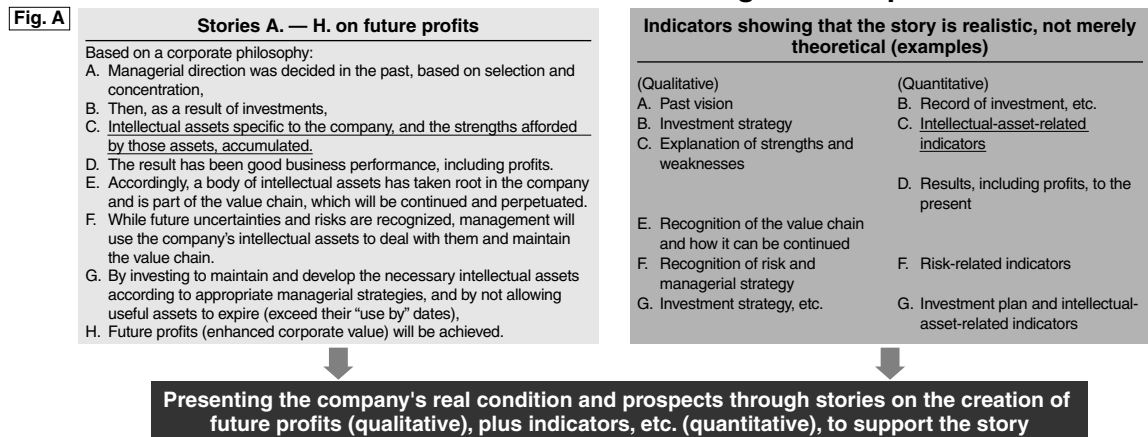
As a practical tactic, the generation of future profits through intellectual-asset management can be explained in a paper of 4 to 5 pages and titled "Intellectual-Asset Management Report." It can then be part of the explanatory materials referred to or given when consulting with a

financial institution (sample: Appended note 1-3-6). Additionally, such a report can be used when recruiting employees, as training material, or to help suppliers, etc., know the company better.

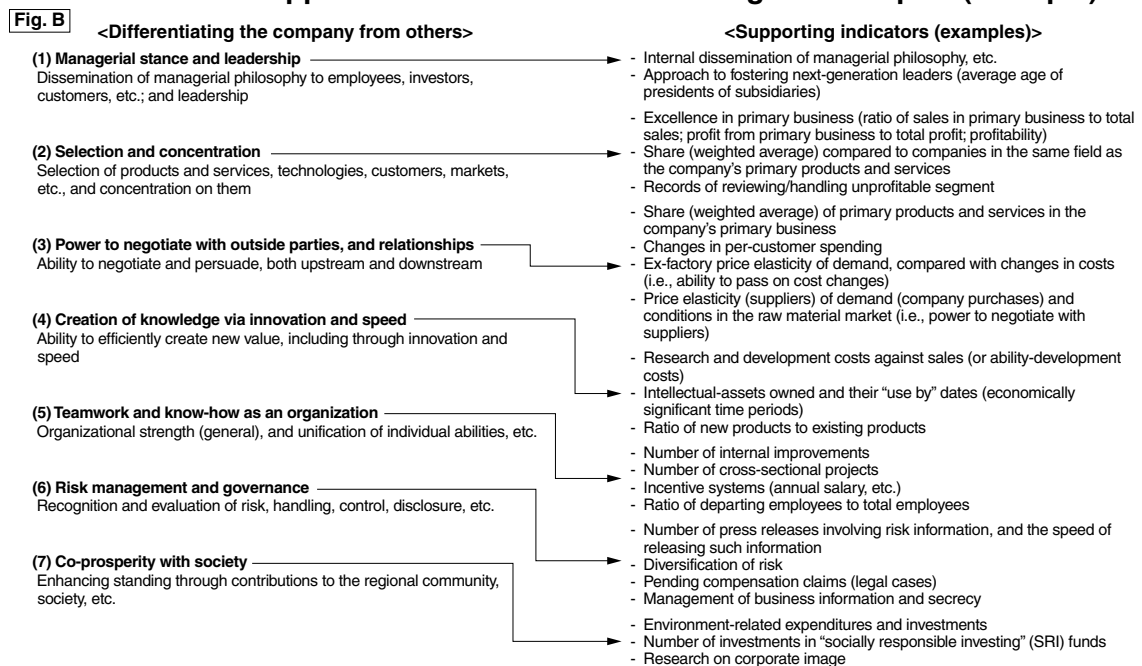
In August 2005, the Working Committee on Management and Intellectual Assets, under the Industrial Structure Council's Subcommittee on New Growth Measures, completed an interim report on intellectual-asset management and disclosure. The Ministry of Economy, Trade and Industry then released in October 2005 its "Disclosure Guidelines for Intellectual Assets."^{*1} Based on those guidelines, All About, Inc., the Development Bank of Japan, and NeoChemir Inc., have each released intellectual-asset management reports, which may be referred to.^{*2}

Following issuance of the interim report and guidelines, a study committee on intellectual-asset management at SMEs, consisting of learned individuals, was established in January 2006 within the Organization for Small and Medium Enterprises and Regional Innovation, Japan (SMRJ), taking up intellectual-asset management and disclosure at SMEs. In March 2006, the committee issued an interim report, which has just been released.^{*3} Hereafter, toward the ongoing growth and development of SMEs, measures will continue, and be improved, to support intellectual-asset management by SMEs. It is expected that SMEs will continue to develop and strengthen their relationships of trust with financial institutions and others, bolstered by their intellectual-asset management – each company making the best use of, and effectively publicizing, its specific strengths.

Overview of Intellectual - Asset Management Report



Indicators to support the Intellectual-Asset Management Report (example)



*1 http://www.meti.go.jp/policy/intellectual_assets/index.htm

*2 <http://www.meti.go.jp/policy/competition/index.html>

*3 <http://www.smrj.go.jp/keiei/chitekishisan/index.html>

Column 1-3-2 Supporting new efforts at SME financing

In a changing financial environment, various efforts are being made to facilitate financing by SMEs. New practices include credit scoring finance (quick loans), loans secured with other than real estate, for example, with privately-placed bonds or via a system to register interests in other property, syndicated loans, etc. It is important that efforts continue toward creating an environment where more SMEs can use these means – and new ones – to vitalize their financing hereafter.

A recent sharp increase in quick loans is playing a certain complementary role in fund-raising. But loan assessments are still being done based on statistically calculated bankruptcy probabilities, etc. Future prospects – positive changes as a result of new business or organizational revitalization – are not adequately taken into account.

Where enterprises are considered relatively risky, such as startups or companies still at a pre-growth stage, or undercapitalized, funds are often obtained from investment funds, through the issuance of stock, debt instruments with stock options, etc. Many of these, however, are on the condition of a later Initial Public Offering (IPO), and SMEs with no intention of going public find it difficult to take advantage of them. New methods should be considered.

Providing funds for corporate revitalization is also deemed highly risky. Regional financial institutions have made a lot of progress in writing off bad loans. Important hereafter will be methods, approaches, contributing to the smooth availability of revitalization funds. More active measures are called for.

Securing loans with accounts receivable is one non-real-estate method. Although a number of problems associated with it have been eliminated or minimized through, for example, removal of prohibitions on transfer of security interests, techniques for countering unfounded rumors, and creation of systems for registering security interests, there remain various others. Securing loans with other property similarly raises issues – for example, shortages of personnel able to perform assessments or to dispose of (liquidate) such property if necessary – which have prevented its wider use in SME financing.

Efforts should not be limited to traditional financial institutions, but should actively embrace fund managers, financing companies and others. This also requires new thinking, a new view – that the strengths of each type of financial entity be used to their full benefit, according to the particular situation and method.

In order for new financing methods to achieve wider use, an environment making them easier to use, both for the SMEs and the financing parties, should be created, among other things. Measures to this end should be further pursued.

Part II

Strengthening of relations with East Asian economies and changing business environment of SMEs

Since the 1990s, the economies of East Asia have achieved rapid growth, transforming them into the “workshop of the world,” and during this time, Japan’s industrial structure has undergone rapid change, particularly in manufacturing. This change is exerting a major impact on all SMEs in Japan, regardless of whether they themselves have a presence overseas or deal directly with foreign firms. At the same time, though, this is generating opportunities for growth.

In **Chapter 1**, we analyze the rapid strengthening in recent years of relations between the Japanese and East Asian economies amid industrialization in East Asia. In particular, the rapid growth in the volume of trade in intermediate parts demonstrates the formation of an advanced system of international division of labor between Japan and East Asia, and we intend to demonstrate that as a result, the business environment faced by SMEs, which are leading players in the parts and material industries, is undergoing particularly major change.

The focus of **Chapter 2** is on the SMEs that have expanded into and developed their own markets in East Asia amid the growing international division of labor throughout the region. We analyze strategies for locating overseas and the state of improvements in productivity resulting from overseas expansion, in conjunction with which we analyze the business risks encountered in China and other parts of East Asia. Working on this basis, we seek then to identify the stage at which overseas expansion becomes a viable option for SMEs, and business strategies that lead to successfully overcoming these risks.

Chapter 3 focuses on the reassessment in recent years of Japan as a location for manufacturing of high value-added products, and the current situation and problems of SMEs that provide the underlying “core manufacturing technologies” for this. We analyze the gaps that have arisen in traditional business groupings and subcontracting networks within Japan amid the increasing international division of labor, and the formation of new patterns of business. We also analyze the international competitiveness of Japan’s “core manufacturing technologies” in comparison with East Asia, and identify growth strategies.

In **Chapter 4**, we focus on the industrial clusters in each region, whose role, which evolved during the high growth period, is now changing as a response to competition with East Asian countries to attract investment. In order for regional economies to continue to develop autonomously, they need to make effective use of their own local resources. With the shift of production of general-purpose goods overseas and clusters’ loss of their traditional strength as efficient systems of mass production, we analyze what benefits clusters can continue to offer as a local resource and what measures should be strengthened in the future.

Through the above, Part II reveals the future shape of SMEs amid the historical structural change of integration with the economies of East Asia.

Chapter 1 Strengthening of economic relations between Japan and East Asia since the 1990s

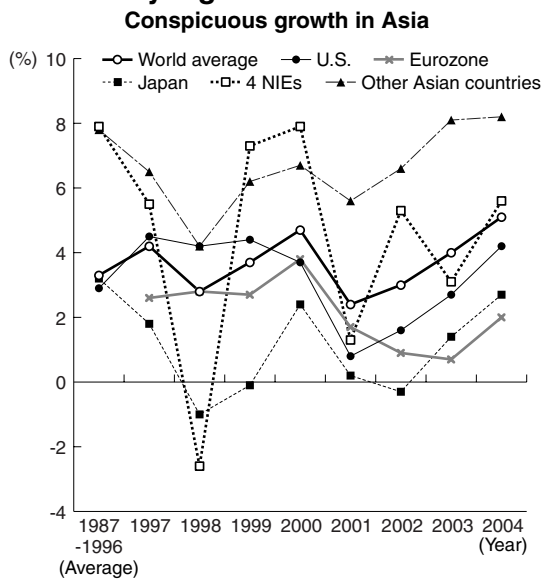
Section 1 Growth and development of East Asian economies since 1990s

The world economy has enjoyed a long and sustained period of growth since the 1990s (Fig. 2-1-1). During this time, a major engine of growth has been the U.S., which has maintained inflation-free growth and represents around 30% of the world economy as a whole. However, buoyant growth in the economies of East Asia,¹⁾ which have grown rapidly despite accounting for only a small proportion of the world economy, and in China in particular has also played an important part. Despite the major short-term impact of the Asian currency crisis, East Asia bounced back relatively quickly, and has achieved continued high growth for the past decade or so (Fig. 2-1-2). As a result of this fast growth, East Asia may be aptly described as one of the engines of the world economy's present prolonged

period of sustained growth.

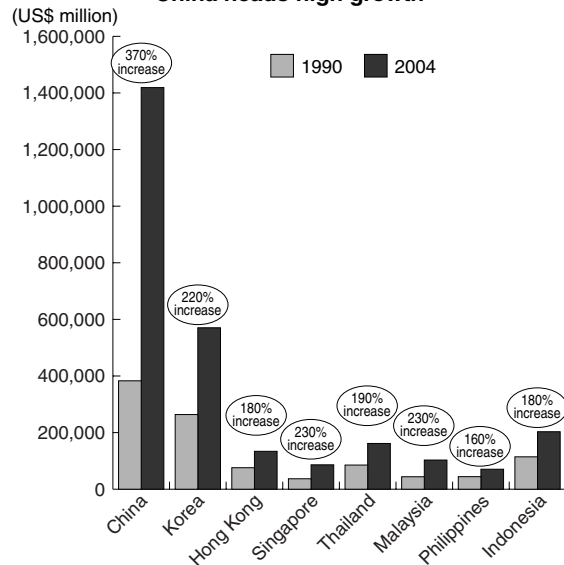
Within East Asia, the Chinese economy has exhibited particularly impressive growth. For more than 20 years following the reform and opening up of the economy in 1978, China achieved real GDP growth of at least an annual average of 9%, and foreign investment has surged since 2000 especially following China's accession to the WTO.²⁾ In terms of international trade as well, China's presence in the world economy is growing substantially, and in 2003 it was ranked fourth in the world for exports and third for imports. While there are concerns over the economic disparity within the country and overdependence on investment caused by the undeveloped state of consumption, the rapidly growing Chinese economy is projected to continue to grow ahead

Fig. 2-1-1 Trends in real GDP growth rates by region



Source: IMF, *World Economic Outlook* (September 2005).
 Note: "Other Asian countries" includes East Asian and South Asian countries.

Fig. 2-1-2 Real GDP of East Asian countries

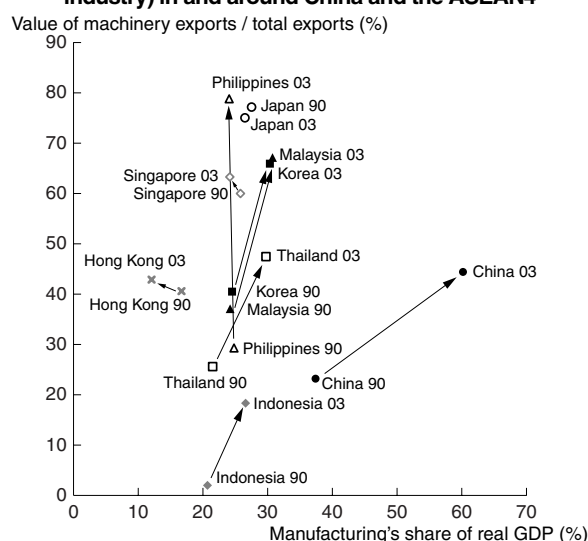


Source: United Nations, *National Accounts Main Aggregates Database*.
 Note: Based on U.S. dollars at 1990 prices.

1) In this white paper, countries and regions are categorized as follows.
 (1) The term "countries" may sometimes include regions as well.
 (2) "NIEs," "ASEAN," and "East Asia" are defined as follows.
 1) The NIEs (also referred to as the four NIEs) consist of Korea, Taiwan, Hong Kong, and Singapore.
 2) "ASEAN" consists of the following 10 countries: Thailand, the Philippines, Indonesia, Malaysia, Singapore, Brunei, Vietnam, Laos, Myanmar, and Cambodia. Of these, Thailand, the Philippines, Indonesia, and Malaysia are also referred to as the "ASEAN4" in this white paper.
 3) "East Asia" means Japan, China, the NIEs, and ASEAN in this white paper.
 4) In some statistical data, reference may be made to "Asia." In such cases, the meaning is glossed as necessary.
 2) China joined the WTO in December 2001.

Fig. 2-1-3 Development of industrial structure and change in trade structure

Accumulation of manufacturing (especially the machinery industry) in and around China and the ASEAN4



Sources: Compiled from United Nations, *National Accounts Main Aggregates Database* and RIETI, *RIETI-TID 2005*.

Notes: 1. The value of machinery exports is the combined value of exports of general machinery, electrical machinery, household electrical appliances, transportation machinery, and precision instruments.
2. In the graph, "90" signifies 1990, and "03" signifies 2003.

of major international events such as the Beijing Olympics and the Shanghai World Expo.

In other East Asian countries, too, while there is some variation from country to country, industrial structures have been evolving since 1990 as domestic supporting industries have developed, especially in areas of industry such as the manufacturing of electrical and electronics products. As is evident from Fig. 2-1-3, manufacturing's share of GDP has grown particularly strongly in China and the ASEAN4 in the past decade or so, and on the trade front, machinery exports by these countries are trending upward, reflecting the development of their domestic manufacturing bases.

Section 2 Changes in trade and investment patterns in East Asia

How is the growth and development of East Asia's economies manifesting itself in trade and investment patterns? And how have economic relations between Japan and East Asia changed? Below, we seek to answer these questions from a statistical perspective.

1. Changes in trade patterns within the East Asian region

As observed in Section 1, the volume of world trade has grown dramatically since the 1990s in tandem with the expansion of the world economy. As can be seen from Fig. 2-1-4, the ratio of intraregional trade in East Asia is rapidly rising, and interdependence in the region is increasing. Against this backdrop, the proportion of Japanese trade with Asian countries had grown in 2004 compared with 1994 – both in terms of imports and exports – to account for almost one half of Japan's total trade (Fig. 2-1-5). There has been particularly dramatic growth in trade with China, with exports growing approximately 400% and imports by 350%. Broken down by industry, the proportion

of intraregional trade is extremely high, especially in the electrical and electronic product manufacturing industries in the ASEAN4 and four NIEs (Fig. 2-1-6).

Next, we outline trade patterns in East Asia focusing on the different categories of goods traded. Fig. 2-1-7 shows traded goods classified into "raw materials and feedstock," "intermediate goods (manufactured goods and parts)," and "final goods (capital goods and consumer goods)."³⁾

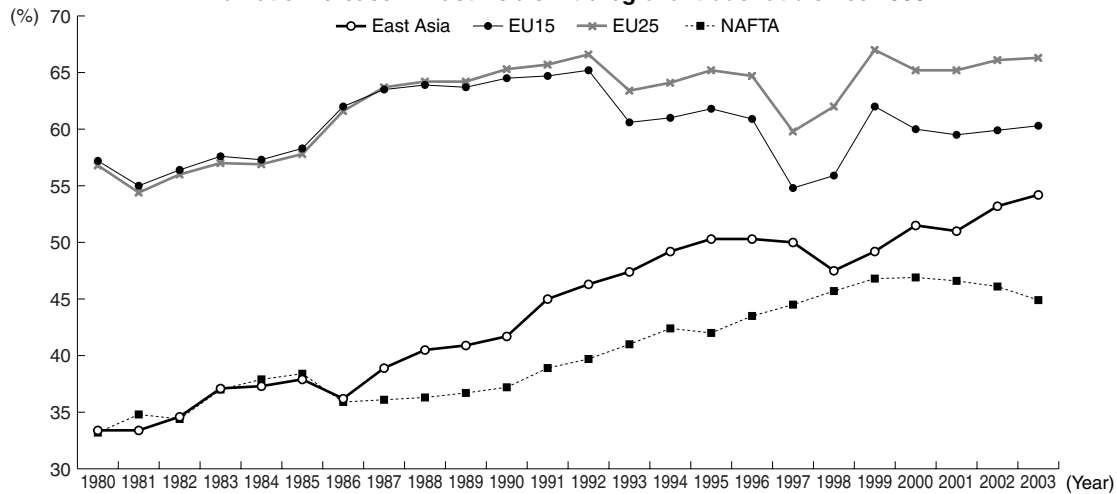
We may observe from this that parts represent the largest proportion of Japanese exports, and manufactured goods for the largest proportion of imports. Final goods' share of both imports and exports, on the other hand, is declining, reflecting an ongoing shift in the trade structure to primarily intermediate goods, such as parts and manufactured goods.

In China by contrast, intermediate goods account for a large proportion of imports, and final goods for a large proportion of exports evidencing a trade structure based on the importation in some industries of manufactured goods and parts, which are assembled into final goods using cheap local labor for export to the U.S., EU, and Japan.⁴⁾

3) See *White Paper on International Economy and Trade 2005*, p. 239.

4) Although in China the proportion of finished goods is high, there also exist cases in areas such as office equipment manufacturing in which production is divided up according to the type of product concerned (e.g., high-end products are made in Japan, and general-purpose products are made in China). Although hard to ascertain from statistics on trade patterns, it should be noted that the international division of labor along these lines is increasing.

Fig. 2-1-4 Intraregional trade ratios
Dramatic increase in East Asia's intraregional trade ratio since 1990



Source: METI, *White Paper on International Economy and Trade 2005*.
 Original sources: IMF, *Direction of Trade Statistics*; Board of Foreign Trade, Taiwan, Chinese Taipei, *Trade Statistics* (<http://eweb.trade.gov.tw/default.asp>).

- Notes: 1. East Asia includes Japan, China, Korea, Hong Kong, Taiwan, and the ASEAN10. Data from each economy on imports from and exports to Taiwan are for 1989-2003, but data from Taiwan on imports from and exports to other economies are for 1983-2003.
 2. The EU15 are Belgium, Germany, France, Italy, Luxembourg, Netherlands, Denmark, Ireland, U.K., Greece, Spain, Portugal, Finland, Austria, and Sweden. The EU25 are the EU15 plus Hungary, Czech Republic, Slovakia, Poland, Estonia, Latvia, Lithuania, Slovenia, Cyprus, and Malta.

Fig. 2-1-5 Japan's trade partners in 1994 and 2004
Large rise in value of trade, and particularly rapid growth in trade with China

Exports					
Partner	Exports (1994)		Exports (2004)		Rate of growth in value of trade (2004/1994)
	Value (¥10 billion)	Share (%)	Value (¥10 billion)	Share (%)	
Asia	1,615	39.9	2,964	48.4	83.5
China	191	4.7	799	13.1	317.7
4 NIEs	693	23.6	1,127	24.7	62.7
ASEAN4	415	10.3	557	9.1	34.2
Other Asia	315	1.3	480	2.4	52.1
North America	1,264	31.2	1,456	23.8	15.1
Western Europe	674	16.6	979	16.0	45.2
Other	496	12.3	719	11.7	44.8
World total	4,050	100.0	6,117	100.0	51.0

Imports					
Partner	Imports (1994)		Imports (2004)		Rate of growth in value of trade (2004/1994)
	Value (¥10 billion)	Share (%)	Value (¥10 billion)	Share (%)	
Asia	993	35.3	2,222	45.2	123.8
China	281	10.0	1,020	20.7	262.8
4 NIEs	295	11.3	487	10.2	64.7
ASEAN4	327	11.6	597	12.1	82.3
Other Asia	89	2.4	119	2.1	33.5
North America	735	26.1	768	15.6	4.5
Western Europe	441	15.7	683	13.9	54.9
Other	642	22.8	1,248	25.4	94.6
World total	2,810	100.0	4,922	100.0	75.1

Source: MOF, *Trade Statistics*.
 Note: "Other Asia" includes ASEAN countries other than the ASEAN4 and East Asia.

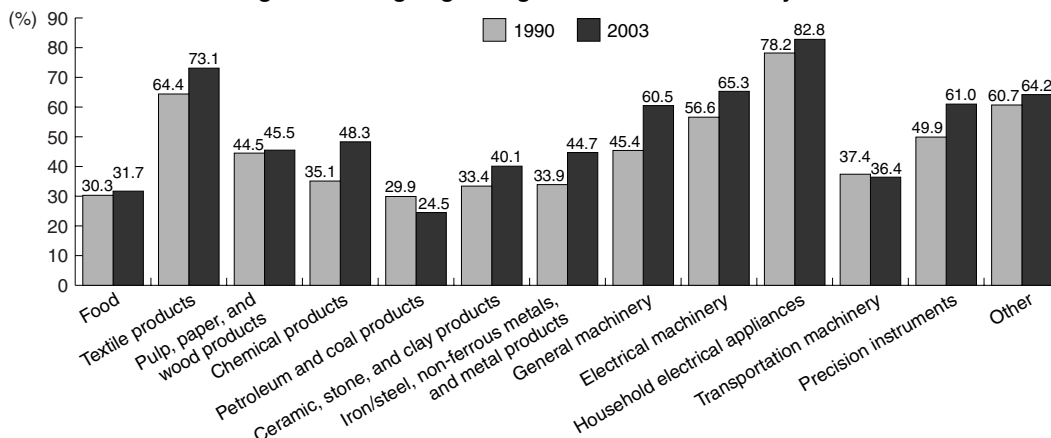
Structurally, the NIEs are comparatively similar to Japan, and following Japan's lead, the proportion of intermediate goods is rising. Regarding the ASEAN economies, although there exists some variation according to country, on the whole the proportion of both imports and exports accounted for by intermediate goods is rising as in Japan and the NIEs. In Malaysia and Thailand, the value added of imported parts is raised in fields that are their fortes – electrical equipment and household electrical appliances in Malaysia, and transportation equipment in Thailand – and these are then exported as intermediate and consumer goods.

An analysis of trade patterns according to category of good thus reveals growing trade in intermediate goods, especially machinery (Fig. 2-1-8). Japan's manufacturing SMEs are considered to play a major role in the production and trade of intermediate goods. Looking at trends in exports by SMEs, therefore, we find that while the proportion of exports of typical SMEs goods⁵⁾ to North America and Europe is falling by the year, the proportion of exports to Asia is steadily rising (Fig. 2-1-9). It is thus apparent that the various ties with the economies of Asia are strengthening among SMEs as well.

Regarding the economies of East Asia, arrangements such as free trade arrangements (FTAs) and economic partnership agreements (EPAs) (Fig. 2-1-10) are being vigorously developed. Due to the diversity of these arrangements, however, institutional economic integration has not progressed to the extent that it has in

5) "Typical SME products" are defined as products that make up at least 70% of the value of shipments of small and medium business establishments according to the Japan Standard Industrial Classification Sub-Classification.

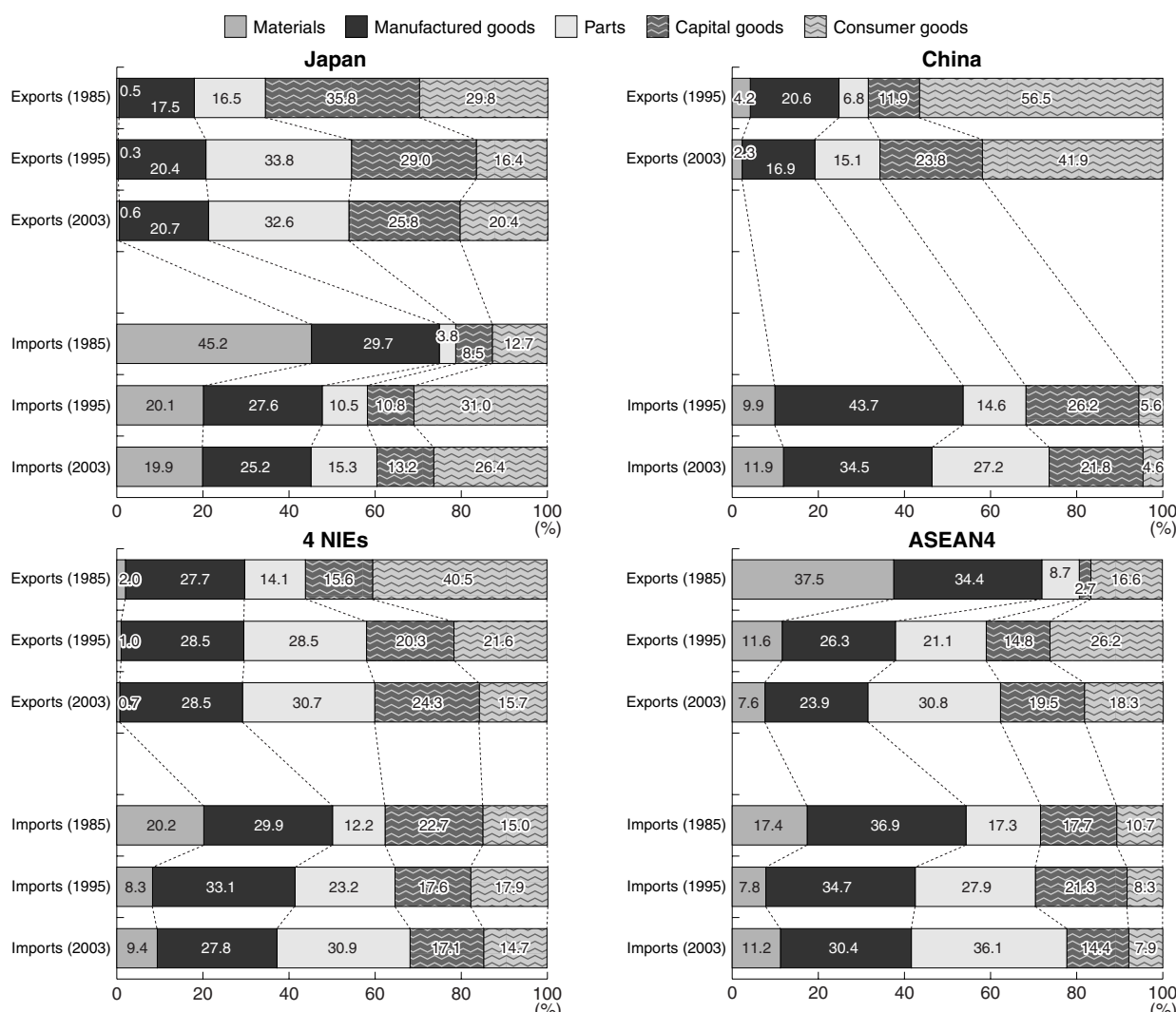
Fig. 2-1-6 Intraregional trade ratios in East Asia (by industry)
 Intraregional trade going strong in textile and machinery industries



Source: Compiled from RIETI, *RIETI-TID 2005*.

Note: East Asia includes Japan, China, Hong Kong, Taiwan, Korea, Singapore, Thailand, Malaysia, Indonesia, and the Philippines.

Fig. 2-1-7 Proportion of tradable commodities in East Asian countries by production process
 Clear increase in trade in manufactured goods and parts in region



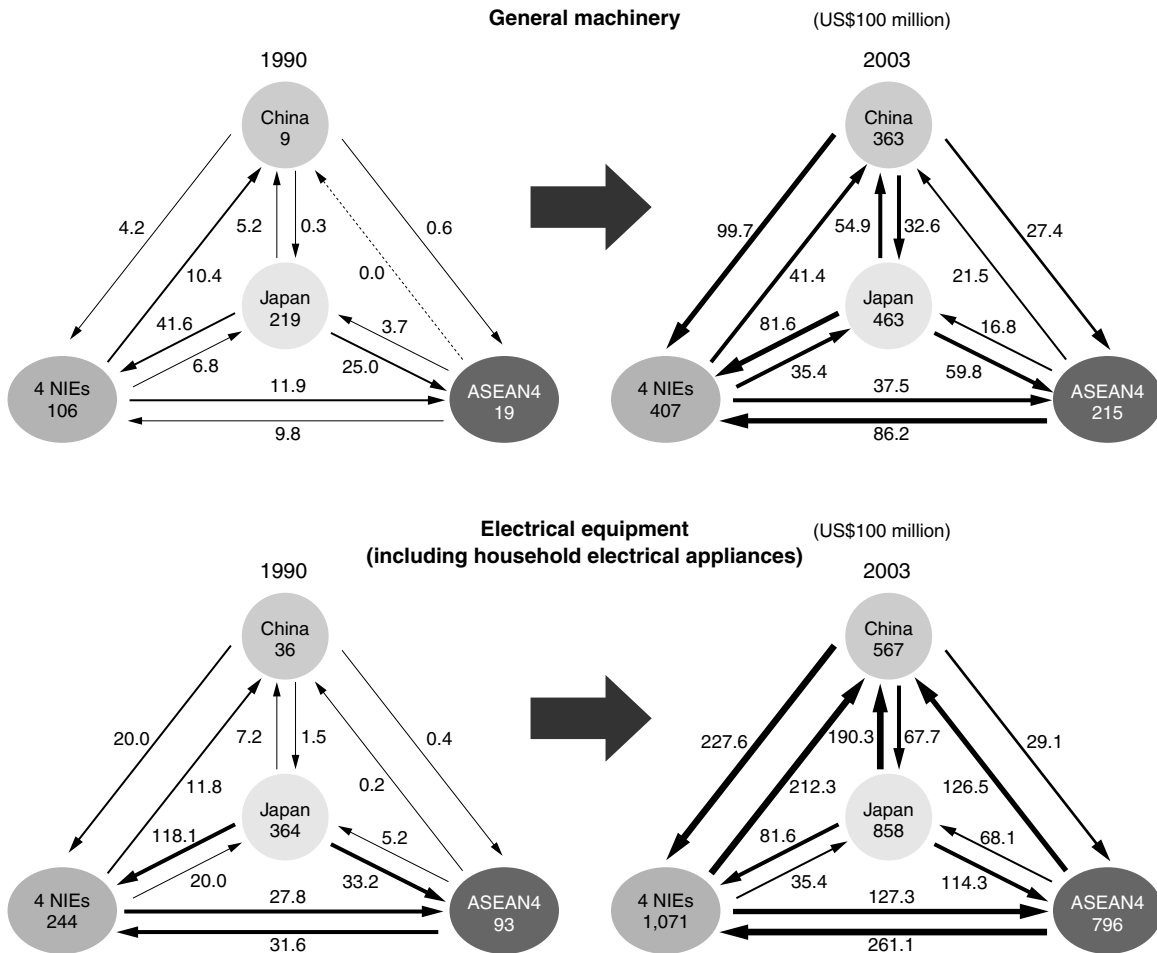
Note: Combined totals for Korea, Hong Kong, Taiwan, and Singapore. (Imports and exports in 1985 do not include Taiwan.)

Sources: METI, *White Paper on International Economy and Trade 2005*; RIETI, *RIETI-TID*.

Note: Combined totals for Thailand, Malaysia, Philippines, and Indonesia.

Fig. 2-1-8 Expansion of trade in intermediate goods

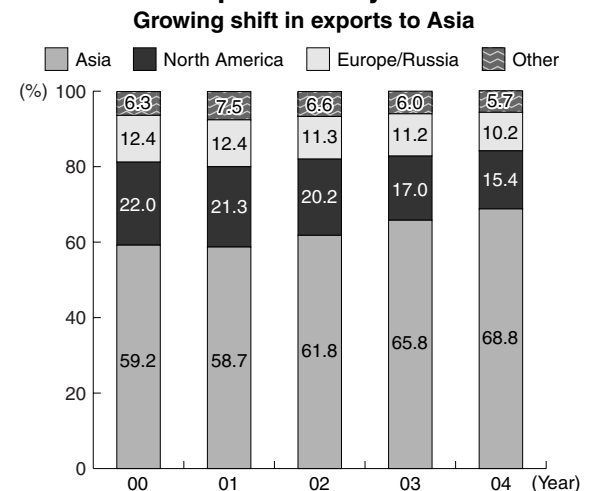
Particularly strong growth in intraregional trade in manufactured goods and parts in general machinery and electrical equipment industries with increased international division of labor



Source: RIETI, RIETI-TID.
 Note: The figures in the circles indicate the total value of exports.

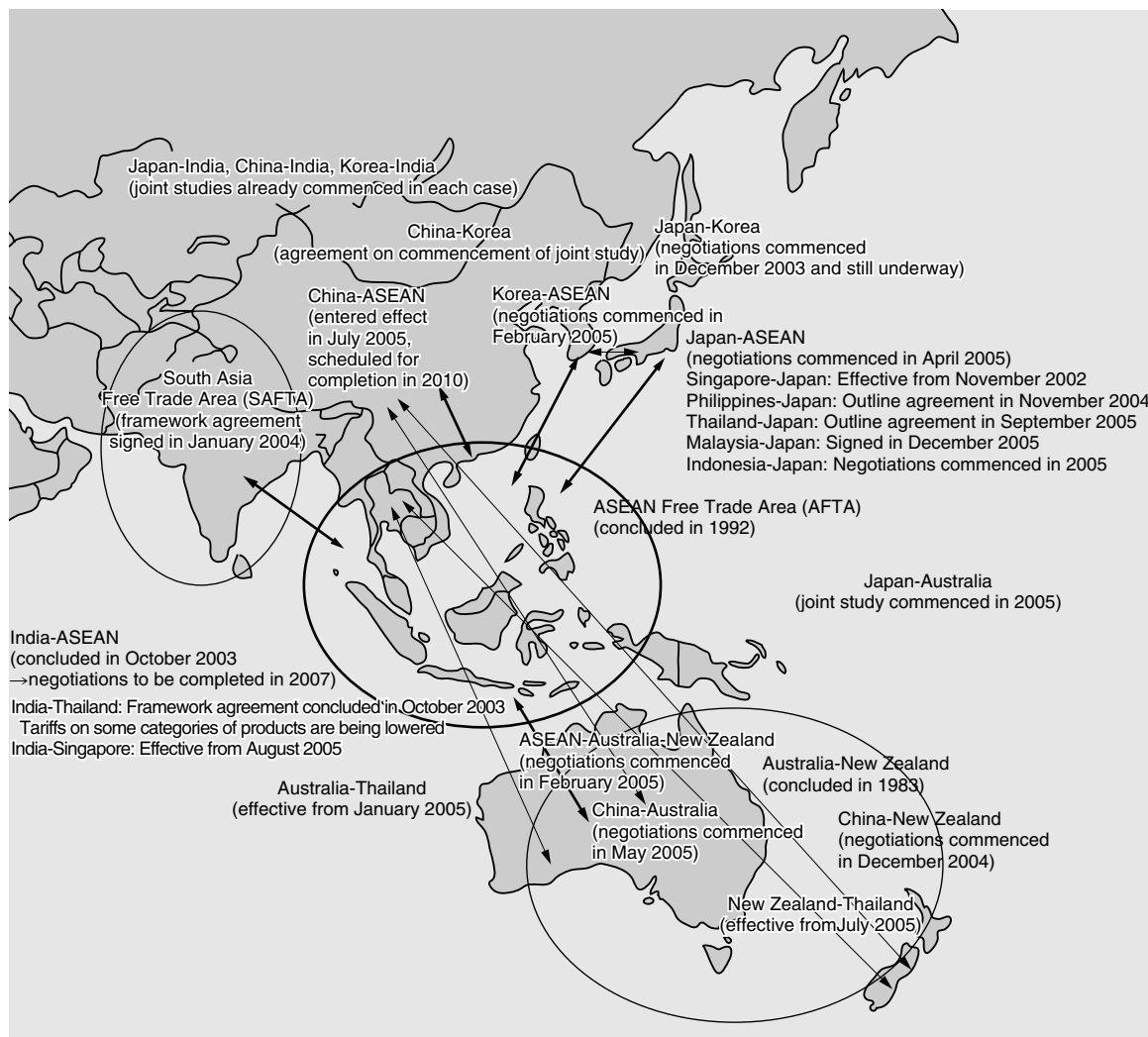
the EU and NAFTA. Nevertheless, as we have already observed, actual economic relations are growing rapidly stronger, and underlying this is thought to be the formation within East Asia of tough, dense networks creating an international division of labor in manufacturing, led by the machinery industry, through the specialization of roles in the production of products and production processes.

Fig. 2-1-9 Breakdown of exports of typical SME products by destination



Source: SME Agency, *Export and Import Value by Size of Enterprise*.
 Note: "Asia" includes the countries of East Asia and South Asia. "Other" includes Oceania, Latin America, the Middle East, and Africa.

Fig. 2-1-10 Main FTAs and EPAs in East Asia and neighboring regions
Active negotiations also underway with India and Oceania



Source: Compiled by METI from various sources (as of end December 2005).

Note: In addition to the arrangements shown above, there are also frameworks at the private-sector research level, such as those between Japan, China, and Korea, and "ASEAN+3" (i.e., ASEAN plus Japan, China, and Korea).

2. Trends in Japanese FDI in East Asia

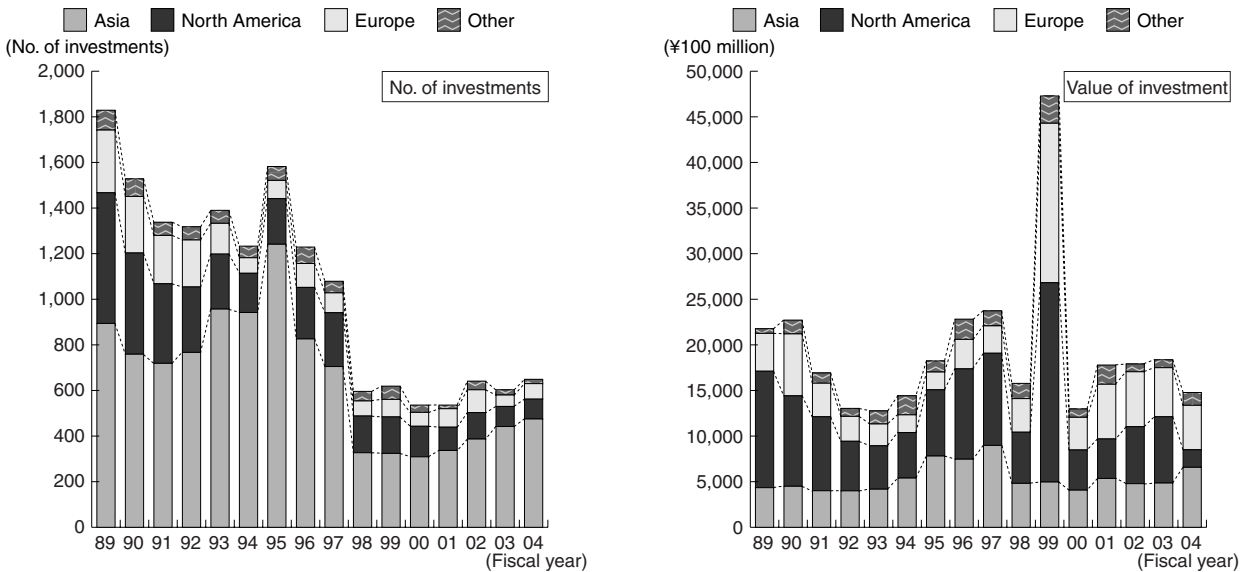
Regarding next foreign direct investment (FDI), we aim to gain a deeper insight into how relations with East Asia have changed, centering on Japan, by reexamining historical trends in Japanese FDI in East Asia.

In the 1960s and 1970s, Asian countries pursued import replacement and domestic production policies; high tariffs were levied on finished products in the household electrical appliances and automobile industries, and efforts were made to develop domestic industries. In this environment, Japanese enterprises (primarily large enterprises) made use of joint ventures to establish knock-down plants in the region, and targeted local markets while assisting in the development of local industries. From the start of the 1980s, Asian countries switched to export-oriented industrial policies,

and there was an expansion of Japanese investment, led by electrical equipment and electronics manufacturers, in export processing zones in the NIEs and Southeast Asia, special economic zones in China, and similar regions. From the latter half of the 1980s, the development of overseas operations throughout East Asia moved into full swing in response to the yen's appreciation, and in the early 1990s there occurred a surge in both the number and value of investments in China and the ASEAN region. FDI subsequently entered a decline in the wake of the Asian currency crisis in 1997, but from around 2000, with China's accession to the WTO in the offing, investment again picked up.

Let us examine these developments from a statistical perspective. As Fig. 2-1-11 shows despite considerable fluctuation each year, the value of Japanese FDI in manufacturing in North America has fallen by the year

Fig. 2-1-11 Trends in outward FDI by Japanese manufacturers (breakdown by region)
 Ratios indicate realignment of interest from North America to Asia



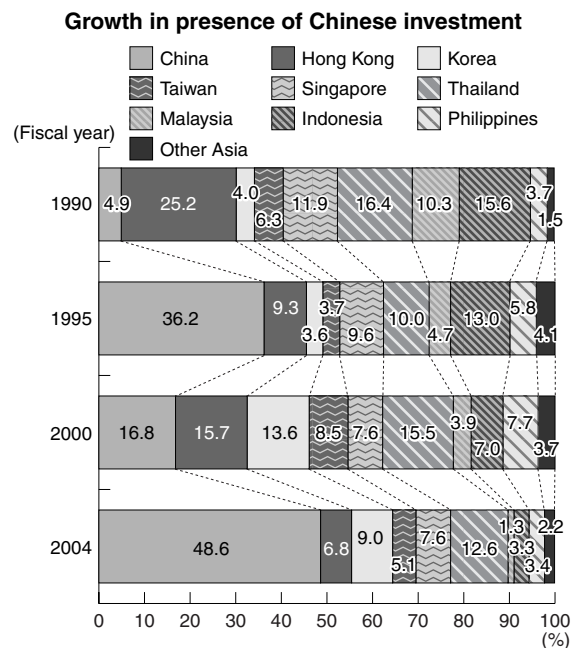
Source: MOF, *Foreign Direct Investment*.
 Notes: 1. Only manufacturing-related investments are included.
 2. Asia includes the countries of East Asia and South Asia.

as enterprises have turned their attention to Asia. As the breakdown by country of FDI entering Asia from 1990 onward shows (Fig. 2-1-12), the proportion of investment in China has considerably exceeded that in ASEAN and the NIEs. As is also apparent from Fig. 2-1-13, Japanese FDI in Asia is characterized by the large proportion of manufacturing investment compared with in other regions around the world.⁶⁾

This expansion of operations in Asia has been accompanied by an almost constant rise in the ratio of production in Asia by Japanese enterprises (Fig. 2-1-14). Looked at by industry, the situation in Asia is characterized by high ratios of production in the precision instrument and electrical machinery industries, and also in textiles. In the transportation machinery industry, too, overseas production, which was traditionally centered on the North American market, has in recent years risen in areas of Asia such as China and Thailand, and the ratio of production has increased. This is consistent with trends in FDI.

Up until around the 1970s, it was almost entirely large enterprises that were establishing operations overseas, and there was hardly any expansion overseas by SMEs. However, the lagging development of supporting industries⁷⁾ in East Asia, together with requirements for local procurement,⁸⁾ created a strong need for parts to be sourced locally. With some suppliers

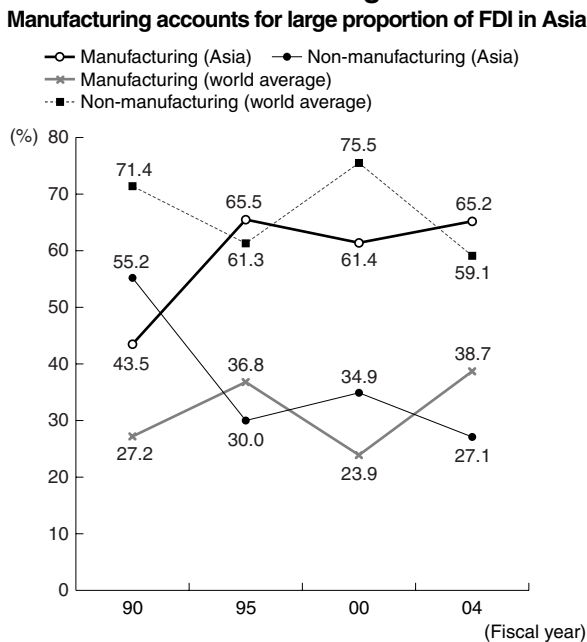
Fig. 2-1-12 Breakdown by country of FDI in Asia
 Growth in presence of Chinese investment



Source: MOF, *Foreign Direct Investment*.
 Note: "Other Asia" includes East and South Asian countries other than those shown.

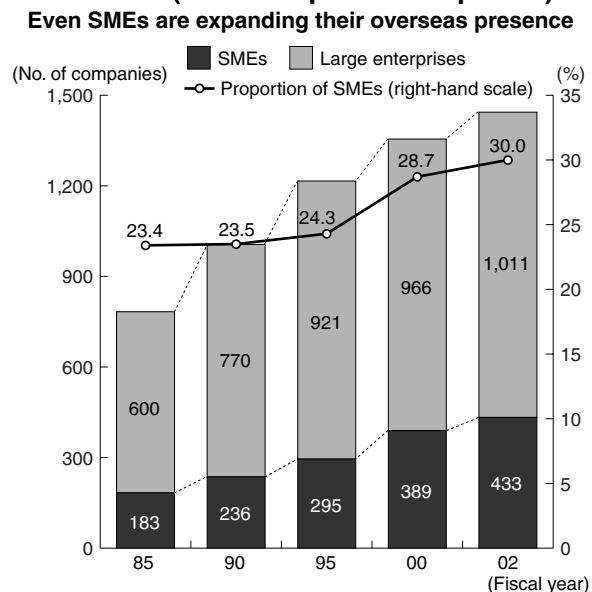
6) Investment in North America and Europe is dominated by non-manufacturing, especially finance/insurance, services, and commerce.
 7) Supporting industries such as the mold-making, casting, plating, pressing, and polishing industries, that provide the core technologies required by manufacturing. One of the main sources of Japanese manufacturing's competitiveness is the technological depth and sophistication of the SMEs that underpin these supporting industries.
 8) Government regulation requiring the domestic procurement of a certain proportion of product parts in order to develop and protect domestic core industries.

Fig. 2-1-13 Manufacturing and non-manufacturing shares of FDI



Source: MOF, *Foreign Direct Investment*.
 Note: Asia includes the countries of East Asia and South Asia.

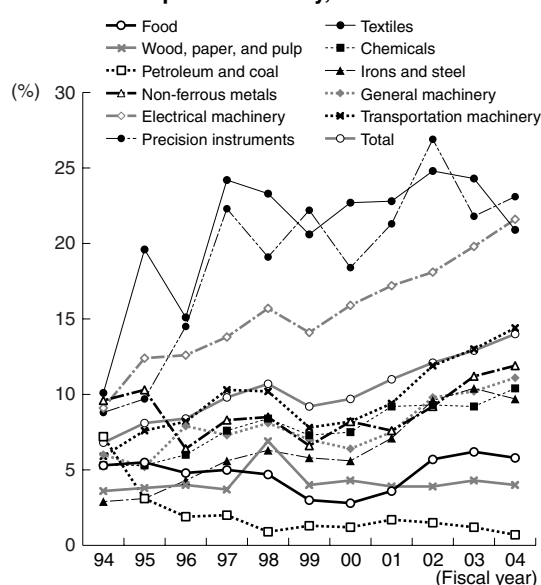
Fig. 2-1-15 Number of manufacturing SMEs with overseas subsidiaries (based on parent companies)



Source: METI, *Basic Survey on Overseas Business Activities*.
 Note: SMEs are defined as enterprises with capital of ¥100 million or less up to fiscal 1995, and ¥300 million or less from 2000.

Fig. 2-1-14 Trends in proportion of production in Asia by industry

High proportion of production in industries such as precision instruments, electrical machinery, transport machinery, and textiles



Source: Recompiled from METI, *Basic Survey on Overseas Business Activities*.

- Notes:
- Sales of domestic corporations and overseas subsidiaries of manufacturers with overseas subsidiaries in Asia (including East Asia and South Asia).
 - Proportion of production in Asia = sales of overseas subsidiaries / (sales of overseas subsidiaries + sales of domestic corporations) x 100

even being requested by large enterprises to establish operations overseas, enterprises such as middle-tier parts manufacturers of a certain size began investing overseas in earnest from the 1980s. From the beginning of the 1990s, the collapse of the bubble and ensuing prolonged slump forced Japanese enterprises to cut costs further, accelerating the transfer of production operations overseas among large enterprises in particular. This changing business environment confronted some SMEs with a perilous decline in business within Japan, forcing them to decide for themselves to expand overseas.

However, this structure is presently deepening further. Large enterprises are developing end-to-end production systems in East Asia that allow everything from development to parts procurement and production of consumer goods to be performed locally, and are working toward increasing the proportion of parts and materials sourced from within the host country or region in order to cut procurement costs. Due in part also to the growth of local manufacturers of finished products, demand is growing for parts and machining throughout East Asia. As a result of these changes, the establishment of operations in East Asia has become an important option in the growth strategies of SMEs as well (Fig. 2-1-15).

Relations between Japan and East Asia are thus growing. On the trade front, networks of international specialization are expanding, while investment ties, too, are strengthening. And as these strengthened investment ties impact on changes in the trade structure, relations at the real economic level, too, are growing ever stronger.

Section 3 Global optimal location strategy and the recent reversion to domestic investment

By moving the production of comparatively low value-added processes and products such as general-purpose goods to East Asia as part of a strategy of locating production operations in the “optimal location,” Japanese manufacturers have succeeded in raising the efficiency of their production systems and heightening value added within Japan. In recent years, however, large Japanese enterprises in some quarters have reverted to investing more in Japan in cutting-edge and associated industries in parallel with developing their presence in East Asia, generating a recovery in domestic investment. As the trends in the value of capital investment in the machinery industry depicted in Fig. 2-1-16 indicate, the past two or three years have seen FDI in Asia by electrical and information/communications equipment manufacturers peak, while there has been a sharp upturn in domestic capital investment. In the transportation equipment industry, on the other hand, in which production in China, Thailand, and other parts of Asia continues to grow, FDI investment is rapidly growing faster than capital investment in Japan. There can thus be

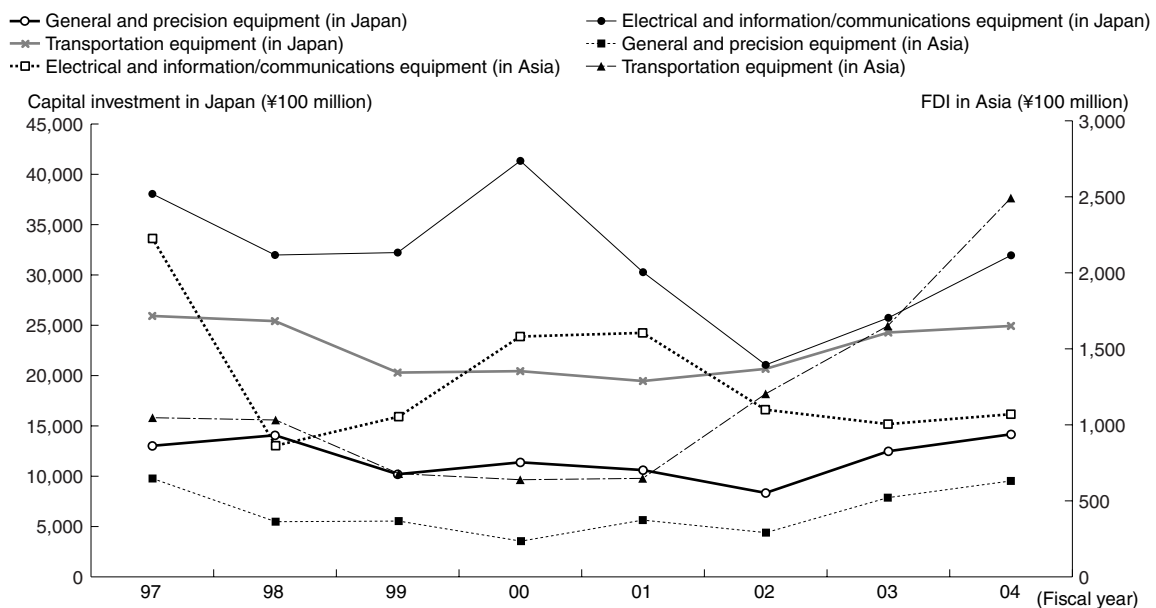
seen to exist some variation in location strategy according to industry.

One factor behind the reversion to domestic investment in especially the electrical and information/communications equipment industry is of course the upturn in business conditions in Japan, which has generated greater scope for investment. A more important factor, however, has likely been a reappraisal of the sophisticated technological capabilities of domestic SMEs, which are the pillar of the wide-ranging supporting industries that are the source of Japanese manufacturing’s strength, that make Japan an attractive environment in which to locate.

The conclusion to be drawn is that in order to maintain and reinforce Japanese manufacturing’s competitiveness in relation to East Asia and ensure that Japan is chosen as a location by globalized Japanese enterprises, the domestic base of the SMEs that underpin these core manufacturing technologies (supporting industries) needs to be further strengthened.

Fig. 2-1-16 Trends in value of capital investment in machinery industry (domestic capital investment and FDI in Asia)

Marked reversion to domestic investment in electrical and information / communications equipment manufacturing, surge in FDI in transportation equipment



Sources: MOF, *Financial Statements Statistics of Corporations by Industry, Quarterly, Foreign Direct Investment*.

Notes: 1. Investment in Japan is shown on the left axis, and FDI in Asia is shown on the right axis.
 2. Asia includes the countries of East Asia and South Asia.

Section 4 Deepening economic ties with East Asia and Japanese SMEs

As have observed, there is developing an international division of labor taking advantage of each country and region's strengths in the East Asian region, which has since the 1990s grown rapidly to become the "workshop of the world." Moves to develop international institutional frameworks, which had been lagging compared with the development of real economic ties, have also been developing rapidly recently, as evidenced by the establishment of AFTA with the aim of integrating ASEAN markets.

How then are these changes impacting on Japanese SMEs?

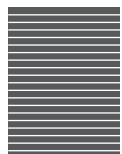
Firstly, more and more SMEs are likely to seek to expand their markets by establishing production operations overseas, especially in East Asia. SMEs are increasingly aiming to optimize their production systems, both in Japan and abroad, in pursuit of survival and growth as well as just limited benefits in the form of reduced labor costs as in the past, and the business challenges and risks faced by such SMEs need to be analyzed and the conditions required for overseas expansion to become an attractive option for expansion identified.

Secondly, in order to raise Japan's international competitiveness, it is necessary to strengthen the foundations of the SMEs that support manufacturing's technological base (supporting industries). SMEs that do not themselves establish operations overseas also urgently need to respond to the changed domestic environment due, for example, to the influx of cheap foreign products, decline in orders due to customers

moving operations offshore, and the restructuring of business networks within Japan. As the above analysis showed, some large Japanese enterprises, particularly in the electrical and information/communications equipment sector, have recently begun to invest once again in Japan and reassess the country's attractiveness as a location for business. If the SMEs that underpin this environment are to survive and demonstrate their capabilities in this changing environment, however, the necessary future course of action needs to be mapped out.

And thirdly, there is the impact on relations with regional economies. The traditional benefits of industrial clusters, which have long sustained local employment and industries, as locations for efficient production of general-purpose products are changing. In the face of competition with East Asian countries, regions are finding it increasingly difficult to use land and labor costs, for example, as lures to attract industry, and autonomous development will in the future have to be pursued by making effective use of each region's own accumulated "regional resources." It is important that clusters' functions be effectively utilized as a part of each region's armory of regional resources, and the benefits of clustering that can still contribute to SME growth need to be identified through analysis of the activities of enterprises located in clusters that are achieving growing profits.

In the following chapters, therefore, we examine and analyze each of these areas in turn.



Chapter 2 State of overseas expansion by SMEs and associated issues

Section 1 Assessment of overseas expansion by SMEs

As analyzed in Chapter 1, large Japanese enterprises' global location strategies have evolved considerably in the face of rapid growth in China and other East Asian countries, and the Japanese economy's prolonged slump. In the process, many SMEs have staked their survival on establishing operations in East Asia, either in the wake of large customers that have expanded into the region or in order to reduce the cost of producing low value-added products. At the same time, many SMEs have actively expanded overseas as a means of moving into and developing new areas of business against the backdrop of these dramatic changes in the business environment.

As reciprocal relations within the East Asian region strengthen, expansion overseas in this way will form an inevitable part of the process of transformation in order to create an optimal international division of labor in industry as a whole that contributes to the Japanese economy. Such a division of labor will be based on the transfer of comparatively low value-added products and processes to East Asian countries where the cost of land, labor, and so on is relatively low, and the simultaneous maintenance and strengthening in Japan of the development and production of high value-added products.

From the point of view of individual SMEs, on the other hand, the establishment of overseas operations can enhance business and increase independence in a variety of areas, including marketing, human resources, and production and development systems. As a result, SMEs in many cases find that investment overseas increases the general sophistication and independence of their operations and improves performance, including in Japan.

Given this situation, the following two strategies need to be pursued in parallel in order for Japanese SMEs to boost their competitiveness internationally.

1) Strengthening the competitiveness of operations in Japan

Japan's manufacturing strength stems from the tight integration (*suriawase*) that exists between SMEs, which are equipped with core manufacturing technologies, and large enterprises, which furnish the end products, and the development of cutting-edge strategic products also emerges from such *suriawase*.

Accordingly, it is necessary to strengthen the domestic base of the SMEs that provide these core manufacturing technologies in order to further strengthen the international competitiveness of Japanese industry in the above process of transformation.

2) Facilitating and reducing the risks of establishing overseas operations

The establishment of overseas operations by SMEs is an inevitable evolutionary process if Japan is to strengthen its industrial competitiveness. At the same time, however, expanding overseas entails numerous risks. For SMEs in particular, establishing operations overseas is even more difficult than for large enterprises due, among other things, to their more limited ability to collect the information needed when investing overseas. It is therefore necessary to develop an environment that lowers the unforeseen risks to SMEs of expanding overseas and facilitates the above process of change.

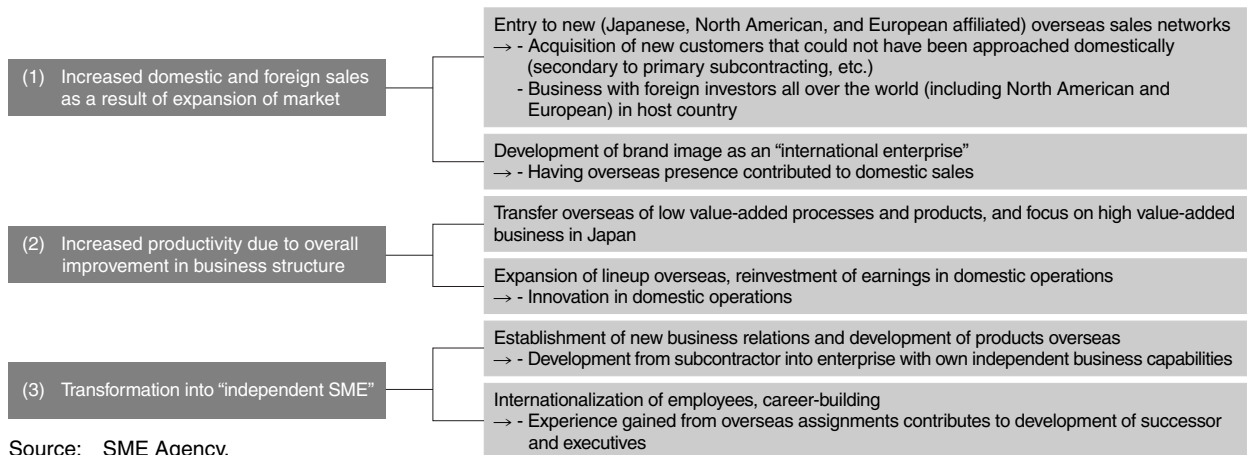
The first of these strategies will be examined in the following chapter (Part II, Chapter 3), while the second we will consider in this chapter. Below, therefore, we proceed with an analysis of the globalization strategies of Japanese SMEs in East Asia, focusing on the changes in business and management arising from SMEs' establishment of overseas operations from the following three main perspectives (Fig. 2-2-1):

- 1 Increased domestic and foreign sales as a result of expansion of market
- 2 Increased productivity due to overall improvement in business architecture
- 3 Transformation into independent SMEs

While appropriate use is made of macro-level statistics in the following analysis, some individual cases are also described based on detailed interviews with enterprises that have established operations overseas (including both the parent companies in Japan and their overseas subsidiaries). The purpose of this is to give the reader a clearer picture of SMEs' situation given that their particularly diverse forms and conditions are not always immediately apparent from such statistics.

Fig. 2-2-1 Examples of increased general sophistication and independence of SMEs as a result of establishment of overseas operations

Overseas expansion by SMEs often leads to change and business innovation

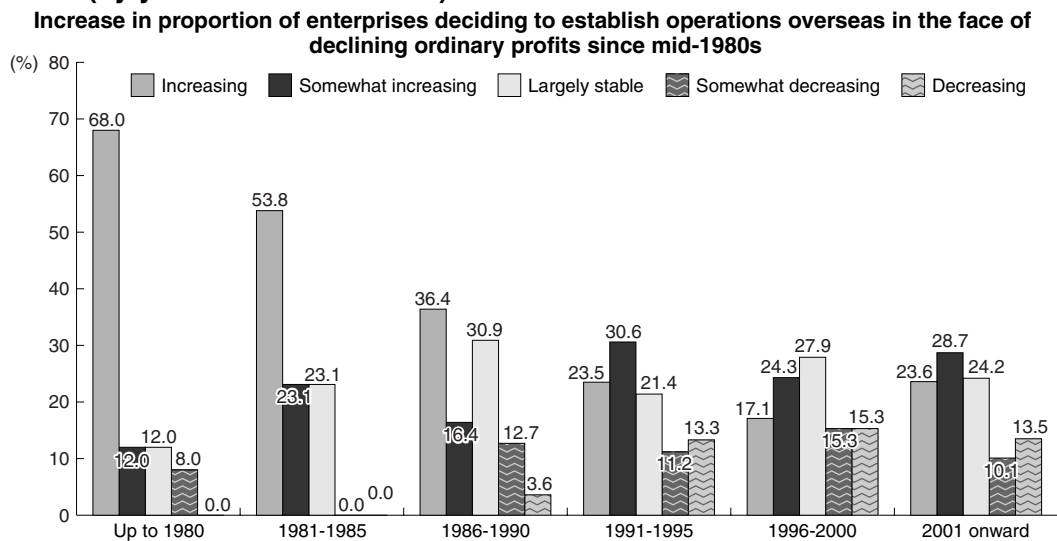


Section 2 Motivations for establishing operations in East Asia and types of presence

The constantly changing nature of business in Japan forces enterprises to make a variety of business decisions. Since the 1990s in particular, the business environment has become especially severe as the rise of the economies of East Asia has led to a growing influx of cheap foreign products, overseas relocation of large enterprises, and increased customer selectivity. Many manufacturing SMEs have as a consequence experienced a decline in orders, forcing them to pursue innovation centered on improvements in business efficiency, and

sometimes to downsize or even close down operations. According to Fig. 2-2-2, which shows the ordinary profit situations of enterprises when they established operations in East Asia according to when they did so, many enterprises used to establish operations when profits were rising and they were in a relatively strong position. Since the latter half of the 1980s, however, a considerable proportion of enterprises investing in the region was experiencing declining ordinary profits in the face of the appreciation of the yen and rise of East Asian

Fig. 2-2-2 Ordinary profit situation at time of establishment of operations in East Asia (by year of establishment)



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

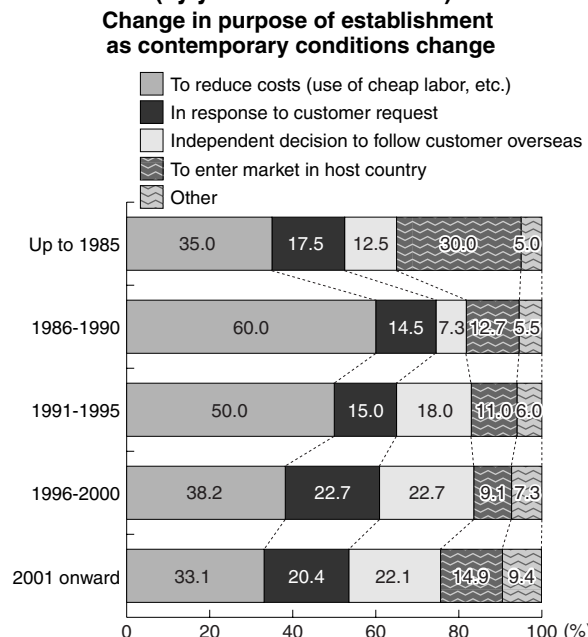
competitors. It can thus be seen that many SMEs that have expanded overseas opted for “aggressive management” in order to gain access to overseas markets in response to changes in their business environment.

Under these conditions, the backgrounds and intentions of SMEs’ deciding to establish operations overseas fall into a number of patterns, and one would expect the corresponding business challenges faced to exhibit different characteristics. While in reality the decision to establish production operations overseas is made based on an all-round judgment involving a number of related objectives and factors, these patterns of overseas expansion by manufacturing SMEs may be broadly grouped into the following four categories.

- 1) Overseas expansion intended to reduce the cost of manufacturing processes (for import into Japan of overseas output instead of selling locally)
- 2) Overseas expansion in response to a request by a parent enterprise that had itself established operations overseas
- 3) Unrequested overseas expansion with the intention of maintaining or expanding business with Japanese affiliates overseas (including a parent enterprise)
- 4) Overseas expansion targeting new customers in the host market

Looking at trends over time in the purpose of establishment of operations overseas following this classification (Fig. 2-2-3), it is apparent that many enterprises during the initial period shown, when the yen was appreciating, manufactured products overseas for shipment back to Japan motivated primarily by the desire to reduce costs. Pattern 1) was thus prevalent. A prime example of this is the contract manufacturing trade,¹⁾ where a Japanese parent enterprise sends the materials and equipment required overseas for processing and assembly by an overseas subsidiary, all output then being exported back to Japan. In the case that a parent enterprise establishes operations overseas, however, costs can be reduced by delivering parts and products made in East Asia directly to the parent enterprise’s overseas plant. This is known as “out-out” production, which in recent years has been increasing more than out-in production. Patterns 1) and 3) are also in many cases combined. The greatest advantage of pattern 1) is that, because the aim is to make use of cheap labor, plants can be located on the outskirts rather than actually within cities, allowing many enterprises to use labor and land that is cheaper than in urban areas. In order to reduce costs, parts that are initially imported from Japan need to be progressively and

Fig. 2-2-3 Purpose of manufacturing operations at a time of expansion into East Asia (by year of establishment)



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

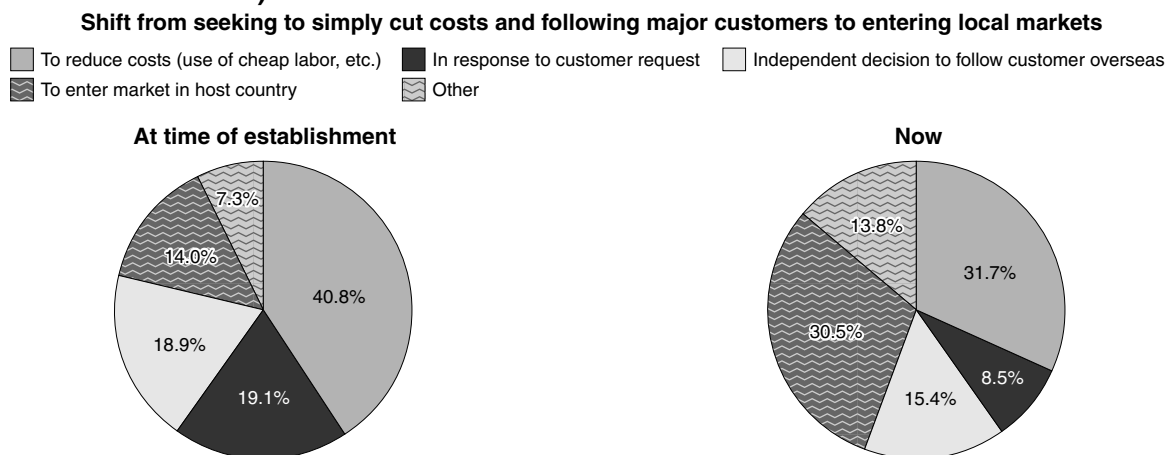
increasingly sourced from within the host region. Risks include the fact that results will be poor unless a certain level of production can be achieved and merits of scale generated, the possibility of labor costs rising over time as the host region’s economy grows, and the risk that expected reductions in costs may not be achieved if local procurement does not increase according to plan.

From the point of view of relations with large enterprises, on the other hand, many SMEs whose businesses are heavily affected by the actions of key customers are more likely to establish operations overseas in order to follow such customers—either requested or unrequested—as in patterns 2) and 3), rather than choosing to do so entirely autonomously, and since the 1990s especially, there has been an increase in such moves overseas amid the growing shift of production overseas by large enterprises.

In the case of pattern 2), enterprises are assured of at least a certain market for their goods, but are on the other hand highly vulnerable to developments at the parent enterprise. If the parent enterprise withdraws from a market, therefore, they are at risk of going down as well unless they have developed other marketing outlets. With the recent changes in patterns of doing business²⁾ in Japan, however, subcontractors are no longer necessarily guaranteed of being given work by parent enterprises that

1) For details, see Section 3 “3. China.”
 2) See Part II, Chapter 3.

Fig. 2-2-4 Comparison of purpose of operations in East Asia (at time of establishment and now)



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

are pursuing increasingly global procurement strategies. Confronted by these changes in the business environment, it is conceivable that considerable numbers of SMEs take the risk of establishing operations overseas having decided, for example, that sales would dwindle if they relied solely on the domestic market, that there are limits to the extent that costs can be cut producing only in Japan, or that there is no alternative but to enter overseas markets if more orders are to be won. Thus with no guarantee of receiving work from parent enterprises overseas, many SMEs ultimately have to decide for themselves whether to establish operations overseas, as in pattern 3). In such cases, there exists the risk customers may not be acquired as successfully as expected, or that significant competition may be encountered from competitors in the host market. For SMEs planning to establish operations overseas, therefore, projecting the acquisition of customers and development of outlets in the host market is growing ever more crucial. Conversely, because subcontracting patterns are less clearly fixed than in Japan, many SMEs find that expansion overseas enables them to do business with large enterprises that they could not have approached in Japan, or to supply unaffiliated Japanese enterprises and European and North American enterprises that have entered the same market.

The establishment of a presence overseas thus also potentially offers major business opportunities.

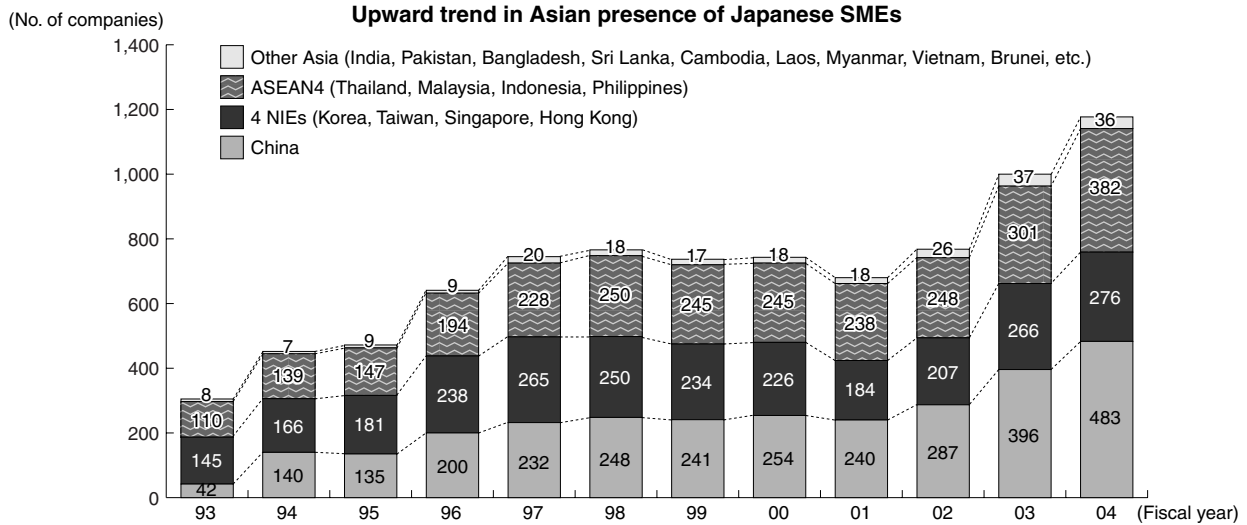
In China, especially in the East China region around Shanghai, where a succession of enterprises have established production operations and the local market is exhibiting conspicuous growth, it is becoming increasingly common to establish a presence with the aim of developing new customers in the host market, as in pattern 4). These new customers include Japanese affiliates with which enterprises have had no business dealings in Japan, third-country enterprises such as those from Europe and North America, and local enterprises and consumers. As can be seen from Fig. 2-2-4, many enterprises that followed pattern 1), 2) or 3) have also gradually changed their objectives and shifted their attention to the host market (pattern 4)) on account of the declining cost-saving effect (e.g., due to rising labor costs) or changes in relations with business partners. However, such a strategy carries with it major risks, such as the difficulty of developing sales channels and creating a brand, and the problems regarding collection of receivables from local enterprises described later. SMEs therefore have to overcome high barriers if they wish to successfully enter host markets.

Section 3 Investment environments in East Asia and characteristics of business models

In the 1990s, Japanese manufacturers stepped up their investment in East Asia in response to their declining price competitiveness due to the yen's appreciation, and the prolonged domestic slump. Although the impact of the Asian currency crisis in 1997 briefly cast a pall on investment, the economies of Asia steadily recovered

and investment by Japanese enterprises is also returning. There has been a particular improvement in the investment environment in China, which has achieved remarkable growth, including tariff reductions and growing deregulation of foreign investment in China following its accession to the WTO in 2001, and

Fig. 2-2-5 Number of Asian subsidiaries of manufacturing SMEs

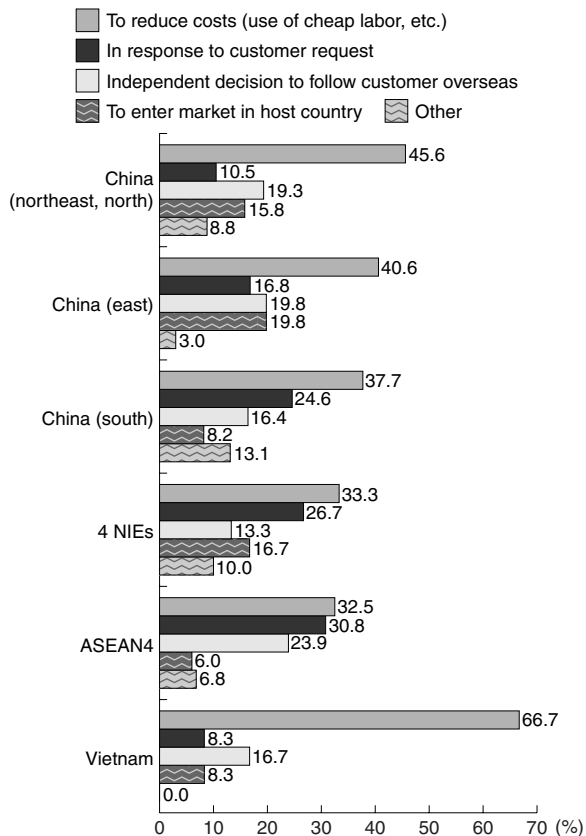


Source: Recompiled from METI, *Basic Survey on Overseas Business Activities*.

Note: Enterprises with subsidiaries are defined as SMEs if the parent enterprise has no more than ¥300 million in capital or no more than 300 regular employees. In fiscal 1994 and 1995, however, SMEs are enterprises with capital of not more than ¥300 million.

Fig. 2-2-6 Purpose at time of establishment of operations in East Asia (by region)

More enterprises attracted by lower costs and domestic sales in China, and business ties with customers in ASEAN



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

investment in the country has as a result grown rapidly. Against this background, SMEs are following large enterprises in dramatically increasing their presence in East Asia, and the number of production operations established overseas is constantly growing (Fig. 2-2-5).

East Asia is a region of cultural diversity and considerable variation in the level of economic development, and investment environments in the region vary greatly too. In China, for example, the business models differ greatly from region to region, such as in the north, east, and south. As can be seen from Fig. 2-2-6, which shows a breakdown of the purpose of establishing operations in East Asia according to region, a relatively high proportion of enterprises invested in East China in order to tap into local markets, but few did so in the south of the country, where contract manufacturing is more common. In the northeast and north, meanwhile, where labor costs are relatively low, many enterprises invested with the aim of reducing costs. In the ASEAN4, many enterprises establish operations solely because of their relations with existing customers.

When selecting a site for overseas expansion, an enterprise needs to be aware of these differences, assess the consequent business risks, and formulate appropriate countermeasures. Below, we briefly describe the investment environments in the NIEs, ASEAN, and China.

1. Four NIEs (Singapore, Hong Kong, Taiwan, and Korea)

Driven by the small size of their domestic markets, the NIEs were quicker than the ASEAN4 and China to focus on export development as, one after another, they set about export-led industrialization by, for example, establishing export-processing zones in the 1960s and

1970s, and, equipped with well-developed infrastructures and high-quality labor forces, they succeeded in developing broad-based domestic industries. As costs subsequently increased due to rising living standards, new investments by Japanese manufacturers leveled off, and the bulk of Japanese investment currently goes into certain high value-added industries, such as the electronic equipment and component industries, and the expansion of existing capacity. The NIEs, which have attracted investment by Japanese enterprises from an early stage, provide functions that cannot be procured in China and serve functions supplementary to investment in China thanks to their varied and well-developed infrastructures. Below, then, we provide an overview of the investment environment in the NIEs bearing in mind how investment in the region intersects with investment in China.

1) Singapore

The Singapore government has worked to develop Singapore as a logistics hub and site for foreign enterprises to locate their regional headquarters, and despite the island state's fading attractiveness as a site for production due to rising costs, its potential as a hub for international procurement of parts remains high. As quick turnaround and just-in-time production systems develop globally, transcending national borders, many enterprises choose to locate their parts procurement operations in Singapore, with its convenient 24-hour airport.

2) Hong Kong

Hong Kong, which has drawn foreign investment against the background of free trade, developed dramatically as a gateway for investment into China, and South China in particular. Attracted by its outstanding clearing functions and advantageous tax regime, many Japanese enterprises have established subsidiaries in Hong Kong in order to engage in contract manufacturing trade taking advantage of the rich source of cheap labor in South China. Due to rising business costs as in Singapore, however, together with the improving state of the investment environment in China with its accession to the WTO in December 2001, Japanese enterprises are now increasingly investing directly in China without going through Hong Kong. Against this background, the Hong Kong and Chinese government signed the Closer Economic Partnership Arrangement (CEPA), which entered effect in January 2004. Using schemes provided for by the CEPA, enterprises can export certain categories of products made in Hong Kong to China without paying customs duty. The market for services has also been opened up sooner to Hong Kong enterprises, creating a further incentive to invest in Hong Kong.

3) Taiwan

Whereas Singapore and Hong Kong function as financial centers and hubs for logistics, procurement, and intermediary commerce in East Asia and to China, Taiwan's function is as a hub for development of human

resources and provider of manufacturing know-how, and Japanese enterprises have long invested heavily in the island's economy, especially in manufacturing. Since the rise of China in recent years, the hollowing-out of Taiwanese industry has grown more serious, and there has occurred a shift of production to China. At the same time, however, some enterprises have maintained their production operations in Taiwan and increased local procurement, and their Taiwanese subsidiaries, with their knowledge of Japanese manufacturing methods, are playing a key role in investing in China. While there are admittedly differences in social institutions and cultures between Taiwan and China, the minor linguistic barriers between the two have led some Japanese enterprises to initially establish operations in Taiwan with a view to expanding into China at a later date, using the island as a base from which to develop human resources and transmit manufacturing know-how.

4) Korea

In contrast with the prevalence of SMEs in Taiwan, large *chaebol* enterprises have traditionally had a major presence in Korea, and while at last many IT ventures are emerging from the ranks of SMEs, manufacturing is driven by high-tech industries such as the semiconductor and LCD industries, and the bulk of recent new investment by Japanese enterprises has been by large enterprises supplying advanced components.

2. ASEAN4 (Thailand, Indonesia, Philippines, and Malaysia)

What then of the situation in the ASEAN4, which have lagged a little behind the NIEs in developing their domestic industries? Each has established export processing zones and industrial estates, and has sought to attract foreign investment. Despite the severe impact of the Asian currency crisis in 1997, their economies have subsequently generally steadily recovered. These countries have traditionally received much of their FDI from Japan, and ties with Japan are particularly strong in areas of manufacturing such as electrical equipment related industries.

1) Thailand

Alongside South China, Thailand has one of the largest concentrations of Japanese enterprises in East Asia. Its political stability, peaceable national character, and broad-ranging concentrations of core technologies make it an attractive investment environment, and growing numbers of enterprises, especially in the electrical equipment, electronics, and automobile-related industries, are making Thailand the hub of their ASEAN production operations (see Case 2-2-1). Against the backdrop of reduced tariffs in the ASEAN Free Trade Area (AFTA)³⁾ and moves toward the establishment of an FTA between China and ASEAN, many large

3) A framework to liberalize trade and stimulate the regional economy by lowering tariff and non-tariff barriers in the region.

enterprises have in recent years been reorganizing their production operations in ASEAN to place a greater proportion in Thailand, with its better investment environment, creating greater opportunities for investment by manufacturing SMEs as well.

2) Indonesia

Due partly to the high unemployment rate, cheap labor is easily available in Indonesia, making it competitive in terms of labor costs. Its rich natural

resources and population in excess of 200 million, making it the largest market in ASEAN, also make it an attractive location. However, investment has at the same time been fettered by repeated acts of terrorism and governance problems involving the authorities. The core technology base is also relatively underdeveloped.

3) The Philippines

Many Japanese electronics and electrical equipment manufacturers have established operations in the

**Case
2-2-1**

A Japanese die maker and a Thai automobile industry cluster

Shizuoka-based Creative Technology Co., Ltd. is a maker of dies for plastic auto parts, and has a workforce of 145 and capital of ¥70 million. It first established a presence in Thailand, Bangkok, in 1997, when its objective was to establish a CAD/CAM center for processing data required for die making, rather than to manufacture dies there. This was due to the enormous cost of labor for such work in Japan, which it wanted to cut. It chose Thailand as the site for its operations in Asia because Japanese people find it a hospitable place, it is religiously and politically stable, Japanese automakers have already established operations there, and its market is projected to grow. As anticipated, Thailand is now emerging as a major global center for automobile production.

It launched its presence in Thailand by employing 10 new graduates of Thailand's famous King Mongkut's Institute of Technology to work on data processing. While 1997 was the year of the Asian currency crisis, the company was fortunately largely unscathed thanks to its small size and business model of performing only work ordered in Japan in Thailand.

In the first four or five years, the company's Thai venture only handled data processing. However, as there arose cases of dies being made that were unusable due to data being processed without any knowledge of actual die making, the company felt

that there were limits to what could be achieved through data processing alone, and so decided to establish a die plant in Thailand as well. The economic environment, too, was brightening – numerous auto parts makers had begun establishing operations in Thailand, creating demand for dies – and having data processing and die production capabilities in the one location was looking increasingly advantageous. The 10 graduates employed on data processing when the venture was launched now serve as key figures on the die-making shop floor. Orders from Japanese auto parts manufacturers in Thailand currently make up the bulk of its business, with die making representing over 90% of sales and the remainder being derived from the venture's original business of data processing.

The question that has most exercised the company in Thailand is that of how to communicate the attention to detail, skills, and technologies of Japanese die making to Thai workers. There is little competition from local die makers, and the company's competitors are, inevitably, Japanese affiliates in Thailand and die makers in Japan. While Japanese automobile set manufacturers and primary subcontractors tried in the past using local die makers in Thailand and East Asia, the frequency with which details had to be redone again led to increasing procurement from Japanese die makers.

**Case
2-2-2**

Recruitment of high-caliber human resources in the Philippines

More than 60% of the output of Company A – a Yamagata-based aluminum cold forging parts manufacturer with 300 employees and capital of ¥98 million – consists of auto parts. It established a plant in the Philippines in 2002 in response to the establishment of operations there by one of its customers. Its move was prompted by the severe slump in domestic demand, and its sales – both in Japan and overseas – are now much better than at that time. As a forging and press molding processor in what is known as the "process industry," labor costs represent a relatively small proportion of manufacturing costs. For precisely that reason, however, it is a line of business that requires experienced engineers, and particularly skilled human resources are required for work such as the design of work processes and precision cutting at the finishing stage.

As Company A is an SME situated in a relatively remote area of Japan, it finds it difficult recruiting top graduates from prestige universities in Japan. In the Philippines, on the other hand, where unemployment is high, there is not only a large supply of unskilled labor, but also ready access to highly skilled graduates of top universities thanks to the good educational environment in the country. The company sees the Philippines as an important source of human resources where skilled workers can be employed for use at plants in Japan, and it is looking forward to progress in negotiations on an FTA between Japan and the Philippines. It is also considering opening company facilities to universities in the Philippines to serve as a university laboratory in order to gain greater access to high-caliber human resources and promote joint industry-university ventures.

Philippines. As unemployment is high and levels of education are also comparatively high, good-quality labor is easily available, in addition to which English's status as an official language makes it comparatively easy for Japanese people to communicate there (Fig. 2-2-2). Japanese enterprises have a high regard for the hard-working nature of the Philippine people, and, as in Thailand, many Japanese die makers have chosen to establish operations there.

4) Malaysia

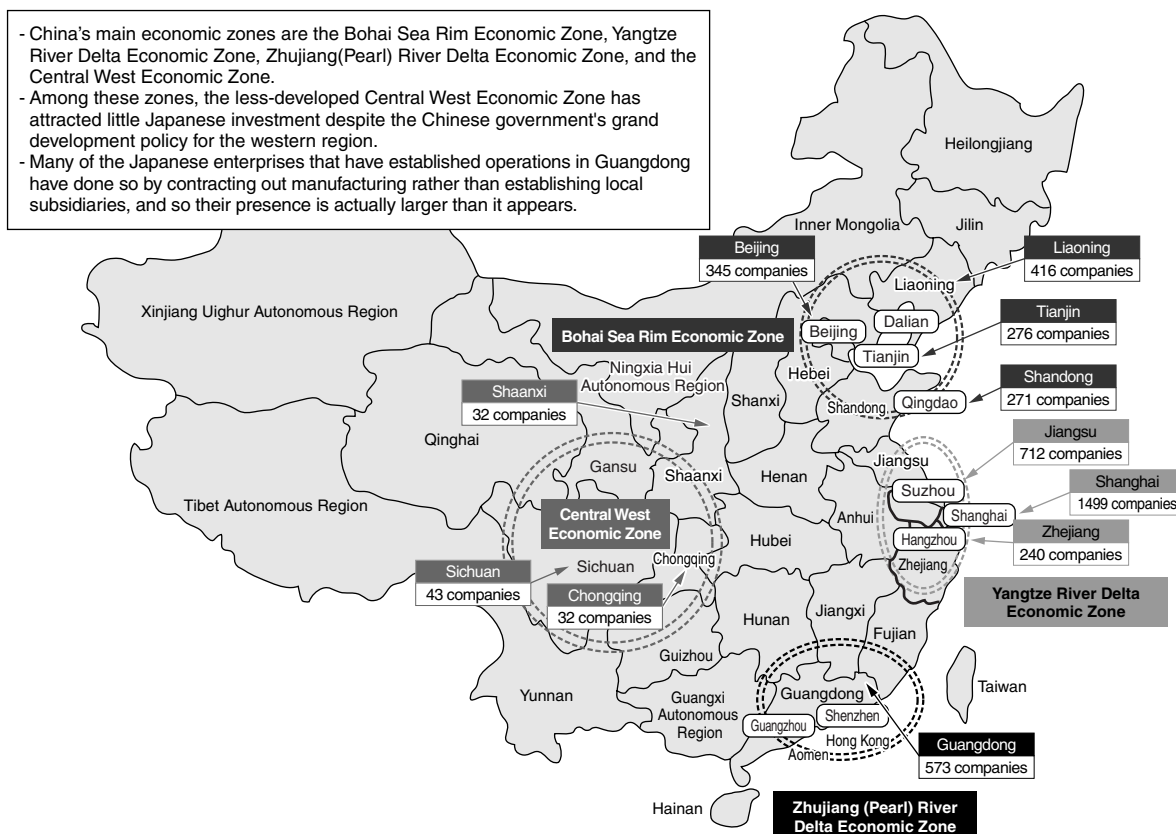
The standard of living is high in Malaysia, which, under the firm leadership of former Prime Minister Mahathir and his famous "Look East Policy" basing economic development on the Japanese model, has employed a variety of industrial policies to develop its infrastructure and actively court foreign investment. Malaysia was especially enthusiastic about attracting investment from technologically advanced Japanese SMEs, and in electronics-related industries in particular, a certain amount of clustering has occurred, creating a favorable environment for procurement of electronic components. In recent years, however, there has occurred a chronic shortage of labor, which has pushed up wage levels and lowered the country's cost competitiveness in relative terms.

3. China

The reform and open-door policy adopted by China in 1978 was stepped up following Deng Xiaoping's lectures on his tour of the south in 1992, accelerating the pace of reform in and around the major coastal cities and propelling the country toward prolonged high economic growth. While little more than a decade has passed since the opening up of China's markets began in earnest, rapid economic growth has generated a deep economic divide between urban and rural areas, and the Chinese government is presently pursuing a grand strategy for development of the west of the country in order to close this gap. The varying pace of market liberalization has led to differences in the business models typically used in each region.

China may be broadly developed into four regions in which heavy concentrations of industry have formed: 1) the Bohai Sea Rim Economic Zone around the northeast and north (including, for example, Beijing, Dalian, and Tianjin); 2) the Yangtze River Delta Economic Zone around the east of the country (including Shanghai, Suzhou, and Hangzhou); 3) the Zhujiang (Pearl) River Delta Economic Zone around the south (including Guangzhou and Shenzhen); and 4) the emerging Central West Economic Zone around Chongqing and Sichuan (Fig. 2-2-7).

Fig. 2-2-7 Trends in establishment of Japanese affiliates in China by region
Growing Japanese presence centered in and around Shanghai



Source: Compiled by the SME Agency from various sources.
 Note: The number of companies given next to each province and city indicates the number of Japanese-affiliated enterprises recorded in The 21st Century China Research Institute (ed.), *A Compendium of Japanese Enterprises in China* (2003-2004).

1) Bohai Sea Rim Economic Zone

Within Northeast and North China, Dalian has long been a recipient of Japanese investment, and has considerable concentrations of Japanese enterprises in a wide range of industries, including food, apparel, general merchandise, and electronic components. In Tianjin, investment by Toyota Motor Corporation has prompted the clustering in recent years of Toyota-affiliated auto parts makers, while in the Beijing area, there have formed high-tech urban clusters of university ventures emanating from institutions such as Peking University and Qinghua University, a particularly well-known example of which is the technology hub of Zhongguancun.

2) Yangtze River Delta Economic Zone

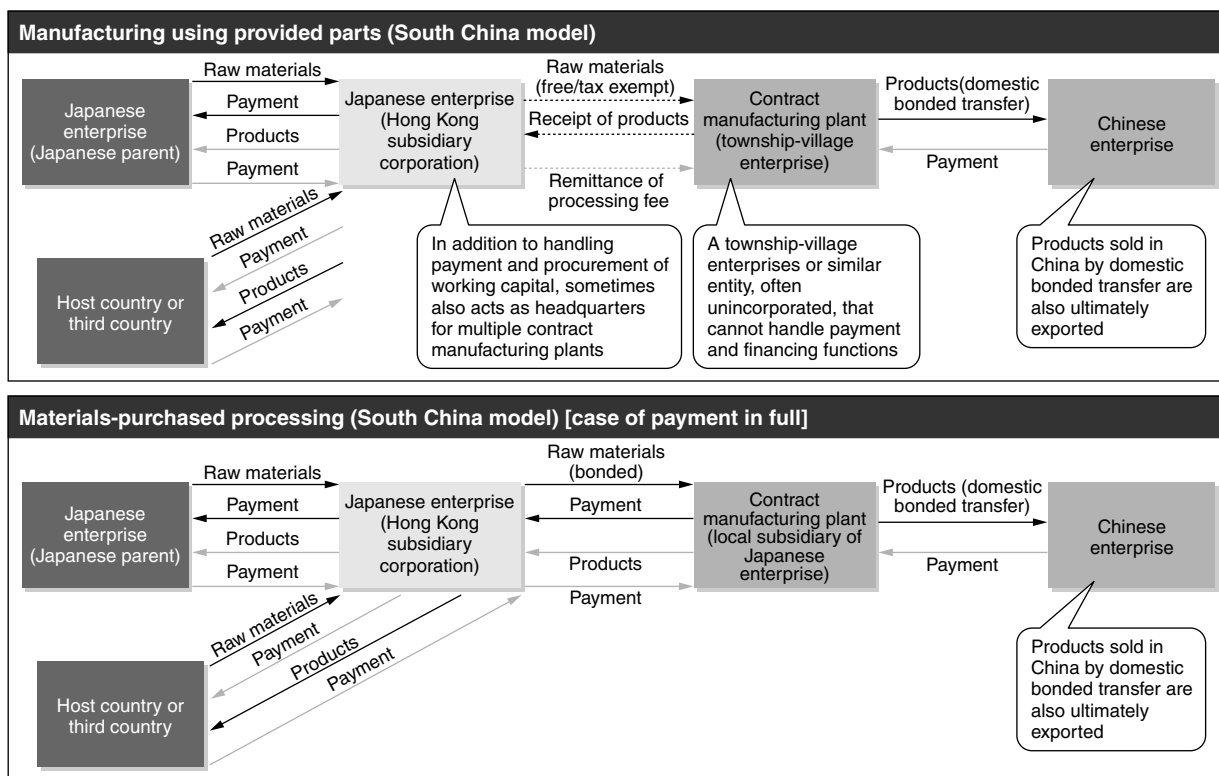
Eastern parts of the country, such as Shanghai, Suzhou, and Hangzhou, are currently attracting the most investment by Japanese enterprises, including many SMEs. One characteristic of investment in the region is the preponderance of electrical equipment and electronics manufacturers, which are attracted by the larger domestic market compared with in the south (3) in addition to the well-developed business infrastructure. The area around Shanghai is well known for its concentration of die manufacturers, including Chinese as

well as Japanese enterprises, and machine tool manufacturers are also clustering in the region.

3) Zhujiang (Pearl) River Delta Economic Zone

South China (Guangzhou and Shenzhen, etc.) was at the forefront of China’s economic liberalization, and has a flourishing contract manufacturing trade. One concrete example of the way investors do business in this region is shown in Fig. 2-2-8. According to this model, an enterprise establishes a local subsidiary in Hong Kong as a procurement hub, and supplies the raw materials untaxed and free of charge for processing at a local contract manufacturing plant, the entire output of which is then exported. As outsourcing production and processing to local Chinese enterprises reduces the financial cost and risk of FDI, SMEs were quick to seize on this approach. However, as the products produced by this method of contract manufacturing are not allowed to be sold purely on the local market, SMEs are increasingly turning to the establishment of separate wholly-owned local subsidiaries in the south and new local subsidiaries in the east as the domestic Chinese market grows.⁴⁾ In Guangdong, there are numerous clusters of manufacturers of office equipment, such as photocopiers, and optical devices, such as cameras and lenses, turning the province into a center for production of electronic components. And in Guangzhou, the

Fig. 2-2-8 Contract manufacturing models employed in south China
Development of the South China region driven by contract manufacturing trade since 1980s

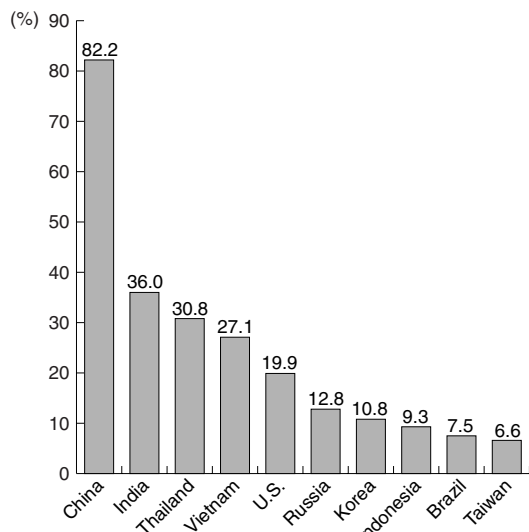


Source: Compiled by the SME Agency based on Bank of Tokyo-Mitsubishi UFJ, *Investment Guidebook: China*.

4) Focusing on being able to import raw materials duty free, many foreign enterprises are engaging in contract manufacturing trade with their own local subsidiaries established in China. The local subsidiary imports raw materials, for which it pays externally in a foreign currency. The processed finished and semi-finished products are then exported outside the country, and payment received for their export. The added-profit trade undertaken by foreign enterprises consists mostly of materials-purchased processing. Where the products made by this method are intermediate goods, they are often sold to domestic Chinese enterprises under an arrangement unique to South China whereby they are allowed to be sold to domestic enterprises on the assumption that they will ultimately be exported.

Fig. 2-2-9 Likely targets for establishment of operations in medium term (next three years or so)

China tops the list, followed by India, Thailand, and Vietnam



Source: JBIC, *Fiscal 2005 Questionnaire Survey of Foreign Direct Investment*.

Note: Valid responses were received from 483 companies. Multiple responses were allowed.

proliferation of Japanese automakers in recent years has led to the rapid growth of clusters of auto parts manufacturers.

4) Central West Economic Zone

Although the provinces of Chongqing and Sichuan are late developers, an increasing number of Japanese enterprises are choosing to locate production operations there attracted by the Chinese government's foreign investment lures and lower labor costs. While

Chongqing is known for its concentration of motorcycle manufacturers, investments by leading Japanese automakers have also led to the formation of growing clusters of auto parts makers in recent years.

The movement in the focus of overseas investment by Japanese manufacturers from the NIEs to ASEAN and then to China is increasingly being reconsidered by enterprises. While China undoubtedly remains a promising place in which to establish an overseas presence, various problems have also arisen there, including energy problems such as power shortages, shortages of human resources in certain occupations, and soaring labor costs. Rising anti-Japanese sentiment is also a concern, and as a result of these factors, enterprises are starting to correct their excessive concentration on China.

As a site for production operations, China's cost advantage purely in terms of production costs is fading as labor costs continue to escalate, while those in ASEAN economies such as Thailand have already stabilized. In terms of market size, however, purchasing power in China is increasing alongside rising labor costs, making it increasingly attractive as a major market in comparison with ASEAN countries.

The purpose of investment in China is therefore shifting from the establishment of a base to serve the Japanese and world markets as in the past, to the establishment of production operations nearer to the target market, as occurred in the case of investment in North America in the 1980s, and there is at the same time emerging a growing recognition of ASEAN countries, such as Thailand and the emerging Vietnamese economy, in the role of supply centers as counterweights to the risk of over-investing in China (Fig. 2-2-9).⁵⁾ While there remain a number of problems

Case 2-2-3

Vietnam moves into the limelight as a new target for investment

Sakurai Ltd. is an auto parts processor and machine tool manufacture based in Shizuoka Prefecture, with 202 employees and capital of ¥200.7 million. Seeing Japanese manufacturers flock to Asia in the 1990s, it soon began considering establishing a presence in Asia, either in Thailand or Indonesia but temporarily abandoned the idea following the Asian crisis in 1997. From the beginning of the 2000s, it focused its attention on Vietnam, and attracted by the establishment of operations in the country by one of its key customers, the good law and order situation, and above all the rich, cheap supply of comparatively high-quality labor, it decided to invest there in 2002. As it built its plant on an industrial estate run with the involvement of a top Japanese trading company, it was able to obtain the assistance of this company with various tasks, starting with the acquisition of approval from the authorities.

The functions of the Vietnamese plant are

basically the same as the company's plant in Japan. Regarding orders received by head office in Japan, the Vietnamese plant is intended to handle processing work that can be performed more economically in Vietnam, and it also has the function of "building systems of cooperation." Sakurai also plans to use its Vietnamese operations as a supply hub for ASEAN (Thailand) and China. The plant in Hanoi is located just 850 kilometers or so from South China's auto industry hub in Guangzhou, making transportation by land perfectly feasible.

Due to the relatively underdeveloped state of its supporting industries in Vietnam, raw materials such as the high-quality steel used for bearings are rather difficult to source locally. If Vietnam's secondary industry is to grow further in the future, its supporting industries must be developed. Thanks to the hard-working nature of the Vietnamese people and their similar mentality to the Japanese, however, the prospects for future growth are good.

5) According to the *Questionnaire Survey on Foreign Direct Investment* conducted annually by the Japan Bank for International Cooperation (JBIC) since 1989. This survey covers more middle-tier and large enterprises than SMEs.

with the business environment in Vietnam, including the lack of infrastructure and low degree of industrial clustering, labor costs are still much lower than in China, and the industriousness of Vietnamese workers is widely recognized (see Case 2-2-3). There is also strong interest in India's potential, which, like China, possesses a vast market and rich reserves of labor. Although the number

of large enterprises investing in India is gradually increasing, infrastructure issues and the distance from Japan mean that investment in the country by manufacturing SMEs has yet to really get underway. In the future, METI plans to support investment by SMEs in India in cooperation with the Indian government by such means as promoting business matches.⁶⁾

Section 4 Economic effects of international expansion and international division of labor

1. Expansion of marketing outlets due to access to overseas markets and knock-on effect on domestic business

What economic impact does establishing operations overseas have on an enterprise? Firstly, not only does having overseas production operations open up overseas markets, but it also leads to an increase in the sales of the Japanese parent company itself. Establishing an overseas presence increases an enterprise's recognition and access to enterprises considering investing in the same region in the future, while having overseas production operations acts as a major selling point for an enterprise, leading to an increase

in interest from new customers within Japan. The acquisition of new customers by overseas operations can also have a knock-on effect on an enterprise's business dealings within Japan. This topic is considered in detail in the next section (Section 5 The trade environment in East Asia).

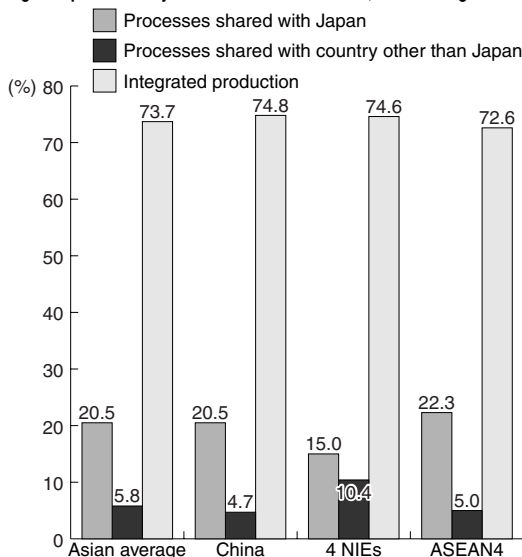
2. Relationship between domestic and overseas operations

(1) Improvement of efficiency due to sharing of functions between Japanese parent company and overseas subsidiary

Enterprises seek to improve management efficiency by

Fig. 2-2-10 Main forms of manufacturing operation established in Asia

Integrated production systems account for over 70%, with little regional variation

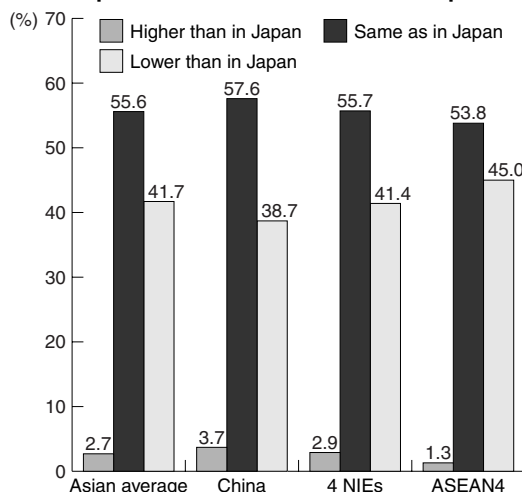


Source: Recompiled from METI, *34th Basic Survey on Overseas Business Activities (2004)*.

- Notes:
1. Only manufacturing SMEs are included (i.e., operations where the parent company has capital of ¥300 million or less, or the overseas subsidiary has 300 or fewer regular workers).
 2. The Asian average includes the countries of East Asia and South Asia.

Fig. 2-2-11 Technological level of manufacturing operations in Asia

Vast majority of operations are technologically on a par with or inferior to those in Japan



Source: Recompiled from METI, *34th Basic Survey on Overseas Business Activities (2004)*.

- Notes:
1. Only manufacturing SMEs are included (i.e., operations where the parent company has capital of ¥300 million or less, or the overseas subsidiary has 300 or fewer regular workers).
 2. The Asian average includes the countries of East Asia and South Asia.

6) SMEs as well as large enterprises are being actively sought as exhibitors at the "International Technology Exhibition," a global exhibition of cutting-edge technology scheduled to be held in Delhi, India, in February 2007. Plans include provision for business matchmaking services.

sharing functions between their domestic and overseas operations. Among manufacturing SMEs with operations in Asia, roughly 20% engage in a division of labor by allocating processes between Japanese and overseas operations, and over 70% engage in integrated production in the host country (Fig. 2-2-10). Some, like the enterprise described in Case 2-2-4, set up large-scale integrated production systems enabling them to engage in quick delivery, high-quality mass production.

Regarding the technological level of their overseas operations, over 50% say that they are approximately on a par with Japan, and over 40% say that they are inferior (Fig. 2-2-11). In other words, enterprises can improve the efficiency of their operations as a whole by transferring simple assembly operations, low value-added products, and mass-produced items that can no longer be made cost effectively in Japan to areas of Asia

Case 2-2-4

Quick delivery, high-quality mass production made possible by establishment of integrated production system

Uchino Co., Ltd. is a company based in Tokyo with a workforce of 628 and capital of ¥240 million. It began life as a towel wholesaler, but now handles a wide range of other bathroom products, including bathrobes and bathmats. As it was originally a wholesaler that designed merchandise in-house and then contracted its production out to manufacturers in Japan, it did not have any know-how about production.

Expecting the yen to appreciate following the Plaza Accord in 1985, Uchino feared an influx of price-competitive products from abroad, prompting it to ask producers in Japan to which it outsourced production to consider establishing operations overseas. However, the time was not ready for gaining contractors' approval for such a plan. The company therefore resolved to go it alone, and in 1988 injected capital and technology into an existing towel factory in Thailand, thus creating its first joint venture, managed by the company, in Thailand. This enabled it to build up production know-how and knowledge about doing business overseas, and in 1993, deciding that it

wanted an independent plant, it established its own 72,000m² factory in Shanghai, China. Its local subsidiary is now a wholly-owned subsidiary of the Japanese parent, which has a workforce of 1,900 employees. While the Japanese market accounts for 90% of production, the company also began selling in the domestic Chinese market in 1997.

Towel production involves around 12 processes, and there are no enterprises in Japan that make towels from start to finish. The Shanghai plant, however, is equipped with the latest in production facilities in order to enable it to produce products on a par with, or even superior to, those made in Japan, and can handle the production of high value-added products from end to end, from spinning to finishing of end products. The advantages of integrated production are that the company can control quality and delivery times directly (which can otherwise create problems given the relative few contractors with a reliable reputation for quality and delivery times), and it can also reduce various indirect costs and so increase its cost competitiveness.

Case 2-2-5

Allocation of functions and diversification of risk between Chinese and ASEAN operations

Japan Precision Instrument Co. is a manufacturer of optical devices and medical equipment based in Gunma Prefecture, and has a workforce of 150 and capital of ¥268 million. Its first venture overseas occurred about 30 years ago, when it established a joint venture in Taiwan in which it had a 50% stake. (This company, called Taiwan Nissei, is now to all intents and purposes a separate company.) It subsequently established subsidiaries in Indonesia in 1997, and in Suzhou, China, in 1998. These make digital and analog blood pressure gauges: two thirds of digital gauges are made in Indonesia and one third in China, the analog gauges being made entirely in China. Specially designed products other than blood pressure gauges that have high markups but have to be made in small lots, such as cardiography equipment and pulse oximeters, are produced in Japan. As management authority has already been transferred to the Taiwanese subsidiary, meters that are not made by the parent company in Japan are made in Taiwan. Basically, a division of labor is employed whereby high-mix, small-volume, high-markup products are made in Japan, and mass-produced products are made in China and Indonesia. The finished products are destined

mainly for the U.S. and European markets as well as Japan, and the company has sales operations in the U.S. and Germany.

As the purpose of establishing operations in East Asia was to reduce costs, almost all parts and materials procured in China are procured from local enterprises and Taiwanese affiliates in order to improve cost savings. The operations in different countries collaborate; the key components for digital blood pressure gauges, for example, are made in China and exported to Indonesia. From an overall perspective, costs are lower in China than in Indonesia, but operations are maintained in Indonesia to cover for the risk of something happening in China.

As the worker turnover rate in China is high and labor management is difficult, the company feels high-caliber Chinese personnel and auxiliary Taiwanese, Hong Kong, and Korean human resources serve a useful role in managing the workforce. As regards human resource issues in Indonesia, few employees consider leaving the company or establishing their own businesses as in China, but there is a shortage of personnel suitable for middle-management positions.

where labor costs are lower, and concentrating its domestic facilities and personnel on higher value-added products, high-mix small-lot production, and R&D.

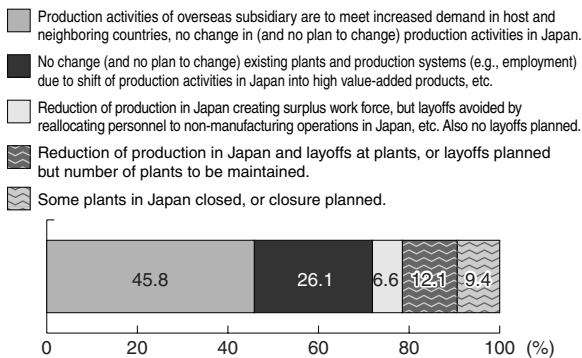
Many enterprises with multiple operations in more than one region overseas are also allocating functions and dispersing regional risk according to differences in technological operations between these operations (Case 2-2-5).

(2) Synergies between domestic and overseas operations

When an SME expands overseas, how do its overseas operations affect its domestic operations? Looking at this question in terms of the relationship between domestic production and overseas production (Fig. 2-2-12), we find

Fig. 2-2-12 Relationship between production activities overseas and in Japan

More than 70% plan to "maintain domestic production at present level" or "shift domestic production into higher value-added fields"



Source: Recompiled from METI, *34th Basic Survey on Overseas Business Activities (2004)*.

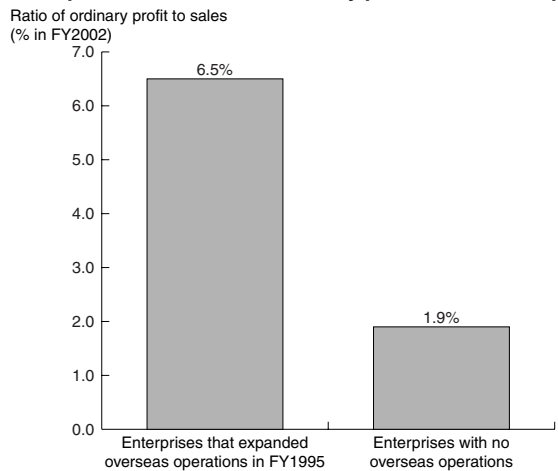
Note: Only manufacturing operations whose parent company in Japan has capital of ¥300 million or less or overseas subsidiary has 300 or fewer regular workers are included.

that approximately 45% of manufacturing SMEs with overseas subsidiaries reported “no change in domestic production activities” when they established operations overseas, and approximately 25% reported a “shift to higher value-added fields in Japan.” If those that said that they “reallocated personnel” are included, almost 80% of enterprises that established operations overseas efficiently maintained domestic production and raised productivity, creating a “win-win” situation (Case 2-2-6).

Next, we analyze the effect of establishing operations

Fig. 2-2-13 Impact of establishment of overseas operations on performance of operations in Japan

Enterprises with overseas operations are more likely to see an improvement in ratio of ordinary profit to sales in Japan



Source: Recompiled from METI, *Basic Survey of Japanese Business Structure and Activities*.

Notes: 1. Manufacturing SMEs with overseas operations (fiscal 1995) and without overseas operations (fiscal 1994-2002)
2. See Appended Note 2-2-1 regarding the estimation process.

Case 2-2-6

Establishment of overseas operations contributes to profits of company as a whole, including domestic operations

Meioh Plastics Molding Co., Ltd. specializes in making dies for precision plastic parts for cell phone and other equipment, and integral molding with metal parts. Based in Tokyo and with a workforce of 80 and capital of ¥30 million, it invested US\$3 million of capital in Shanghai in 2002 in anticipation of the growth of the Chinese market. The company’s business consists mainly of molding and processing work using dies, but it also makes die-insert molding machines. The actual die-making process is outsourced, while the company specializes in the core technologies, from die design to integration of dies and their trial manufacture and assessment.

In China, too, where local procurement of dies is considered to be difficult, the company has succeeded in outsourcing die making by putting considerable effort into finding dependable contractors and establishing the following series of processes:

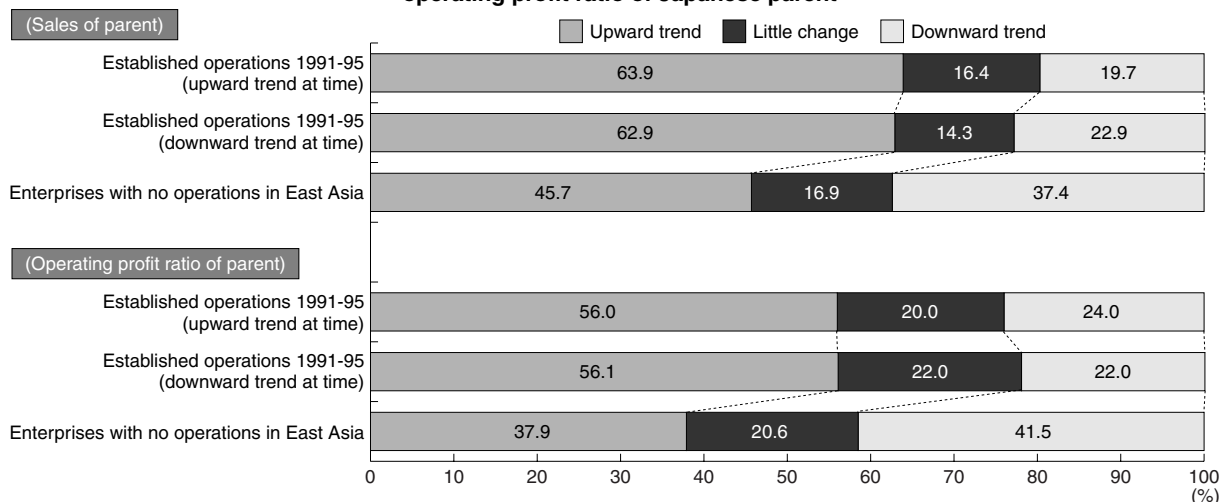
Design of die from customer’s drawings → Design of plans for each part → outsourcing to local die makers → delivery to plant → assembly → manufacture of parts or sale of die

The company has succeeded in finding five contractors for outsourcing, and now makes all dies ordered in Japan in Shanghai – it feels that their quality is at least as good as, and in some cases better than, that of its contractors in Japan.

Meioh’s experience has shown it that establishing operations overseas certainly does not lead to a downsizing of domestic operations, but instead leads to domestic growth as well, resulting in a truly “win-win” relationship. For example, its presence in China opened the way to doing business with European enterprises in the country. Being able to provide technologies and capabilities identical to those in Japan to European and North American enterprises that had formerly had to shop for such technologies in Japan due to their unavailability in China acts as a major business advantage. The three young employees sent to China to launch the business also turned out to be outstanding workers, and the success of the Chinese venture has acted as a stimulus upon the company’s employees in Japan, consequently raising production efficiency at its Japanese plant.

Fig. 2-2-14 Relationship to performance of Japanese parent after establishment of overseas operations (most recent 10 years)

Enterprises that established operations in East Asia in the early 1990s see a positive impact on sales and operating profit ratio of Japanese parent



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

Note: Enterprises that first established operations in East Asia between 1991 and 1995 were grouped into those whose sales and ordinary profits at the time were following an “upward trend” or “downward trend (including little change).” Trends in the sales and ordinary profit ratios of these enterprises over the last 10 years (1996-2005) were then calculated, and these compared with trends among enterprises without operations in East Asia.

overseas on the performance of SMEs using individual data from the *Basic Survey of Japanese Business Structure and Activities*. Fig. 2-2-13 depicts an analysis of the impact of establishing overseas operations on the domestic performance of SMEs that invested overseas in fiscal 1995.⁷⁾ A hypothetical enterprise was assumed described by the medians for ordinary profit to sales (ordinary profit / sales), enterprise size, enterprise age, and ratio of tangible fixed assets to total assets of the entire sample in the year before establishment of overseas operations (fiscal 1994), and the ratio of ordinary profit to sales in fiscal 2002 was simulated according to whether or not the enterprise established operations overseas. In order to avoid the conclusion that “enterprises that establish operations overseas have superior management capabilities to start with, and so would perform better regardless of whether or not they actually established operations overseas,” the estimation process was modified in order to measure the net effect of establishing operations overseas. The results of the simulation indicated that the ratio of ordinary profit to sales seven years after establishing operations in fiscal 1995 would be 6.5%, while that of establishments that did not expand overseas would be only 1.9%. It may be surmised from this that enterprises that establish operations overseas experience a major increase in the profitability of their domestic operations.

A comparison of the domestic performance of SMEs that established operations in East Asia at the beginning of the 1990s and those that did not according to the results of a questionnaire survey (Fig. 2-2-14) likewise indicates that overseas investment has a positive impact on business, with a large proportion of enterprises whose performance was stagnating or deteriorating experiencing an upturn in the sales or operating profit ratio of the parent company.

7) For details of the method of analysis, see Appended Note 2-2-1.

Results such as these indicate that successfully situating operations in the optimal locations through investment overseas and the allocation of functions between the parent company and its overseas operations contributes to company-wide improvements in efficiency, and also the acquisition of new customers as observed in 1. above.

International expansion thus leads to domestic operations becoming more sophisticated and shifting into higher value-added fields, thereby helping to raise the total factor productivity of Japanese manufacturing.

3. Impact of development of human resources on corporate management

The establishment of operations overseas by SMEs also often generates advantages in terms of the development of human resources. Having overseas subsidiaries not only raises employees’ awareness of internationalization; in many cases, it also contributes to the career development of an enterprise’s future executives by giving employees sent overseas the opportunity to confront various challenges and gain in the process firsthand experience of globalization and the supervision and direction of large numbers of subordinates, which they would not normally have the opportunity to do in Japan. At SMEs in particular, the dispatch of the proprietor’s son or other potential successor to head an overseas subsidiary can develop and secure a successor who feels confident in an international business environment. Regardless of whether or not they establish operations overseas, there is now no avoiding the effects of global competition, and it is vital that enterprises raise international awareness among their employees as well as successors.

Section 5 The trade environment in East Asia

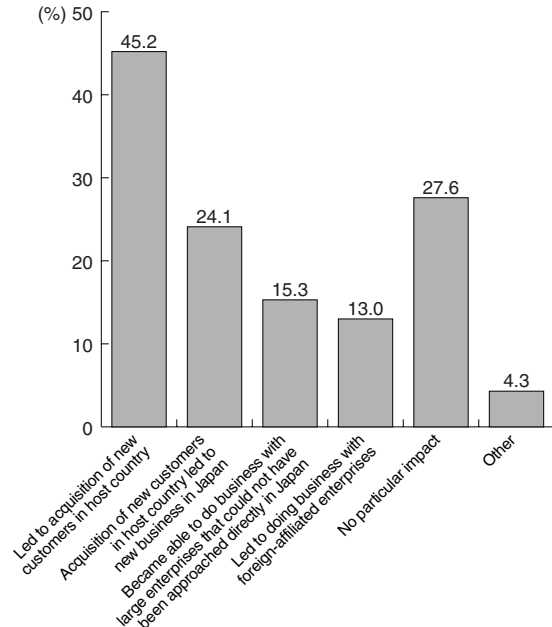
1. Business relations affecting the receipt of orders

As has been noted in preceding sections, one characteristic of business relations in East Asia is the prevalence of relationships that enterprises have not traditionally been able to form within Japan.

According to Fig. 2-2-15, over 40% of contractors said that establishing operations overseas “led to acquisition of new customers in host country.” Additionally, more than 20% of enterprises said that “acquisition of new customers in host country led to new business in Japan,” demonstrating that, as observed above, it is not unusual for entry into overseas markets to have a positive impact on an enterprise’s domestic operations. It can also be seen that enterprises that were second or third-tier subcontractors in Japan in some cases found that their overseas presence enabled them to do business with large enterprises that they could not have approached directly in Japan, or led to their doing business with third-country enterprises.

Regarding how contractors acquired new customers in their host countries (Fig. 2-2-16), the commonest method was “own direct business activities,” followed by “introduction and recommendation by business partners.” Although this is basically the same as in Japan, it is apparent that participation in trade fairs,

Fig. 2-2-15 Impact on receipt of orders
Effects include new customers in host country, expansion of business in Japan, and direct dealings with large enterprises

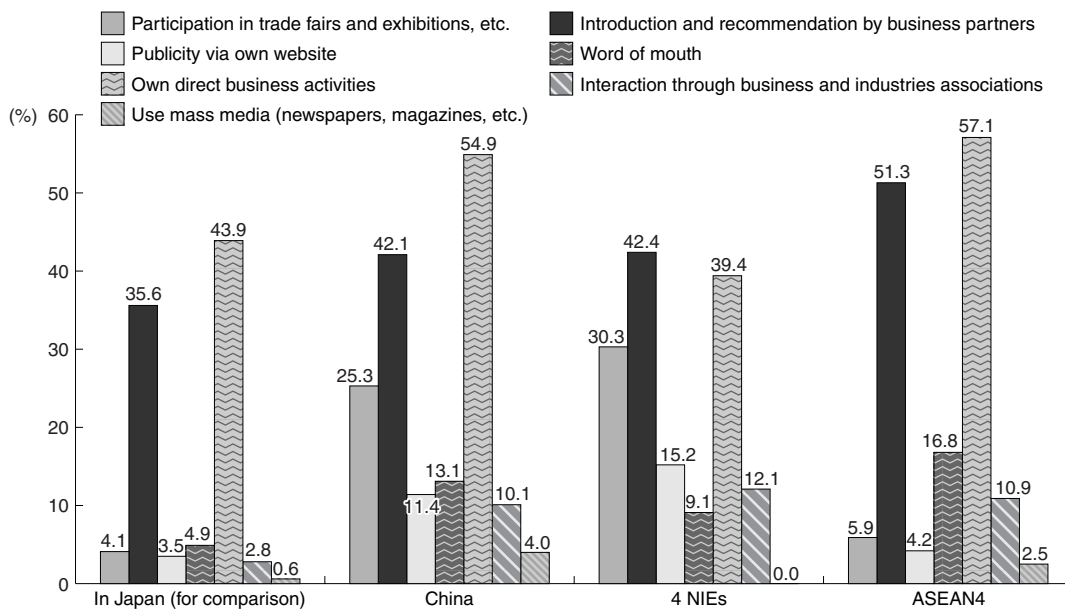


Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

Note: Multiple responses allowed.

Fig. 2-2-16 Methods of acquiring new customers in host country (by region)

Increase in importance of non-face-to-face means, such as trade fairs, word of mouth, and business associations, in overseas operations



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

Note: Multiple responses allowed.

exhibitions, and similar events has an important impact in the NIEs and China. “Word of mouth” and “exchanges through business and industry associations” also play a proportionately greater role than in Japan. Japanese enterprises overseas thus commonly gain new

customers through networks of business contacts and other Japanese individuals in the host country, and, as in Case 2-2-7, having operations overseas frequently makes a positive contribution to an enterprise’s sales activities.

Case 2-2-7

Enterprise grows sales in Japan and overseas through expansion overseas

Osaka Welding Industrial Co., Ltd. is a spray and surface processor and precision equipment processor based in Osaka Prefecture, and has a workforce of 70 employees and capital of ¥30 million. It established a presence voluntarily in Shanghai in 2001 with the aim not only of reducing costs, but also of acquiring more customers overseas and tapping into latent demand in the Chinese market. As it had no definite customers in China immediately after establishing a venture there, it sought to drum up business in Japan. It began by focusing on the unique advantages accruing from having a presence in China, such as being able to use its distinctive surface reforming technology while at the same time reducing costs by using China as a base to bulk produce sophisticated parts involving numerous processes, which cannot easily be produced more cheaply in Japan, and 10 months after entering operation, the venture went into the black.

Functions are presently divided up between the Japanese and Chinese operations as follows. Production of high-mix, small-lot products and development of new technologies and applications are undertaken in Japan, while the Chinese side handles everything from mass production to high-mix, small-lot production (as in Japan) for the domestic

Chinese market, and also exports to Japan to meet orders of at least a certain size. The Japanese and Chinese operations basically have the same capabilities, and the decision on where to make products is made according to volume and price range.

The Japanese and Chinese plants generate synergies. When doing business in Japan, the company found that having operations in China led to discussion of local procurement of supplies on a par with those available in Japan, and inquiries from Japanese enterprises that themselves had operations in China. This led in turn to more referrals, and more and more customers. Establishing a plant in China also had a positive impact on existing customers in that the company was consequently able to supply cheaper products to them. Presently, earnings are growing on the Japanese side as well as in China.

Regarding how it has dealt with risk, the company only sells to companies that it can really trust due to the problem of obtaining payment from local enterprises, and it also collects payment immediately after delivery (or even in advance in some cases). The company is in addition careful about how it allocates human resources in order to prevent technology leaks.

2. Local procurement environment

An important business challenge faced by many Japanese enterprises that expand into East Asia is how to raise the proportion of local procurement in order to meet stiff demands for lower costs. In recent years, the improving infrastructure in East Asia, establishment of operations in the region by large numbers of Japanese manufacturing SMEs, and rising level of local enterprises due, among other things, to technology transfers from Japanese affiliates have enabled large enterprises at least to steadily increase their local procurement ratios. Given their limited business resources, however, it is not easy for Japanese manufacturing SMEs that have established operations overseas to raise their local procurement ratios.

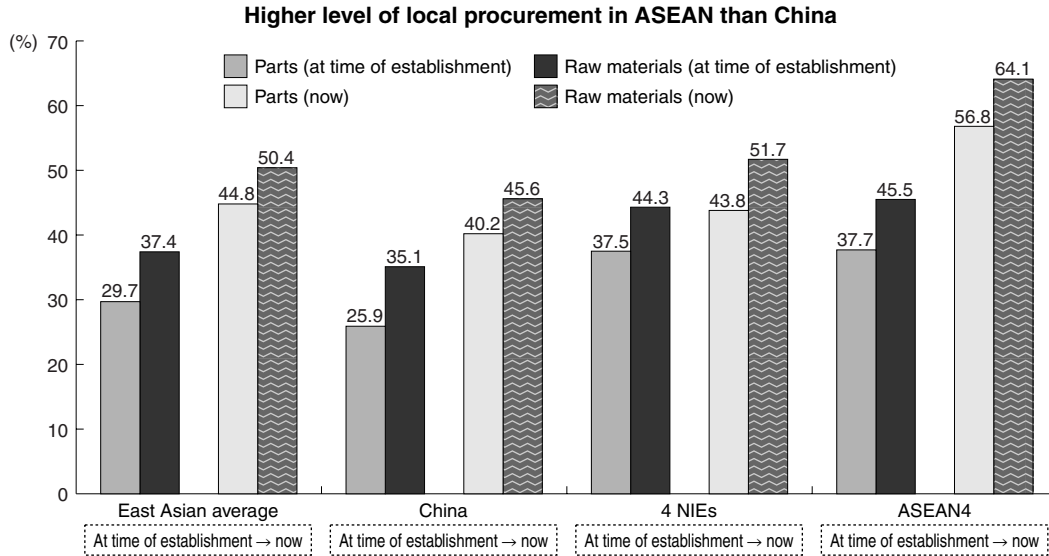
Looking at the state of local procurement of parts and raw materials in East Asia shown in Fig. 2-2-17, it can be seen that manufacturing SMEs, too, have steadily procured more locally compared with when they established their operations. Regionally, local procurement ratios are noticeably higher in the ASEAN4 than in China.

From Fig. 2-2-18, which shows trends in local procurement according to the purpose of establishing overseas operations, it is evident that the local procurement ratio is higher in the case of enterprises that established operations overseas in response to a customer’s request. Considering the regional breakdown of enterprises’ reasons for establishing operations overseas shown in Fig. 2-2-6, the high local procurement ratio in ASEAN, where many enterprises established a presence at the request of customers, makes sense. This is likely due to the fact that when enterprises expand overseas at a customer’s request, the procurement and manufacturing process from procurement to delivery has often already been predetermined according to the wishes of the customer concerned.

The parts that are successfully procured locally tend mainly to be standard and general-purpose products (Fig. 2-2-19), and custom-made goods with complex designs and requiring special technologies often have to be sourced from Japan.

Regarding the relationship between the ratio of production in East Asia and local procurement ratio in different industries (Fig. 2-2-20), the increasing shift in

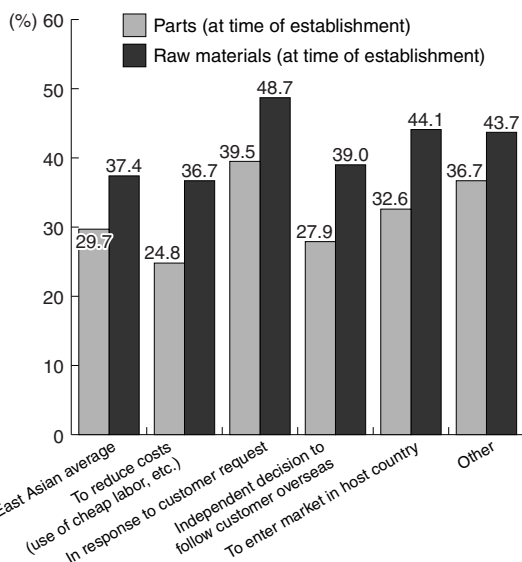
Fig. 2-2-17 State of local procurement of parts and raw materials in East Asia (at time of establishment of operations and now)



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

Fig. 2-2-18 Trends in local procurement by type of overseas presence

Better conditions for local procurement when overseas operations established in response to request by customers



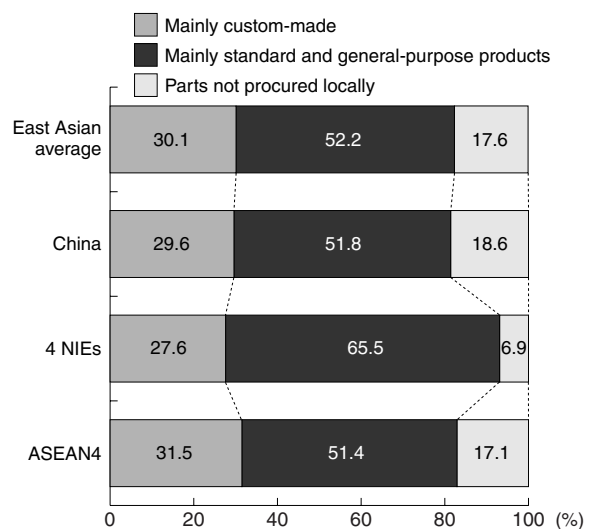
Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

production to East Asia in fields such as “electronic components and devices,” “information and communications equipment,” and “electrical equipment” is being accompanied by growing local procurement against the background of growing use of module production systems. In the precision/medical equipment field, however, which requires delicate parts, the proportion of parts procured from Japan is high.

Growing numbers of enterprises are doing business

Fig. 2-2-19 Characteristics of parts procured locally in East Asia

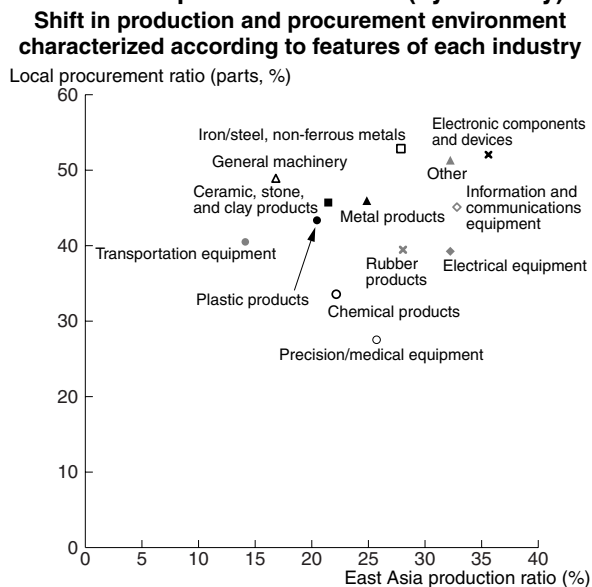
Local procurement of standardized and general-purpose products is more advanced



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

with local enterprises in order to procure cheaper parts and raw materials. However, the evidence indicates that satisfaction with local enterprises is somewhat on the low side (Fig. 2-2-21). Asked their reasons for being “somewhat dissatisfied” or “dissatisfied,” the commonest responses included “stability of quality,” “reliable observance of delivery deadlines,” “quality of products and processing,” and “ability to cater to quick deliveries,” indicating concern about quality and delivery times (Fig. 2-2-22). With large Japanese enterprises that have

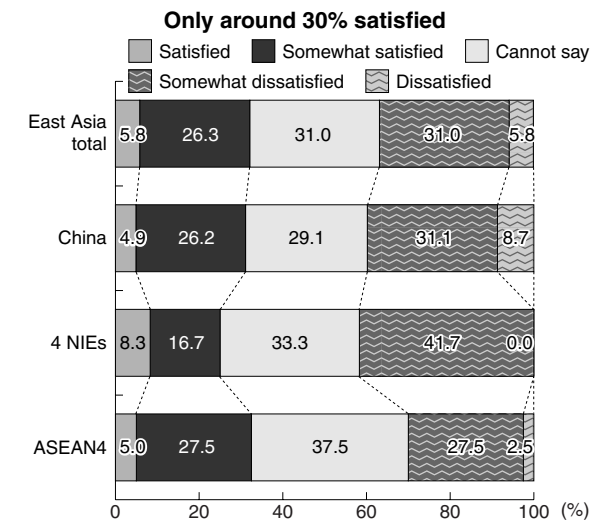
Fig. 2-2-20 Relationship between ratio of production in East Asia and local procurement ratio (by industry)



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

operations in China and elsewhere advocating 100% local procurement, the Japanese manufacturing SMEs that assist them by supplying them with parts are trying to do business with local enterprises so as to cut material costs by at least a little, but seem to be running into difficulties obtaining materials of uniform quality, forcing them to

Fig. 2-2-21 Satisfaction with dealings with local subcontractors



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

import expensive materials from Japan (see Case 2-2-8).

Regarding the production technologies of parts that are difficult to procure locally and are procured from sources in Japan, a breakdown according to type of final product (Fig. 2-2-23) shows “die making,” which requires skill, experience, and ingenuity, to be cited by a high proportion of respondents in almost all categories; the proportion is especially high in the case of automobiles, which requires particularly sophisticated

Case 2-2-8

The difficulties of local procurement

Company B is an Aichi-based casting manufacturer with 70 employees and capital of ¥96 million that established a wholly-owned subsidiary in Dalian, China, in 1991. This makes water valves, hydrants, and joints to order. The casting industry was one of the first in Japan to be considered a “3K industry”—i.e., *kitanai* (dirty), *kiken* (dangerous), and *kitsui* (hard). This, combined with environmental factors, makes it difficult to expand production capacity and recruit employees, as a consequence of which the company decided to invest in China. The problems that it ran into in the process concerned plant construction, and included work not proceeding as contracted, the prices of construction materials being raised, work being interrupted, and difficulties receiving electricity.

The Chinese venture presently makes more joints than valves, and orders are received from Japanese set makers. Regarding the division of roles between Japan and China, large orders are met by the Chinese subsidiary, while small orders and the production of prototypes are handled by the Japanese parent. As the parent company’s production systems have reached their limits and offer no further scope for reductions in unit manufacturing costs, for example, products ordered in large lots or on a continuing

basis are manufactured by the Chinese subsidiary. For 15 years since its establishment, employees have become more skilled, and are now trusted by the Japanese side.

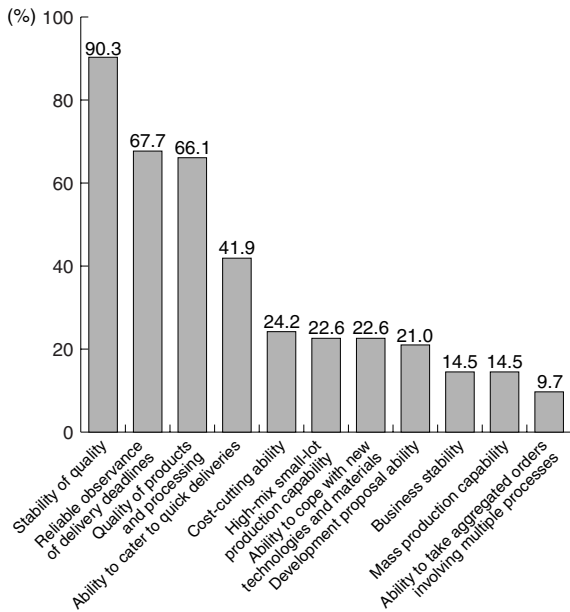
The reason why output is not sold domestically in China is that on the Chinese market, where there tends to be preference for low-cost rather than high-quality products, they would not anyway be price competitive, product standards differ, and collection payment can be difficult.

Local procurement of raw materials has not progressed as much as had been expected due to problems with quality and supply stability. Local procurement represents 10-15% of the product price at most, with the rest being accounted for by materials imported from Japan. Because of the difficulty of obtaining low-priced raw materials that meet JIS standards in China, the copper that is the principal raw material also has to be imported. If a single screw were to fail, all products containing the same part would have to be recalled from the end user, which would be enormously expensive. Because of the consequently huge risk, therefore, the company feels that it is better to procure stable supplies from Japan.

parts. Put the other way around, one might say that these difficulties with the local procurement environment are also an indication of the high regard in which Japanese enterprises have traditionally been held, and highlight the fields in which Japanese SMEs are at a competitive advantage in the global marketplace.

Fig. 2-2-22 Points of dissatisfaction with East Asian subcontractors

Japanese affiliates' areas of competitive advantage apparent from dissatisfaction with local enterprises

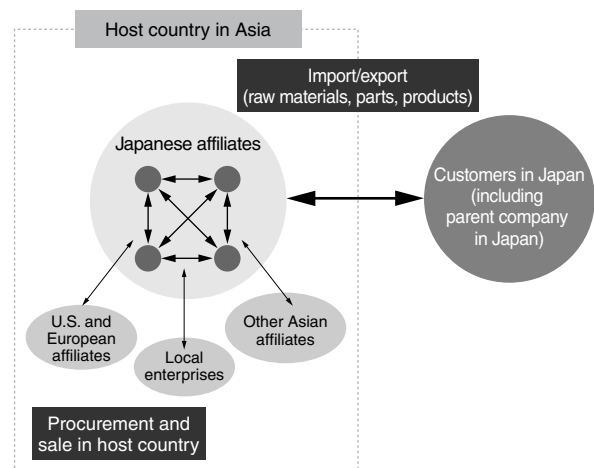


Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).
 Note: Multiple responses allowed.

As observed in 1. and 2., there form in the East Asian market complex networks involving not only interaction between the parent companies and existing customers back in Japan as in the past, but also dealings between Japanese enterprises untrammelled by their business affiliations in Japan, and transactions with enterprises from around the world (Fig. 2-2-24). Strengthening business relations overseas with non-Japanese enterprises—both as sources of procurement and customers—in host country markets will grow increasingly important according to the state of development of these markets in the future.

Fig. 2-2-24 Trade environment facing Japanese enterprises in Asia

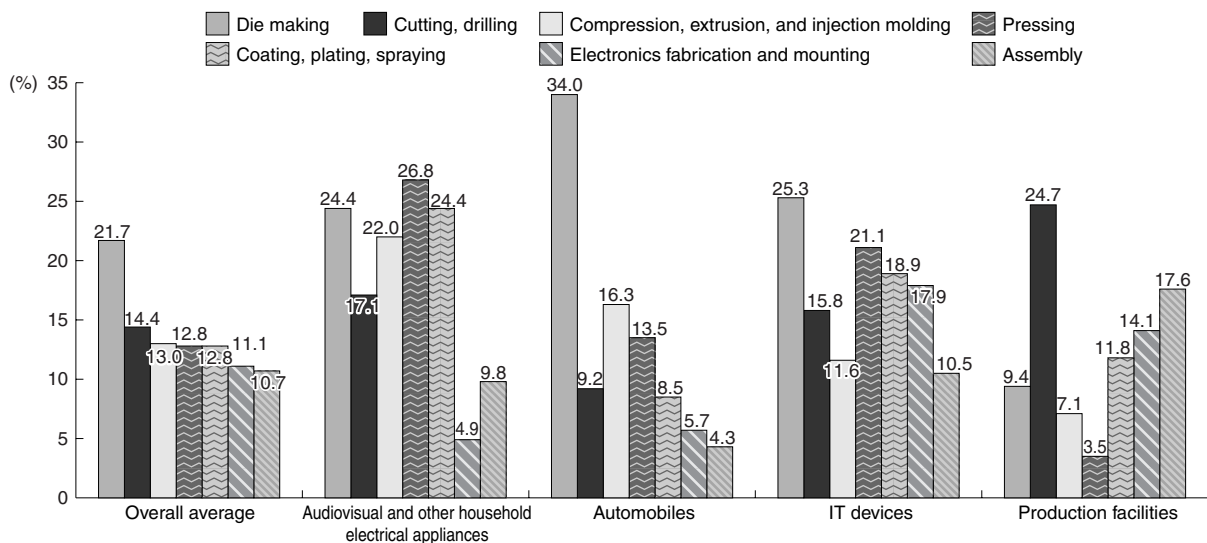
Growth in importance in the future of doing more business in the host country with non-Japanese affiliates as well



Source: SME Agency.

Fig. 2-2-23 Top seven manufacturing technologies of parts sourced from Japan (by category of final product)

Characteristics vary according to product, but local procurement of dies tends to be difficult in all categories



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).
 Note: Multiple responses allowed.

Case 2-2-9

Establishment of NC Network China to support Japanese manufacturing SMEs in the Chinese market

NC Network Co., Ltd., based in Tokyo and with 25 employees and capital of ¥442 million, began as a consortium established in 1997 by nine SMEs involved in the production of metal presses, springs, dies, sheet metal, and so on in order to take orders jointly for its members. The consortium has established a virtual online factory and set up a business-to-business matching site targeted at manufacturing SMEs in order to publicize what the member companies can do for each other, resulting in the formation of various business ties between them, including receipt and placement of orders for trial products. The consortium's membership has now grown to 13,000 companies in Japan, including a considerable number that have operations in China. With international networks in manufacturing expanding, the consortium moved into Shanghai, China, in 2003 with the launch of "NC Network China" with the aim of building a "global platform for partnerships."

NC Network China's main functions are fourfold: 1) to run a business matching site especially for manufacturers, 2) to publish information and encourage exchanges through its magazine, entitled *Emidas*, 3) to provide a venue for business matching (hosting of business conventions), and 4) individual surveys and accompanied visits to plants. Around 2,500 companies are site members, including Chinese, Taiwanese, and Hong Kong enterprises as well as Japanese ones. 400-500 Japanese affiliates in

China (about 15% of the total) and approximately 2,000 Chinese or other enterprises are registered in the database, and the company has information on around 5,000 companies in total. Regarding its third function, NC Network China arranges business conventions for members and co-hosts business conventions sponsored jointly by regional banks. The trend toward localization of overseas operations having made local procurement a key issue, NC Network China aims to provide a forum for contact between enterprises (between Japanese affiliates and between Japanese affiliates and non-Japanese affiliates) and contribute to the expansion of the trade environment in the host country. Regarding its fourth function, the venture conducts market research, surveys of competitors, and surveys of individual enterprises, and arranges plant visits at the request of enterprises considering investing in China in order to provide them with the data that enable them to make informed investment decisions.

SMEs that were in a second or third-tier subcontracting relationship with large enterprises in Japan are also able to do business directly with large enterprises, and these relations formed in China sometimes lead back to direct business relations with large enterprises in Japan, and one of NC Network's aims is to show SMEs that have been reluctant to invest abroad the business potential of doing so and to assist their expansion into China.

Section 6 The risks of doing business overseas

Doing business in an unfamiliar overseas environment brings with it various difficulties and risks. Given SMEs' particularly limited business resources, a single problem can often threaten their continuation in business. Below we examine the problems encountered by SMEs in East Asia, and solutions to them.

1. Characteristics according to region and purpose of establishment of operations overseas

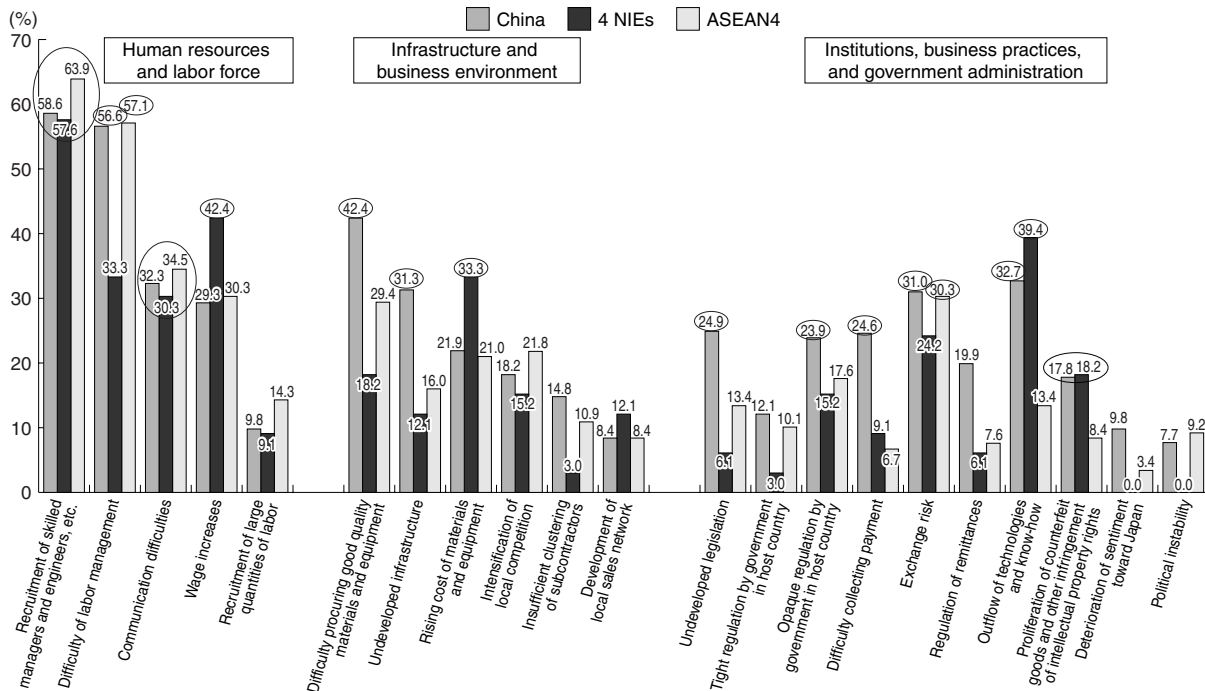
Fig. 2-2-25 depicts a breakdown of the perceived problems associated with doing business in East Asia broken according to region (China, the four NIEs, and the ASEAN4). Looking firstly at "human resources and labor force," human resource management problems such as "recruitment of skilled managers and engineers, etc.," "difficulty of labor management," and "communication difficulties" are frequently identified in almost all regions. In the NIEs, where rising living standards have pushed up wages, the proportion citing this problem is relatively higher. However, fairly high proportions cite

"wage increases" as a problem in China and ASEAN as well, suggesting that investments motivated solely by the aim of cutting labor costs are near their limit.

Regarding "infrastructure and business environment," the proportion of enterprises citing "difficulty procuring good quality materials and equipment" as a problem is high in China, but not particularly so in the NIEs. A similar trend is apparent in the case of "undeveloped infrastructure" and "insufficient clustering of subcontractors." (As "undeveloped infrastructure" also includes power shortages, this is in part a reflection of the recent emergence of such shortages as a problem in China.) In the NIEs, where price levels are high, a higher proportion of enterprises identified "rising cost of materials and equipment" as a problem compared with other regions.

Regarding "institutions, business practices, and government administration," most items are cited as problems by a higher proportion of enterprises than in other regions, and the problems regarding "difficulty collecting payment," "undeveloped legislation," and "opaque regulation by government in host country" are

Fig. 2-2-25 Perceived problems regarding business in host country (by region)
 Perceived problems vary according to region, but China scores high in all categories



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).
 Note: Multiple responses allowed.

vivid evidence of China’s unique business practices and business environment, and a major reason why doing business in China is considered to be difficult.

As their technological strength is one of the things that gives Japanese SMEs their edge, “leaks of technologies and know-how” and “proliferation of counterfeit goods and other infringements of intellectual property rights” are also issues that cannot be ignored, and, among the NIEs, are cited by large proportions of enterprises in Taiwan and Korea as well as in China.

Owing to the revaluation of the yuan in July 2005, speculation about further revaluations in the future, and bitter memories of the Asian currency crisis in the past, the proportion of enterprises citing “exchange risk” was also relatively high in all regions.

Fig. 2-2-26 shows a breakdown of the same items but according to purpose of establishment of operations overseas instead of region, and this reveals some differences according to business model due to differences in the areas of competitive advantage and markets targeted in each case.

Regarding “human resources and labor force,” for example, enterprises that establish operations overseas in order to cut costs generally pursue a model of employing large numbers of works to mass-produce products for export to Japan, and are consequently sensitive to “recruitment of large quantities of labor” as an issue. On the other hand, they are relatively less likely than enterprises

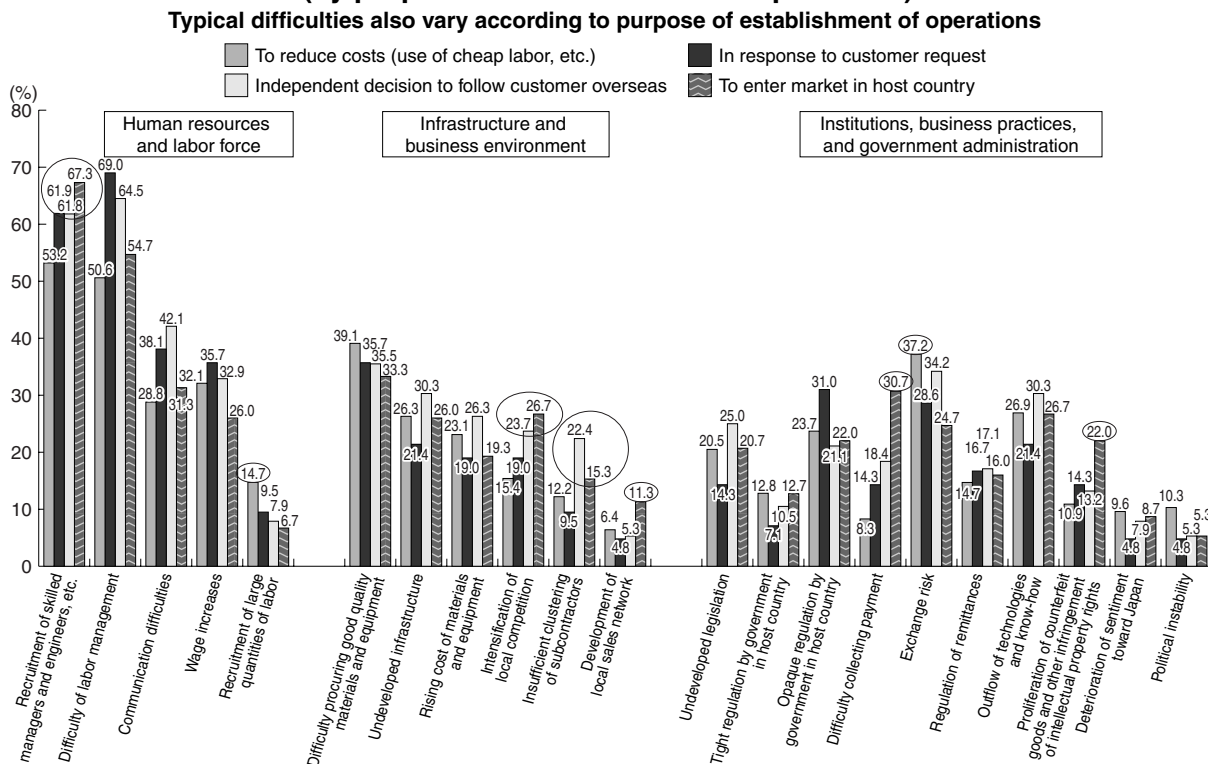
that expand overseas for other reasons to encounter problems regarding the quality of their labor force.

Regarding “infrastructure and business environment,” enterprises that are more interested in tapping into local markets or that voluntarily establish operations overseas rely more on open business relations rather than doing business with existing customers, making them relatively more likely to find that “intensification of local competition,” “extent of clustering of subcontractors,” “development of local sales network,” and similar issues present problems.

Regarding “institutions, business practices, and government administration,” involvement in the local market is typically lowest among enterprises that established operations overseas in response to a customer’s request, higher at those that chose independently to follow a customer overseas, and higher still at those that did so in order to tap into the host market, and the proportion of enterprises that encounter problems with collection of payment and proliferation of counterfeit products follows a similar progression. Also apparent is that the establishment of operations overseas in order to reduce costs, which is the type of investment that is most sensitive to cost trends, is also sensitive to exchange risk.

With these characteristics in mind, we examine trends concerning several problems in turn, illustrating each problem with reference to actual cases.

Fig. 2-2-26 Perceived problems regarding business in host country (by purpose of establishment of operations)



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

Note: Multiple responses allowed.

2. Trends regarding various risk factors

(1) Local business management systems

Regarding the problem of human resource management identified as a problem by enterprises in all regions, the problem in China and ASEAN is the high turnover of labor. Utterly unlike employment practices in Japan, just slight differences in wages can cause people in these regions to change jobs, and so employees are frequently lost to other companies after going to the trouble of hiring and training them. Due also to the prevalence of this form of short-term employment, along with variations in education levels and the short history of industrial development in these regions, it is difficult to train and hire local people who can be expected to fulfill their functions as executives and core engineers.

In order to somehow remedy this situation, many enterprises try to motivate their employees by, for example, paying higher salaries and sending workers who perform better to Japan for short-term training in order to encourage them to stay with their employers for longer. The existence of problems specific to certain regions also needs to be noted. In China, for example, there exists a strong sense of rivalry according to where one is from, while in Malaysia and Indonesia, there are complex ethnic mixes and differences in living standards between ethnic Chinese and local people.

Regarding management personnel, permanent staff are often sent over from the parent company in Japan to act as business managers and provide technical guidance. At the initial startup stage, several full-time Japanese staff are often needed. Having a high proportion of Japanese pushes up the cost of stationing staff overseas, including personnel expenses, and so there is a recognition of the importance of developing local human resources as soon as possible in order to localize management. As the development of local markets and management of local workers also tends to go more smoothly if handled by local people, a key concern is how to identify and train reliable local human resources and use them in management. Human resources who studied in Japan and have a good command of Japanese and understanding of Japanese business, human resources with experience of working at other Japanese enterprises, and contacts with government local figures who have connections to local government officials often have a major effect (see Case 2-2-10).

Case 2-2-10

Modification of business management and technology transfers

Takeuchi Kogyo Co., Ltd. is a manufacturer and distributor of cosmetic containers based in Tokyo, with 100 employees and capital of ¥16 million, and it voluntarily established a presence in Tianjin, China, where there are many enterprises in similar lines of businesses and labor costs are low, in 1993 in response to customer calls for lower costs and to follow customers that had themselves established operations in China. Also underlying the decision to invest in China was the abolition in 1992 of export requirements on wholly-owned affiliates of foreign enterprises (requiring that 80% of output be exported) and the connections between the local government and a customer that had established a joint venture in Tianjin.

A division of labor is achieved between operations in the two countries by allocating different processes to each. Sales activities and the development of technologies are basically all performed in Japan, while all processes once product plans have been handed over are handled in China. A little over a decade since the launch of its operations in China, the company has achieved some success in training skilled local engineers, and the venture is acquiring the capability to produce high valued-added high-mix, small-lot products as well as mass-produced low-end products. Raw materials are therefore largely procured locally. Due to the wide variation in the

quality of locally produced materials, however, Japanese raw materials are used for products that have to be of high quality.

Roughly 20% of the operation's sales are to Japanese affiliates in China, and the remaining 80% is exported to Japan. Although until recently the company targeted existing companies, it is now considering developing sales to North American and European enterprises with manufacturing plants in China, and it has already begun doing business with them on an albeit small scale. Takeuchi Kogyo believes that this would not have been an option had it not been for its overseas subsidiary.

The general manager is a Chinese man in his mid-thirties who once went to Japan as an overseas student on a government scholarship. He and the president of Takeuchi Kogyo became acquainted eight years ago, by which turn of fate this talented individual began working for the company. Because of the high turnover rate in China, the company has tweaked its labor management system to give employees an incentive to remain by selecting from between four to eight local employees for training in Japan lasting around 10 to 14 days. Employees all work hard so as to be chosen for training, and when they return from their training they have a greater understanding of Japan as a country and of the subject of product quality.

(2) Opaque implementation of legislation and negotiations with local authorities

Doing business in an unfamiliar overseas environment, enterprises often run into unexpected legal regulations or become confused in negotiations with governments. Enterprises also sometimes end up in wrangles with the authorities regarding interpretations of taxation, and disputes between enterprises regarding the performance of contracts can end up having to be resolved by the courts. In such circumstances, foreign affiliates are not exactly in a very strong position, and there is a significant risk that they may be unable to enjoy sufficient legal remedies.

In China in particular, the manner of implementation as well as the underdeveloped state of the legal system create noticeable problems for enterprises. Around the time of its accession to the WTO, China amended, repealed or enacted an estimated 1,000 items of legislation and administrative regulations in fulfillment of its accession commitments, but some commentators have noted that the rapid pace of change served to further increase the confusion.⁸⁾ There also frequently arise differences between central government notices and their interpretation by local governments, and regional

variations in their implementation.

In order to sidestep these problems, enterprises not only have to keep an eye on developments regarding the amendment and repeal of legislation. It is also important that they work to identify reliable legal experts and other local talent with a firm understanding of local conditions, and that they build smooth everyday relations with local government officials (such as those involved in industry and commerce administration, customs, public security, taxation, labor matters, and foreign exchange).

(3) Unique business practices

An extremely high proportion of enterprises that establish operations in China complain of difficulties collecting payment (receivables) locally. This is the biggest obstacle to development of sales in the Chinese market. Enterprises in China are often late making payment, and this includes even Japanese affiliates if the person in charge of finances is Chinese. This is due to the unique practice of rating more highly those financial managers that manage to delay payment, if only by a little.

In addition, as enterprises that bounce their checks are not punished by having their business transactions suspended, as in Japan, even some quite large enterprises occasionally do so.

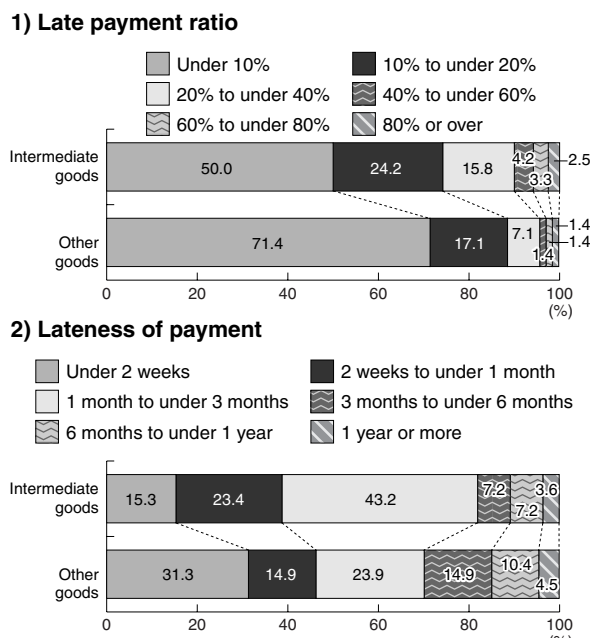
8) See p. 228 of the *White Paper on International Economy and Trade 2005*.

Because of this situation, Japanese enterprises that invest in China often only deal with local Japanese affiliates that are likely to pay on schedule rather than actively developing domestic sales, thus failing to achieve their original goal.

The *Fact-Finding Survey of the Payment Collection Difficulties of Japanese Affiliates in China* conducted by the JETRO Shanghai Center in East China (Fig. 2-2-27) indicates that the late payment ratio is particularly high in the case of suppliers of intermediate goods, and notes that the period of lateness is increasing. As many SMEs are thought to produce intermediate goods in the host country and are not in a strong position from the standpoint of business transactions, this situation presents a major risk to SMEs.

In Japan, legal frameworks are in place to protect subcontractors. These include regulations against the “abuse of dominant position” under the Antimonopoly Law and the Law on the Prevention of the Delay in the Payment of Subcontracting Charges and Related Matters. Presently in China, however, no such frameworks exist.⁹⁾ Although pursuing action through the courts is one option, this is in practice a costly and time-consuming process, and if the business status of the other party really deteriorates, there is no guarantee of being able to obtain payment even if a case is won (see Case 2-2-11). In the end, therefore, enterprises tend to try to look after themselves through negotiation with other parties, obtaining payment in advance, and receiving payment when products are delivered.

Fig. 2-2-27 Late payment ratio and state of late payment in China
High proportion of late payments for intermediate goods, and lateness increasing



Source: JETRO Shanghai Center, *A Fact-Finding Survey of the Payment Collection Difficulties of Japanese Affiliates in China* (2004).

Case 2-2-11

Debt collection problems in China

Higashiyama Film Co., Ltd. is an Aichi-based company with 179 employees and capital of ¥292.95 million, and its main lines of business are film coating, industrial laminating, and laminating for offset printing. It established a venture in Singapore in January 1995, and on the outskirts of Shanghai, China, in December of the same year. At the time, a stream of Japanese manufacturers was entering the Chinese market, and, expecting China to become a world center for air-conditioner production, it decided to establish operations there in order to supply insulation products to air-conditioner manufacturers, even though it did not have any established customers there.

Almost all the products produced locally are sold in China. As the company did not initially have a stable clientele there, it approached local compressor motor manufacturers as well as Japanese affiliates. At present, the Chinese subsidiary does business with a large enterprise in

a corporate group that the parent company in Japan had not been able to approach, and these activities have had a positive impact on the business of the parent company as well.

At one point, the Chinese subsidiary did business with around 30 compressor manufacturers, including local enterprises. As a result of reviewing its business dealings with customers that failed to pay promptly, however, it has now narrowed its clientele down to around 10 key customers. Although left to the decision of the courts, debts can be collected in only a few cases. Even in the case of Japanese affiliates, collecting debts can be as difficult as with local enterprises if the person in charge of finances is a local.

When a new clean room plant currently under construction and scheduled for completion in May 2006 comes on stream, the company will have in place a stable system of supply for new business, and aims to achieve further growth.

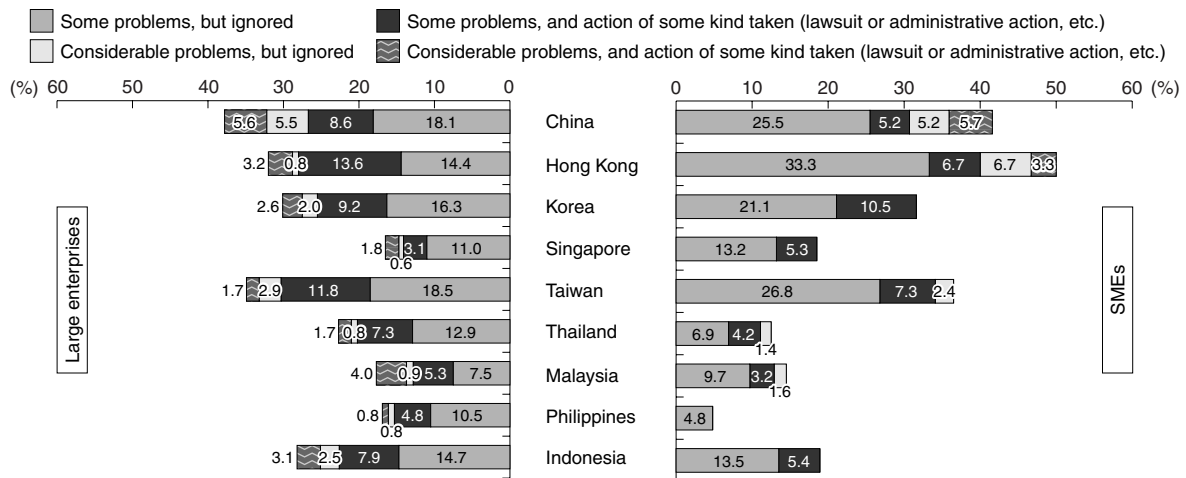
9) Enactment of legislation equivalent to Japan’s Antimonopoly Law is under deliberation.

(4) Counterfeit goods, technology leaks, and the protection of intellectual property rights

Losses caused by counterfeit goods produced by Asian enterprises in China and other East Asian countries are considerable. SMEs are particularly vulnerable to losses due to “dead copies,” and frequently have no alternative but to grin and bear it due to the greater difficulty of demonstrating rights infringements compared with large enterprises that encounter problems

such as trademark infringements. While the proliferation of counterfeit goods reduces direct market share, it also has a serious impact on business relations as the expansion of the counterfeit market lowers the prices of genuine produces made by Japanese affiliates and leads to customer calls for price cuts. Counterfeit goods can also damage a genuine manufacturer’s brand image if the counterfeits are of poor quality but are not recognized as such.

Fig. 2-2-28 Intellectual property right problems and responses
Problems common in China, Hong Kong, Taiwan, and Korea, but SMEs tend to just grin and bear it without taking countermeasures



Source: Recompiled from METI, *32nd Basic Survey on Overseas Business Activities (2002)*.

Note: In manufacturing, parent companies in Japan with capital of over ¥300 million and overseas subsidiaries with more than 300 regular workers are classified as large enterprises, and parent companies in Japan with capital of ¥300 million or less or overseas subsidiaries with 300 or fewer employees are classified as SMEs.

Case 2-2-12

The proliferation of counterfeit goods in the Chinese market

Company C, a manufacturer of precision instruments based in Niigata with a workforce of 180 and capital of ¥95 million, established a wholly-owned subsidiary (capitalized at ¥240 million) in Dalian, China, in 1991 in order to manufacture precision instruments for architects and similar professions. It chose Dalian due to the well-developed investment conditions for Japanese enterprises, and the greater availability of Japanese speakers in the city.

The investment was initially in a single line of business, but has now broadened out considerably. However, while the company originally explored developing sales in the Chinese market in addition to locating there to reduce costs, a number of factors—primarily its prices being too high for the market, differences in construction techniques between Japan and China, and the existence of strong demand from Japan—mean that plant demand (i.e., use in plants) accounts for virtually all sales within China, and almost all output is exported. There is a division of functions between the Japanese and Chinese operations, with the Japanese parent company presently producing

custom-built products for rapid delivery and products that require special processing, and the Chinese subsidiary producing products ordered in large, stable lots.

In the beginning when the company was more interested in domestic sales, it struggled even to recover payments worth only a few tens of thousands of yen. Now, though, this problem has been resolved by requiring payment in advance. The company has also dealt with counterfeits in the past by detecting them in cooperation with the local authorities responsible for commerce and industry. Astonishingly, even some of the company’s authorized dealers sold counterfeit goods as imitations alongside the real things. The company is not now focusing on developing sales in China, and is ignoring infringements without even knowing how much damage they might be causing because of the considerable cost of simply exposing them. It tried registering its intellectual property, but in some cases the companies making copies had already acquired the design rights. In China, it is considered difficult to overturn such registrations even if one’s own company was first to market.

Case 2-2-13

One SME that took on a large enterprise in the world marketplace to protect its intellectual property

For SMEs competing in niche markets armed with their own special technologies, the protection of intellectual property rights is an important business concern.

Nemoto & Co., Ltd., based in Tokyo with a workforce of 92 and capital of ¥99 million, is the world's largest producer of luminous paints, which glow even at night and in the dark. Fluorescent paint is mass-produced in Dalian, China (where the company established a presence in 1995 to serve the U.S. and Asian markets) and Portugal (where the company established a presence in 1990 to serve the European market), while R&D and small-lot production are performed in Japan.

The company's luminous paints offer outstanding brightness and persistence, but unlike conventional products contain no radioactive substances, and it has applied for patents in Europe, China, and Korea as well as Japan in order to defend itself against rivals. Just after its

European patent was approved, however, a leading U.S. enterprise, Company D, filed an objection. Although this objection was subsequently rejected, Company D requested that it be granted a license and, after consideration within the company, was granted one. However, the real purpose of this was in order to acquire a patent in China. In actual fact, there was a company (Company E) producing low-priced copies in China, and this not only interfered with Nemoto's acquisition of a patent in China, but Company D also sold Company E's imitations on the European market. By granting a license to Company D, Company E also became jointly involved. The upshot was that Company E was granted a sub-license, thus removing it as an obstacle and allowing Nemoto to at last acquire a patent in China in May 2004. At present, Company E, which used to produce imitation products, is now working to eliminate other copies flooding the Chinese market.

If we look at the state of intellectual property right infringements and responses according to size of enterprise (Fig. 2-2-28), it emerges that the incidence of infringements is highest in China and the NIEs (principally Hong Kong, Taiwan, and Korea), and a high proportion of SMEs, while aware of infringements, ignore them as they are unable to take any countermeasures (see Case 2-2-12). As in the case of collection of payment, SMEs' limited business resources make it difficult to secure the funds and establish the management setup to sustain a court case. And in practice, many SMEs do not even have the resources to ascertain the level of losses caused by counterfeit goods.

The danger of technology leaks is also considerable. A particular challenge is preventing the outflow of technologies and know-how when employees who have acquired skills are poached by other companies or start up their own independent businesses. Responses to this problem include writing clauses into employment

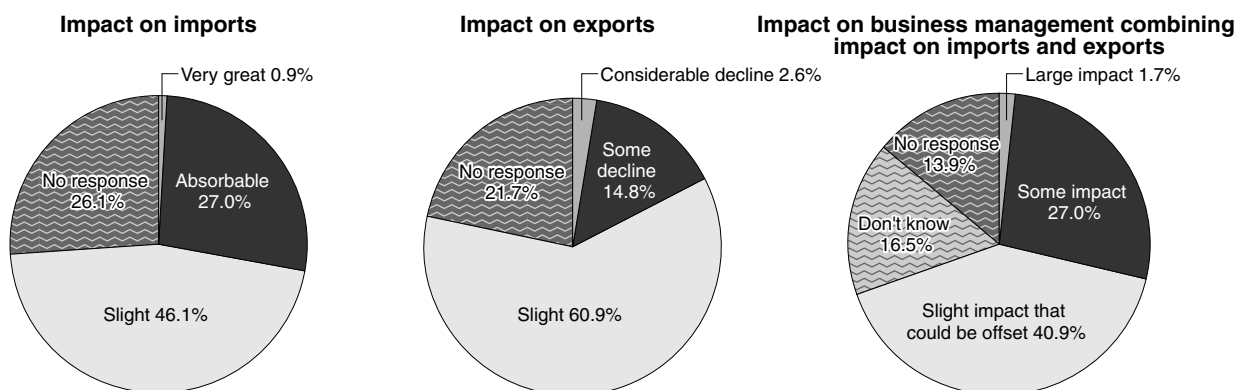
contracts to prohibit the leakage of technologies, dividing up processes so that no single person can accumulate complete skills and know-how, and paying core personnel high salaries.

Given that Japanese enterprises are differentiated in large part from highly cost-competitive local enterprises by the technological gap between them, mechanisms in Asia for the protection of intellectual property need to be further developed through collaboration between states, various supporting organizations, enterprises, and other relevant parties.

(5) Revaluation of the yuan (exchange risk)

On July 21, 2005, the yuan was revalued by 2.1%. Due to the small scale of the revaluation, a questionnaire survey of Japanese affiliates in China indicates that most feel the impact on business to have been slight (Fig. 2-2-29). From the standpoint of Japanese affiliates in China, the revaluation of the yuan has a negative effect

Fig. 2-2-29 Impact on imports and exports of devaluation of yuan (Japanese affiliates in China)
Devaluation has so far had a limited impact on imports/exports and business management



Source: JETRO Beijing Center, *Emergency Questionnaire on Impact of Devaluation of Yuan* (July 2005).

Column 2-2-1 Financing and Fund Raising for Overseas Affiliates

When an overseas affiliate of a Japanese SME requires funds, the Japanese parent company generally puts up security with a Japanese bank in Japan, and the company's affiliate borrows from an overseas branch of the same Japanese bank; or the parent company borrows from the Japanese bank in Japan and transfers the money to its overseas affiliate in the form of an investment.

As background for this, Japanese banks, in principle, deal with an overseas affiliate of a Japanese company by extending credit to the company in Japan, and do not usually accept security based on real property, facilities or other assets overseas, because it would be difficult for the banks to foreclose on and dispose of such property. An overseas affiliate of a major Japanese company above a certain size will commonly borrow under the guarantee of its parent company, but an overseas affiliate of an SME with a lower credit rating may not be able to arrange such borrowing. It could, theoretically, borrow money from local banks overseas, using its own real estate or other assets as security, but, in many cases, the necessary relationship with a local bank does not exist.

An environment restricting the raising of funds may hinder an SME with an opportunity to extend its business overseas. An SME with an already developed presence overseas, insofar as the main business of the affiliate is to sell/export products to the parent company in Japan and procure most of its components from the parent company in Japan, will not experience a need for operating funds through appropriate adjustments/settlements between it and the affiliate. But if, in the future, local sales or local procurement increases, a need for operating funds at the local operational base may well arise. In addition, if a company that has transferred most of its production overseas and cut back domestically tries to expand business overseas, its ability to raise funds may be affected by an insufficiency of assets in Japan to be used as security. Consequently, it has become important for a Japanese lender to determine a borrower's asset values, business risks, growth potential, etc., both in Japan and overseas.

on exports to Japan. As the rise of the yuan also leads to an increase in the wage costs of Chinese workers in yen terms, revaluation can potentially have a major impact on enterprises that have established operations in China as a means of reducing costs, depending on the scale of the revaluation. Because of China's ballooning trade surplus, there are also calls in the international community, particularly from the U.S., for a more flexible response to be adopted toward the yuan's exchange rate band to match the actual situation regarding the strength of the Chinese economy.

In addition to the issues considered individually above, numerous other phenomena impede the development of operations overseas by SMEs. For SMEs with limited business resources, external networks of support can play a valuable role, and making use of the advice of business partners (such as large enterprises that are customers and trading companies), various public agencies (such as JETRO, JICA, and the SMRJ), correspondent banks, lawyers and accountants, business consultants, and others with a detailed knowledge of the host country can prove extremely useful.

Section 7 Reconsideration of Japan as a site for investment in manufacturing

As touched upon in Part II, Chapter 1, recent years have seen renewed interest among some Japanese enterprises, especially in high-tech industries, in investing in Japan in parallel with expanding operations in East Asia. As SMEs are heavily influenced by trends in the locating of plants and overseas investment by large enterprises, a constant eye must be kept on developments in the location strategies, both overseas and in Japan, of large enterprises.

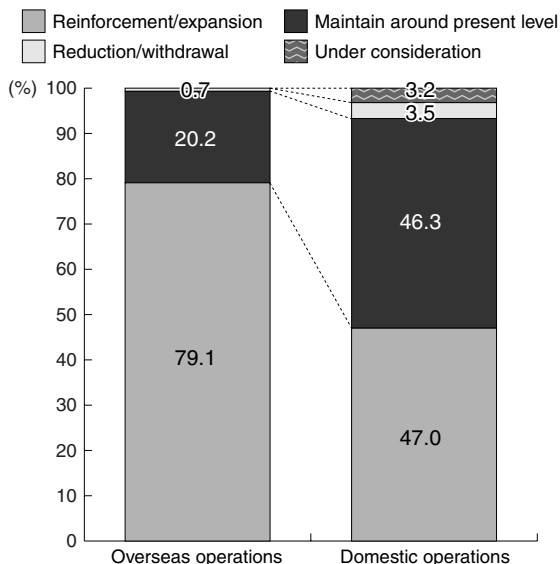
According to Fig. 2-2-30, the stance toward overseas operations in the medium term (i.e., over the next three years or so) remains positive, with almost 80% of enterprises responding that they intended to reinforce or expand them. Regarding the medium-term outlook for domestic operations, too, however, almost 50% say that they will reinforce or expand them. Regarding the fields in which enterprises said that they intended to focus in

Japan, many responded "production of value-added products" and "R&D" (Fig. 2-2-31), providing evidence of a clear division of roles between domestic and overseas operations through the deft use of an international division of labor as part of a global strategy.

Regarding the impact of establishing operations overseas on their domestic operations, only 14.8% responded "reduced due to replacement of domestic production by overseas production," and most instead answered "no impact on domestic operations" or "decrease in domestic production made up for by engagement in new products and fields" (Fig. 2-2-32). This tendency is consistent with the trends among manufacturing SMEs analyzed in "Section 4. Economic effects of international expansion and international division of labor."

Fig. 2-2-30 Medium-term outlook regarding for overseas and domestic operations

Roughly 80% intend to bolster overseas operations, around one in two to boost operations in Japan



Source: JBIC, Fiscal 2005 Questionnaire Survey of Foreign Direct Investment.

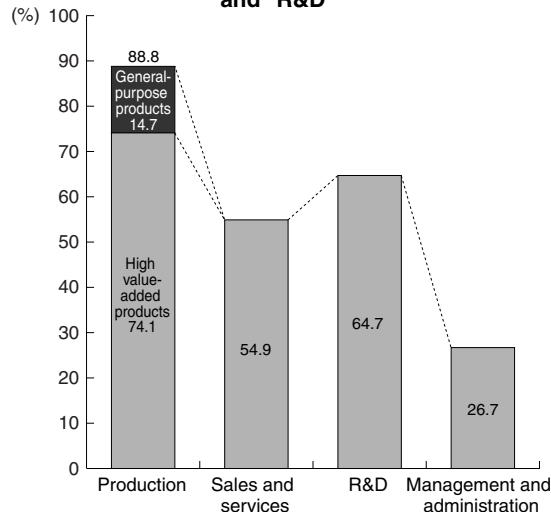
Meanwhile, while the overseas production ratio of Japanese manufacturers continues to rise, there has in fact recently occurred an upturn in capital investment in Japan, with a number of large enterprises making the headlines by locating large new plants in the country.¹⁰⁾ This trend is thought to be due to three main factors: firstly in the case of large enterprises in particular, the greater competitiveness of parent companies in Japan due to efficiency improvements resulting from the establishment of systems of division of labor with their operations overseas; secondly at the macroeconomic level, the comparatively firm tone of the Japanese economy and recovery in domestic demand, providing greater scope for reinvestment in Japan; and thirdly, the choice of sites in Japan for the production of certain high value-added products that enterprises have found to be unsuited to production overseas due to technological constraints and an examination of the “optimal locations” for their production.

Overseas manufacturing operations will undoubtedly continue to be expanded in the future, with a particular focus on production of general-purpose and low-end products. However, this parallel trend toward the re-strengthening of domestic operations by large enterprises is highly likely to have a significant impact on the

10) See Fig. 2-1-16.

Fig. 2-2-31 Fields in which enterprises intend to strengthen their domestic operations

Focus on “production of high value-added products” and “R&D”

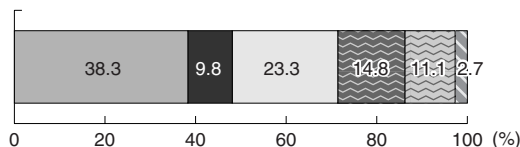


Source: JBIC, Fiscal 2005 Questionnaire Survey of Foreign Direct Investment.

Fig. 2-2-32 Impact of overseas operations on domestic operations

Small proportion say “reduction of domestic operations”

- Investment to maintain or increase market in host country, and no impact on development of domestic operations
- Products produced differed from domestic products, so no impact on development of domestic operations
- Production of products hitherto made in Japan transferred overseas, and decrease in domestic production made up for by engagement in new products and fields
- Reduced due to replacement of domestic production by overseas production
- Increase in production of parts and materials, etc. supplied from Japan to meet increased production overseas
- Other



Source: JBIC, Fiscal 2005 Questionnaire Survey of Foreign Direct Investment.

business strategies of SMEs in Japan and overseas in the future, and deserve to be watched closely. Moreover, as it is in the field of high value-added products in which large enterprises plan to expand capacity in Japan, manufacturing SMEs in Japan with the advanced technological capabilities to support the development and production of such products look set to grow ever more in importance.

Section 8 The role of Japanese SMEs in the growing international division of labor (summary of Chapter 2)

The preceding sections have provided an overview of the wave of manufacturing SMEs that have boldly established operations in East Asia against the backdrop of the various changes in the business environment since the 1990s. They have also shown how many enterprises have achieved growth despite the various difficulties and risks that they have encountered in their host countries.

It hardly needs to be said that Japanese manufacturing's greatest strength lies in the sophistication, breadth, and depth of its supporting industries, and the tight integration (*suriawase*) that exists between the SMEs that make up the bulk of these industries and the large enterprises that supply end products. With their advanced technological capabilities, therefore, SMEs in Japan are expected to continue to play an important role as the bedrock for constant technological innovation.

With Japanese society on the verge of population decline and the decline of the domestic labor force now a certainty, it is crucial that productivity in manufacturing be increased. At the micro level, it is important that enterprises strategically combine use of "processes and production of products left in Japan (shifting toward higher value-added manufacturing in Japan)" and "processes and production of products that should be performed overseas," thereby improving the efficiency of their operations and increasing the sophistication of domestic industry while making appropriate use of business resources overseas. This will result in the

formation of an optimal international division of labor and improve the productivity of the Japanese industry as a whole.

In the years ahead, growing economic integration and the development of IT networks will cause cross-border movements of people, goods, and money to accelerate ever more. While increasing numbers of SMEs will enjoy the advantages of expanding overseas, those that remain behind are also expected to feel the increasing impact of globalization and encounter strengthening competition from overseas enterprises. In East Asia, Japan's supporting industries will have to constantly combine cutting-edge technologies and skills, and SMEs will simultaneously have to internationalize their human resources and management if Japan's supporting industries are to retain their competitive advantage in East Asia. At the same time, governance capabilities will have to be raised in order to allow internal divisions of labor and allocations of functions that will lead to more efficient business dealings with enterprises in general, both at home and abroad, as well as just the sharing of roles and functions with specific business partners.

In the following chapter, we shall examine trends among the SMEs that underpin Japan's supporting industries and analyze their growth strategies from the point of view of bolstering the competitiveness of their domestic operations.

Chapter 3 Core technologies supporting Japanese industry amid the growing international division of labor

Throughout the 1990s, Japanese manufacturers continued to invest in East Asia. More recently, however, there has been what might be dubbed a “return to domestic investment in Japan,” particularly in high-tech industries (Part II, Chapter 1). Underlying this, observers have noted, has been the emergence of global optimal location strategies revolving around the establishment of international divisions of labor with East Asia (Part II, Chapter 2). This is indicative of the fact that large Japanese enterprises, having established operations in East Asia, are now reassessing Japan’s comparative advantages as a base for R&D and production of high value-added products, and a major reason for this has been the high regard in which the technologies of the SMEs that form the backbone of Japan’s supporting industries is held.

As global optimal location becomes increasingly

widespread in Japanese industry, transaction patterns in Japan are also changing, forcing the SMEs that support manufacturing to adapt correspondingly. Against this background, the changes occurring in the transaction environment must be recognized and action taken to reform traditional patterns of corporate behavior if the SMEs that support Japanese manufacturing are to maintain their locational advantages over East Asia and other regions and individual SMEs are to achieve growth.

In this chapter, we examine the changes in transaction patterns occurring within Japan, the extent of technological and market competition with East Asia experienced by manufacturing SMEs, and what action SMEs are taking in the face of this environment, and consider what course manufacturing SMEs in Japan should steer in the future.

Section 1 “Meshing” of transaction patterns in Japan and its impact

Up until around 10 years ago, it was mainly large enterprises that were establishing manufacturing operations overseas. As was observed in Chapter 2, however, recent years have seen an upsurge in activity by SMEs entering local manufacturing networks in East Asia, creating divisions of labor in manufacturing that integrate the entire East Asian region. This is having an impact on enterprises that remain in Japan as well as those that expand overseas in the form of the shift of customers overseas and competition with cheap foreign products in the domestic market as Japanese manufacturing enters a period of structural change.

1. Change in transaction patterns

The traditional pattern of business relations, considered a defining feature of Japan’s industrial structure since the high-growth period, revolved around stable, long-term transactions between “parent enterprises (clients) and subcontractors.” This created a hierarchical division of labor with the parent enterprise at its apex that was continuously maintained for a considerable period. The advantages of this arrangement for both parent enterprises and subcontractors were as follows.¹⁾

1) Parent enterprises

Subcontracting acted as a buffer alleviating the

impact of fluctuations in orders due to market trends. Subcontracting additionally allowed investment capital to be reduced, wage and labor management to be farmed out, and use to be made of specialized technologies.

2) Subcontractors

With a stable stream of orders from their parent enterprise, subcontractors were able to survive without actively developing new outlets themselves. This made it possible for them to concentrate their relatively scarce business resources on the development of new products and technologies.

This structure, consisting of a business grouping of subcontractors with specialist technologies formed around a parent enterprise at its core, is considered to have represented a microcosm of the supporting technologies required to produce a finished product. Within such structures, there also appear to have functioned “information distribution networks” through which information was transmitted on the development of technologies and market trends.

Subcontractors situated “upstream”²⁾ in this business relationship were able to find out about trends in the market for finished products and trends in technologies needed based on the information that they received from the parent enterprise “downstream.” Likewise, “downstream” parent enterprises found it easier to ascertain the supporting technologies (core technologies)

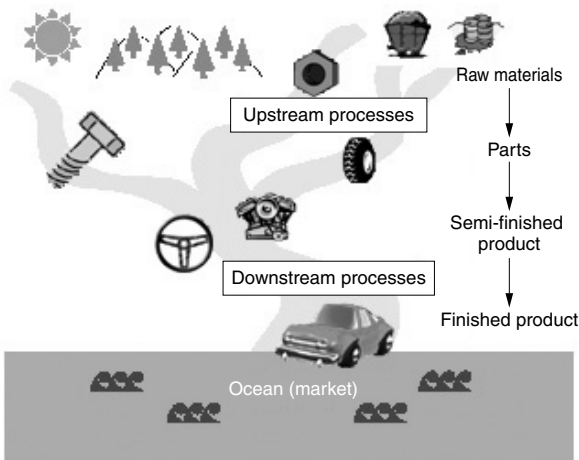
1) See 1969 White Paper on Small and Medium Enterprises in Japan, p. 103 (Japanese edition).

2) “Upstream” and “downstream” are terms used to refer to positions in the “stream” of processes from the production of raw materials and parts to their fabrication and sale (Fig. 2-3-1).

available based on the information received from “upstream” subcontractors. The result was to enable manufacturing through swift and sophisticated integration (*suriawase*) along the supply chain, from the supply of raw materials and parts to the production of the finished product.

However, the establishment of manufacturing operations overseas and development of international divisions of labor in recent years is exerting an impact on the transaction environments of not only enterprises that expand overseas, but also those that remain in Japan.

Fig. 2-3-1 Schematic of upstream and downstream processes



Source: Compiled by the SME Agency.

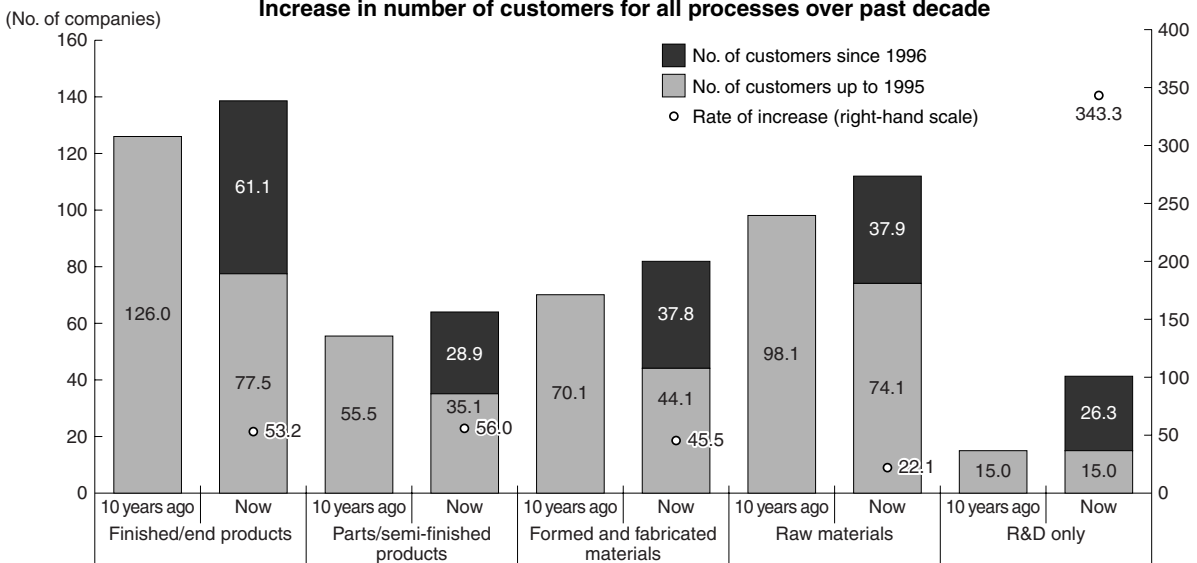
Below, we examine exactly what changes are occurring.

Fig. 2-3-2 shows the changes in the number of clients of SMEs at each stage of production based on the results of a survey conducted by Mitsubishi UFJ Research and Consulting Co., Ltd. in November 2005, entitled *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (referred to below as the *Transaction Environment Survey*), and from this it can be seen that the number of clients has increased at all stages – from raw materials to production of finished products – over the past 10 years. Focusing only on enterprises involved in the production or processing of parts, semi-finished products, and formed and fabricated materials, Fig. 2-3-3 shows how the number of clients has changed according to the category of finished product in which the parts, etc. made by enterprises are most used. As can be seen, the number of clients has increased in all categories.

The fact that the number of clients has grown more rapidly than sales means that business with small numbers of large-volume clients has declined and transactions have become more dispersed. The increase begun to become particularly marked from the 1990s (especially the latter half of the decade), indicating that this is not something that has long been universally observed (Fig. 2-3-4).

In actuality, an examination of changes in business relations with large-volume customers shows that while enterprises relying on their top three customers for the greater part (at least 61%) of total sales were in the majority in all industries 10 years ago, the proportion has

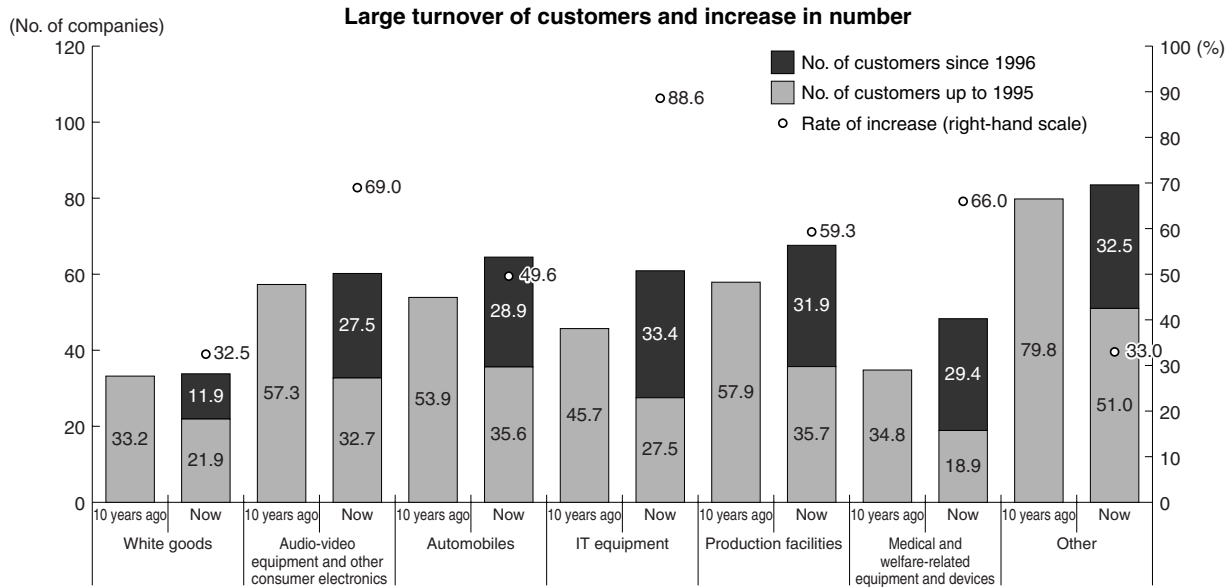
Fig. 2-3-2 Changes in number of customers by process
Increase in number of customers for all processes over past decade



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

- Notes:
1. Enterprises with 300 or fewer workers.
 2. Enterprises that responded that the number of customers 10 years ago was less than the number of companies with which they did business for 10 years or more, or the number of customers now was less than the number of companies with which they did business for 10 years or more, were excluded.

Fig. 2-3-3 Change in number of customers by category of end product



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

- Notes:
1. Manufacturers and processors of parts, semi-finished products, and formed and fabricated materials with 300 or fewer workers.
 2. Enterprises that responded that the number of customers 10 years ago was less than the number of companies with which they did business for 10 years or more, or the number of customers now was less than the number of companies with which they did business for 10 years or more, were excluded.

now fallen below 50% in all industries except the automotive industry. Of particular note is the fact that the proportion of enterprises depending on certain large-volume customers for almost all (at least 81%) of their sales has also fallen in all fields over the past 10 years (Fig. 2-3-5).

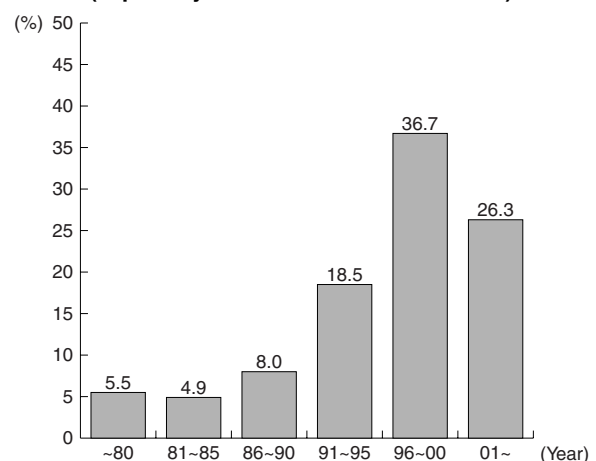
If we look on the other hand at relations from the point of view of receipt of subcontracting orders, we find that whereas there has been a slight increase in enterprises receiving subcontracting orders in the past 10 years, there has also been a slight decline in the proportion of sales accounted for by subcontracting³⁾ (Fig. 2-3-6).

Based on the above observations, we may conclude that:

- 1) Clientele size has followed an upward trend over the past 10 years, the proportion of enterprises dependent on certain customers for almost all of their sales has declined, and there is occurring a shift to business relations requiring that business be conducted with a wider clientele.
- 2) Although there has not been a decline in enterprises engaging in “subcontracting” in terms of producing for a larger enterprise than itself as an affiliated or partner enterprise, dependence on subcontracting business is declining.

3) A breakdown by related product field shows that, with the exception of a slightly lower proportion of sales being accounted for by subcontracting in the medical and welfare-related equipment field compared with other product fields, the extent of engagement in subcontracting and proportion of sales accounted for by subcontracting exhibit similar trends in all product fields.

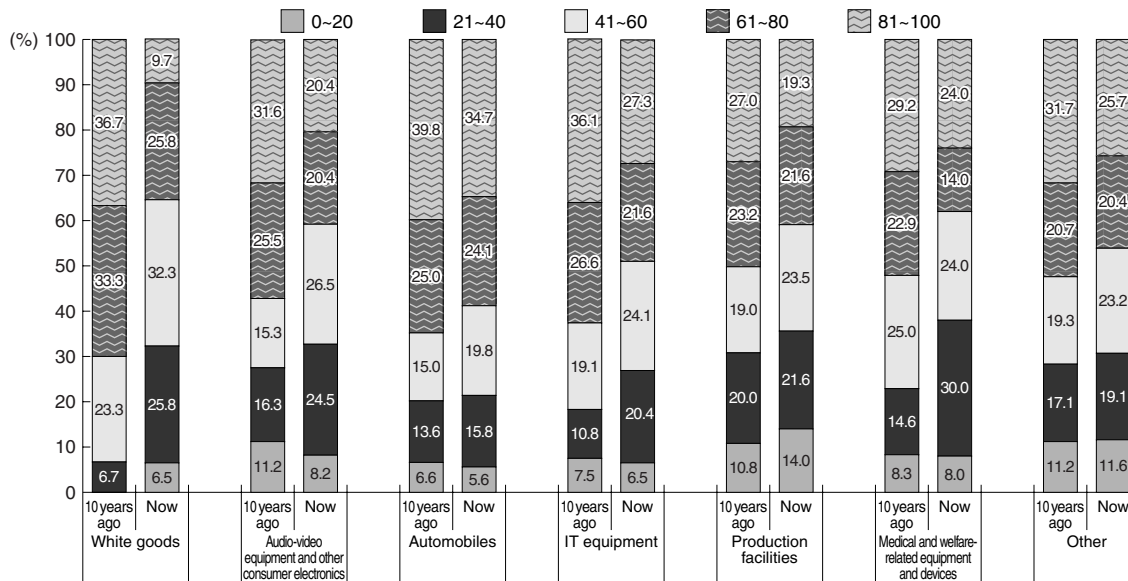
Fig. 2-3-4 Timing of event or background factors leading to increase in clientele
Concentrated in the 1990s onward (especially the latter half of the decade)



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

Note: Enterprises with 300 or fewer workers dealing in parts, semi-finished products or formed and fabricated materials whose clientele increased in the previous 10 years.

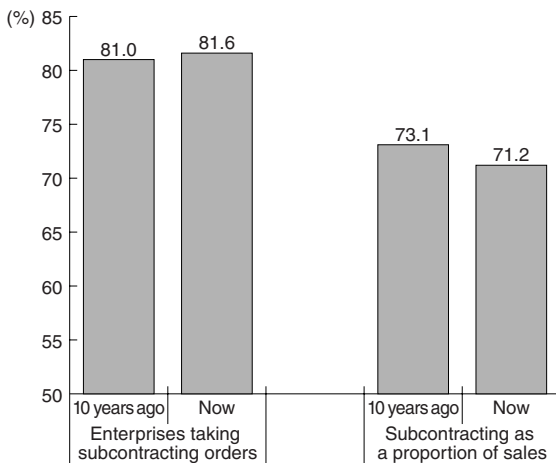
Fig. 2-3-5 Proportion of total sales accounted for by top three customers
Downward trend in dependence on small number of major customers



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

Note: Manufacturers and processors of parts, semi-finished products, and formed and fabricated materials with 300 or fewer workers.

Fig. 2-3-6 Evolution of subcontracting
Slight increase in proportion of enterprises taking subcontracting orders and slight decrease in proportion of sales accounted for by subcontracting



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

Notes: 1. Manufacturers and processors of parts, semi-finished products, and formed and fabricated materials with 300 or fewer workers.
 2. "Subcontracting" is here defined as the manufacture or processing of products or parts, etc. by an enterprise as an affiliate or partner of a business larger than itself.

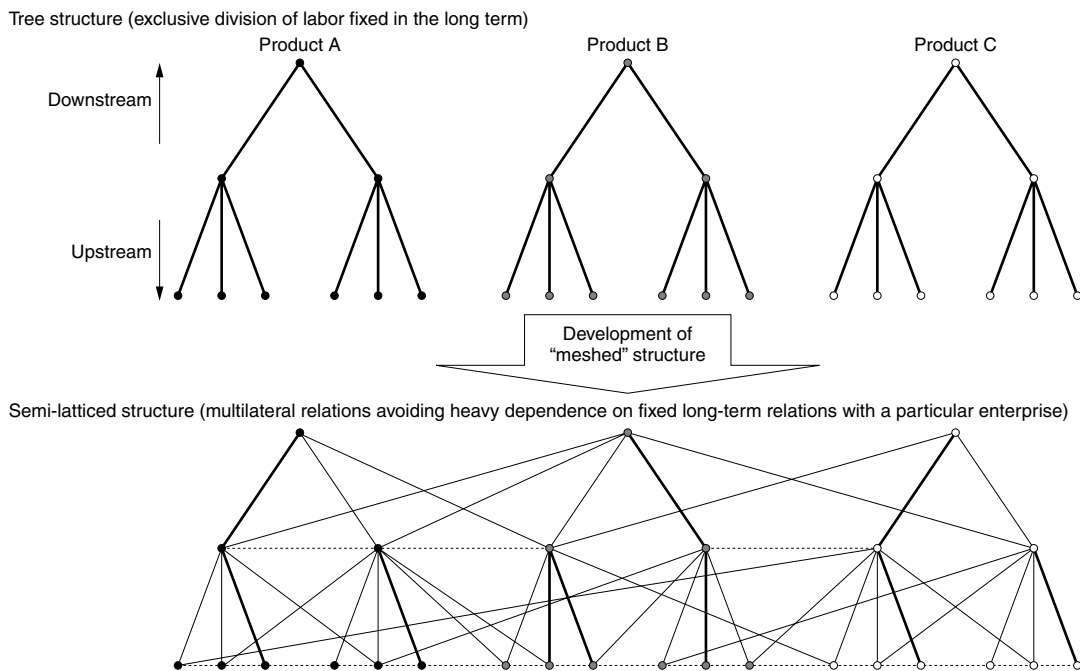
In other words, the pattern of transactions by manufacturing SMEs appears to be growing increasingly "meshed" as they become less intimately dependent on a small number of customers and develop thinner, broader, and multifaceted transactions with a larger clientele⁴⁾ (Fig. 2-3-7).

4) The data used here cover only enterprises engaged mainly in the manufacture or processing of parts, semi-finished products, and formed and fabricated materials, and exclude enterprises involved solely in finished and end products, raw materials, and R&D. It needs to be borne in mind, therefore, that these data do not depict the average state of Japanese manufacturing in Japan as a whole.

Regarding also comparisons with the past, it must be remembered that the data depict trends among enterprises that have remained in business, and do not depict trends in manufacturing as a whole taking into consideration entries and exits.

In addition, it should be noted that although the subcontracting business structure is said to have collapsed, this does not mean that more enterprises have terminated their previous subcontracting relations and become independent. Based on the above, it would be more accurate to say that there is occurring a shift away from dependence on certain enterprises, while maintaining engagement in subcontracting as a way of doing business.

Fig. 2-3-7 Change in transaction patterns (schematic)



Source: Compiled by the SME Agency based on Hironobu Oda, *Machinery Industry Clustering in Modern Japan* (2005).

- Notes:
1. The solid lines indicate vertical links, and the dotted lines indicate horizontal links.
 2. The thickness of the lines indicates the strength of the business and marketing ties and level of dependence between enterprises.

2. State of changes in transaction patterns

Next, we look at the reality of this “meshing” of business relations by examining changes in the demands of business partners from the point of view of both contractors and clients.

Fig. 2-3-8 illustrates the needs of clients that contractors in subcontracting relations perceive to be stronger than 10 years ago. Each element of QCD⁵⁾ – quality (level and stability of quality of products and processing), cost (cost-cutting ability), and delivery (ability to cater to quick deliveries and reliable observance of delivery deadlines) – is cited by a high proportion of respondents (around 60-70%), and a breakdown according to enterprise size reveals delivery-related demands to be felt slightly more at smaller enterprises. There is also a tendency for enterprises with around 50 or more workers to perceive a stronger demand for the ability to establish operations overseas, although the proportion is still small.

It may seem surprising that demand for QCD, which has traditionally formed the basis of business management, has risen in the past 10 years. Depending on how one looks at it, however, this could just indicate a demand for ever higher standards of what should be common practice. In other words, the transaction environment in Japan appears to demand ever higher quality, greater yields, larger cost savings, more rapid

deliveries, and stricter observance of delivery deadlines than in the past.

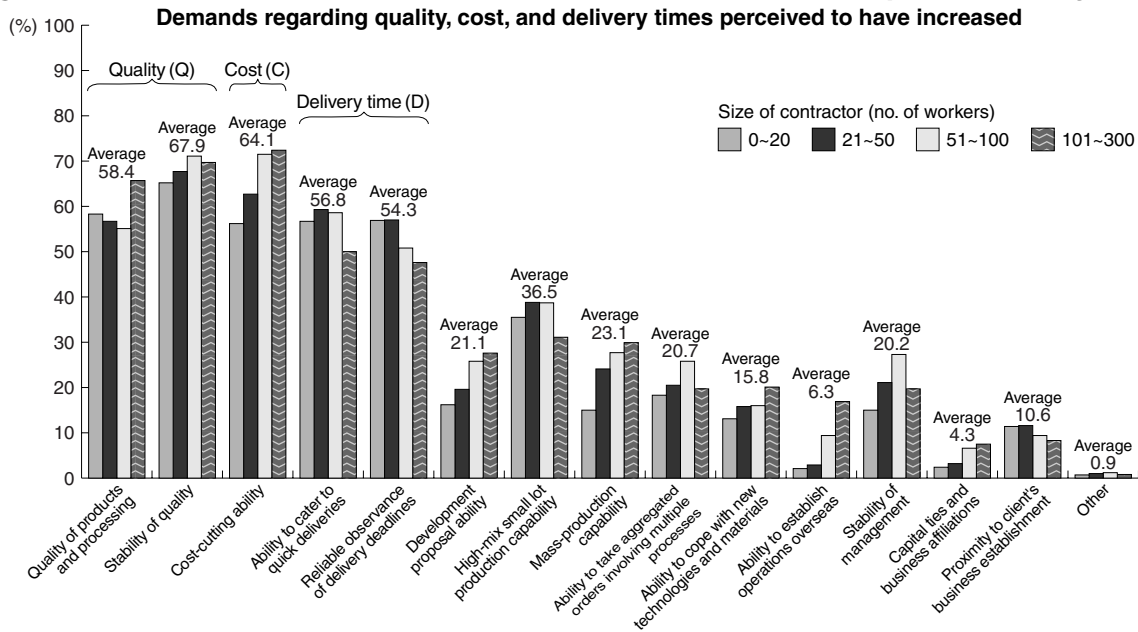
At the same time, it is worth noting that a little less than 20% of enterprises now sense strong demand from clients regarding “development proposal ability,” “ability to take aggregated orders involving multiple processes,” and “ability to cope with new technologies and materials.” Although this is still a relatively small proportion, this provides some indication that even in subcontracting, enterprises are now being expected to fulfill, regardless of their size, some of the functions previously performed by clients by, for example, coming up with development proposals themselves and taking orders encompassing a number of processes. It is as though clients want their subcontractors to evolve more into partners.

On the opposite side of the coin to the increase in needs felt by contractors, how do clients choose which enterprises to do business with? Fig. 2-3-9 shows what needs clients felt were not properly met when they terminated subcontracting relations. The high proportion of respondents citing QCD coincides with the above results regarding subcontractors. Interestingly, however, there is markedly less sense among clients of shortcomings regarding “quality of products and processing.”

The reason why clients tend not see “quality of products and processing” as lacking when terminating a

5) “QCD” is an acronym made up of the initials of Quality, Cost, and Delivery, which are considered to constitute the three elements of management.

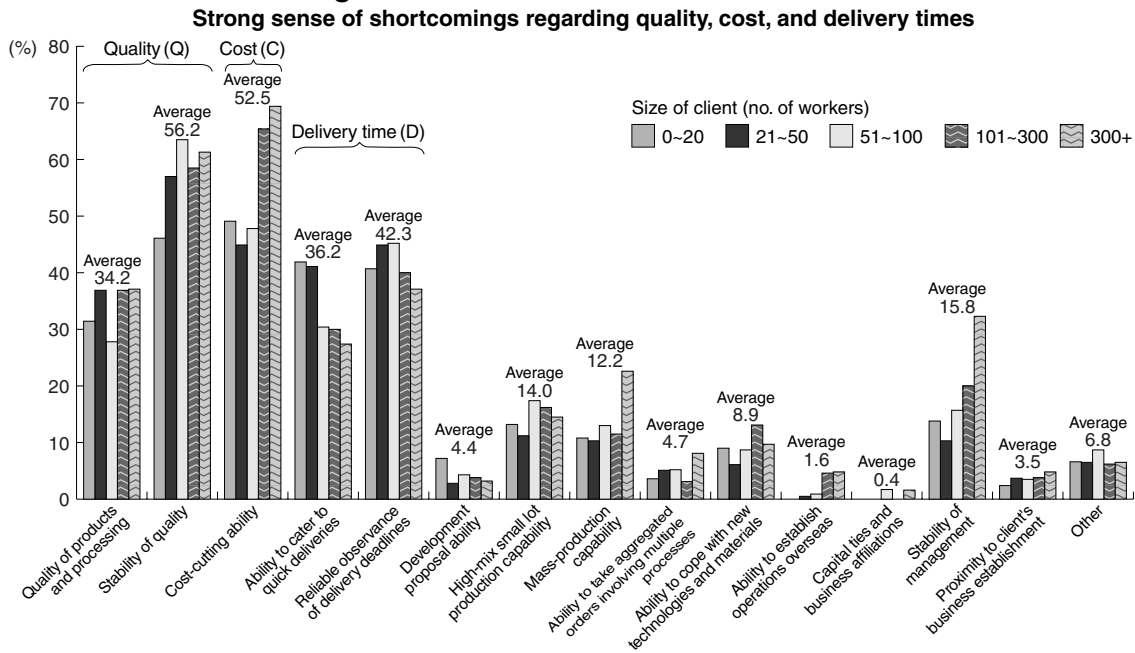
Fig. 2-3-8 Client needs that subcontractors feel have increased compared with 10 years ago



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

- Notes:
1. Subcontractors with 300 or fewer workers undertaking production or processing of parts, semi-finished products or formed and fabricated materials.
 2. "Subcontracting" is here defined as the manufacture or processing of products or parts, etc. by an enterprise as an affiliate or partner of a business larger than itself.
 3. The number of workers shown is that of the subcontractor.
 4. Totals exceed 100 due to multiple responses.

Fig. 2-3-9 Shortcomings of subcontractors perceived by clients when they terminate subcontracting relations



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

- Notes:
1. Enterprises engaged in the production or processing of finished products, end products, parts and semi-finished products, or formed and fabricated materials that have in the past terminated a subcontracting relationship.
 2. The number of workers indicates the number of workers of the client that terminated the subcontracting relationship.
 3. Totals exceed 100 due to multiple responses.

subcontracting relationship whereas subcontractors sense a strong need for “quality of products and processing” on the part of clients may be that because many subcontractors actually have to meet greater demands than in the past regarding the quality of products and processing, this does not often provide the grounds for termination of a subcontracting relationship. If this is so, then it would appear that selection of contractors is taking place in an increasingly competitive domestic transaction environment in which considerably high (and at times even overspecced) levels of quality are required. According to the *Transaction Environment Survey*, clients have to date terminated their subcontracting relations with approximately one third (29.7%) of the subcontractors with which they did business 10 years ago.

Regarding which needs are felt most strongly by contractors and clients broken down according to category of end product, there tends to be a particularly strong demand for “ability to establish operations overseas” in the case of white goods, audio-video equipment, other consumer electronics products, and IT equipment, “mass-production capability” in the case of automobiles, and “ability to cope with new technologies and materials” in the case of IT equipment. On the other hand, there is little demand for “mass-production capability” or “ability to establish operations overseas”

in the case of production facilities.⁶⁾

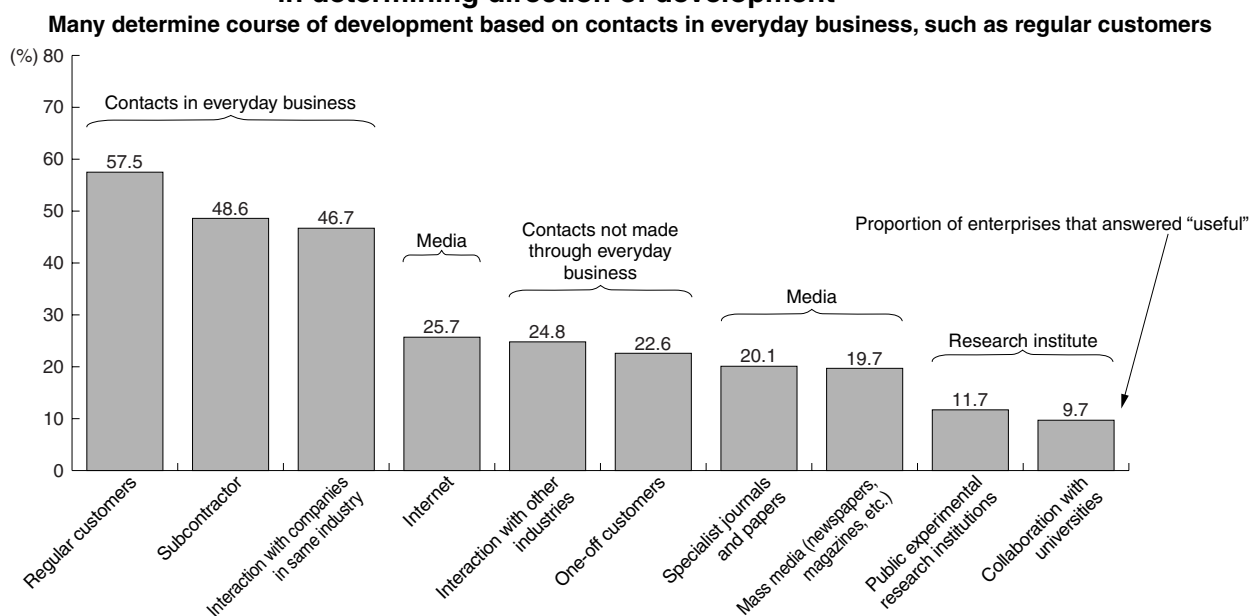
Leaving the topic of how enterprises have responded to the above changes in transaction patterns to Section 3, we turn next to consider the problem of the increasing difficulty of determining what course technology development should take due to these changes in transaction patterns.

3. The problem of increased difficulty of determining what course technology development should take

As the pattern of transactions becomes more “meshed,” is this impeding in some way communication between contractors and clients premised on conventional stable, long-term business relations? To answer this question, we next analyze how enterprises exposed to changes in transaction patterns obtain information that gives them pointers on what direction development should next take.

We begin with a general overview of what sources of information are emphasized by SMEs engaging in subcontracting. Fig. 2-3-10 confirms that, quantitatively speaking, information obtained through continued everyday contact with customers is used most. This is hardly surprising, and the high frequency of use of information obtained through daily contact is what one

Fig. 2-3-10 Helpfulness of information obtained through various channels in determining direction of development



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

- Notes:
1. Manufacturers and processors of parts, semi-finished products, and formed and fabricated materials with 300 or fewer workers.
 2. Respondents were asked to rank the usefulness of information obtained by each channel in determining the course of development of products and technologies according to a five-step Rickert scale.
 3. The proportion of enterprises that answered “useful” is the proportion of the total sample that answered 4 or 5 (“useful”).

6) See Appended Note 2-3-2.

would expect, regardless of changes in the times.

At the crux of the matter is the “content” of the information that enterprises obtain through various channels.

Not all information obtained from daily contact with related parties is of the same quality. Thus when long-term, collective business relations functioned as a “information distribution network” between parent enterprises and subcontractors, the tight integration that existed appears to have enabled enterprises to acquire information that allowed them to ascertain what course they should steer in the future.

The question we have to ask is whether the increasing “meshing” of transactions has resulted in the information obtainable becoming more superficial and general, making it less useful for determining what direction of growth an SME should pursue.

Regarding each of the information sources shown in Fig. 2-3-10, therefore, we analyze using a method called “factor analysis” which information sources SMEs choose to use when engaging in what kinds of activity.

While the reader is referred to Appended Note 2-3-3 for details of the analysis, it was concluded that SMEs’ choice of which information to use was broadly influenced by two types of direction: “action to develop new technologies, etc.” and “response to needs of existing customers, etc.” (Fig. 2-3-11). Use of information therefore falls into the following two main categories:

- Information from parties with no involvement in everyday business, such as exchanges with media and research organizations and inter-industry exchanges
→Factor 1: High level of use in “action to develop new technologies, etc.”
- Information from everyday contacts in business, such as regular customers and enterprises in the same line of business

→Factor 2: High level of use in “response to needs of existing customers, etc.”

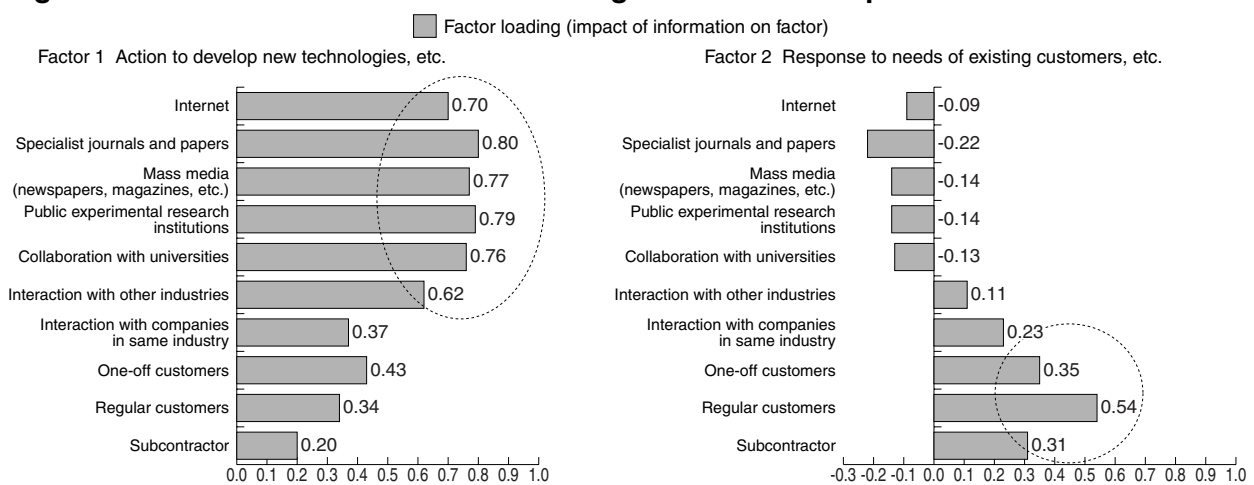
We then looked at the state of use of this information by enterprises that increased their clientele over the past 10 years. It was found as a result that enterprises that gave “to increase open transactions through standardization of products and parts” and “weakened affiliations or cooperation with specific enterprises,” which are thought to be more likely to be involved in a “meshed” structure of transactions, were found not to make relatively greater use of information for factor 1 “development of new technologies, etc.” (Fig. 2-3-12).

If we look in particular at enterprises that expanded their clientele by “increasing open transactions through standardization of products and parts,” we find that they are unable to make good use of information for not only factor 1 “development of new technologies, etc.,” but also factor 2 “response to needs of existing customers, etc.” It is conjectured from this that enterprises whose transactions have grown more “meshed” find it more difficult to discern the appropriate direction of product and technology development due to the deterioration of their information distribution networks.

The indications are that these enterprises are in fact performing poorly and are struggling, uncertain of what direction of development to pursue. Enterprises that “increase open transactions through standardization of products and parts” and enterprises with “weakened affiliations or cooperation with specific enterprises” perform worse than other enterprises in terms of both sales and profit ratio (Fig. 2-3-13).

Investment in R&D exposes SMEs to growing costs due to the increasing sophistication and specialization of technologies, and this burden is rising by the year (Fig. 2-3-14). As they tend to lack business resources such as funds and human resources, investing in the wrong area of R&D can, far from generating new strengths,

Fig. 2-3-11 Use of information in determining course of development and common factors

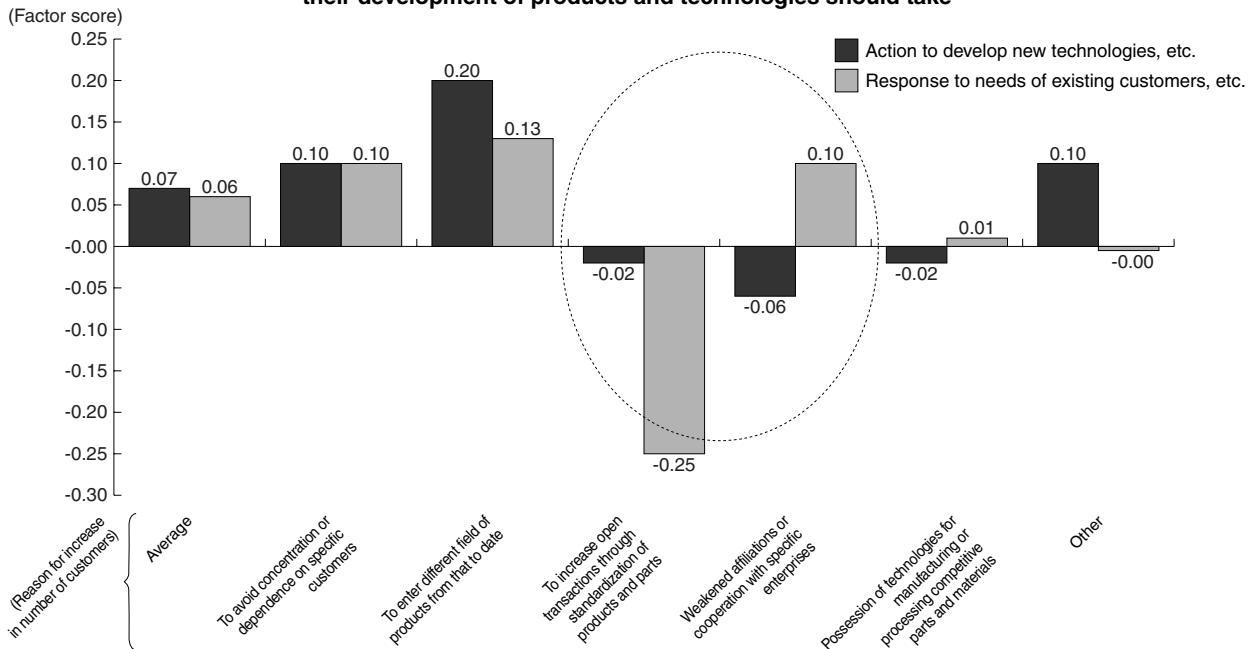


Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

Note: Manufacturers and processors of parts, semi-finished products, and formed and fabricated materials with 300 or fewer workers.

Fig. 2-3-12 Reasons for increase in number of customers and direction of product and technology development at enterprises whose clientele increased

Enterprises whose transactions have grown more meshed appear to find it harder to determine what direction their development of products and technologies should take

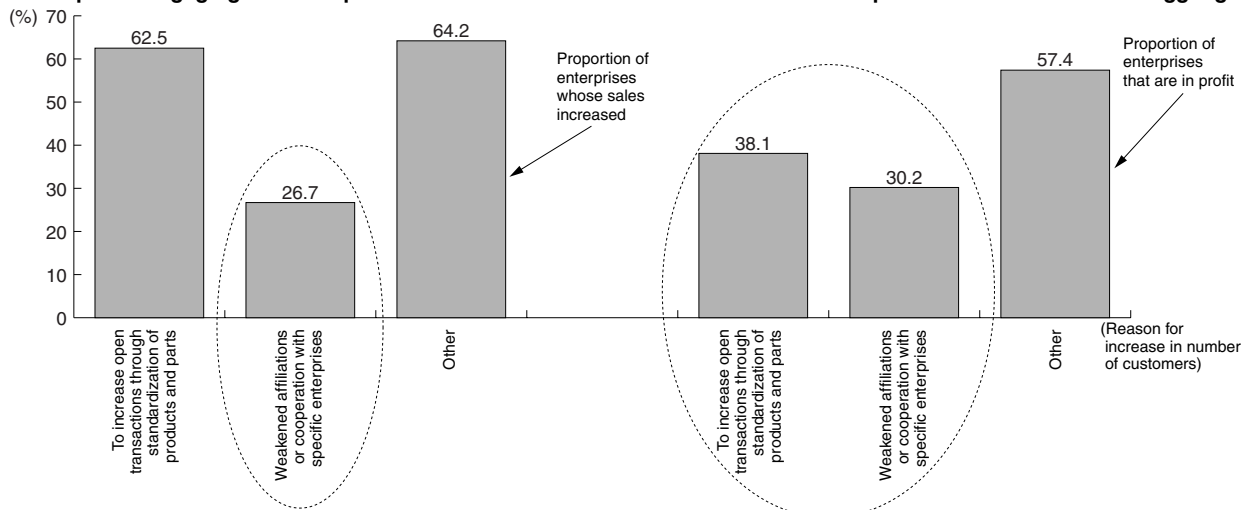


Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

- Notes:
1. Manufacturers and processors of parts, semi-finished products, and formed and fabricated materials with 300 or fewer workers.
 2. A higher factor score indicates greater use of information in development of new products and technologies.

Fig. 2-3-13 Reasons for increase in number of customers and sales / ordinary profit

Enterprises engaging in more open transactions and with weaker affiliations or cooperative ties seem to be struggling



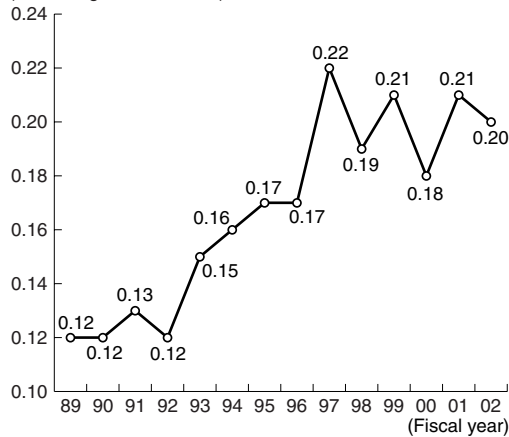
Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

- Notes:
1. Manufacturers and processors of parts, semi-finished products, and formed and fabricated materials with 300 or fewer workers.
 2. Enterprises that reported an increase in their number of customers in the past 10 years were divided into three groups based on the reasons that they gave for the increase. "Other" is the combined total of enterprises that responded "to avoid concentration or dependence on specific customers," "to enter different field of products from that to date," "possession of technologies for manufacturing or processing competitive parts and materials" or "other."
 3. "Enterprises whose sales increased" is the combined total of enterprises that responded that their profits "increased" or "somewhat increased" in the past 10 years.

Fig. 2-3-14 Changes in proportion of total costs of SMEs accounted for by R&D expenditure

Burden of R&D expenditure increasing at SMEs

(Percentage of total costs)



Source: SME Agency, *Small and Medium Enterprise Cost Metrics*.

Note: Percentage of total costs = R&D expenditure / total costs

potentially be a quite risky undertaking.

The “meshing” of transactions is a structural change accompanying the establishment of operations in East Asia by Japanese manufacturers and the integration of the East Asian economic bloc, and is likely to continue in the future. Against this background, the rising number of enterprises finding it difficult to determine which direction they should take in technology development could result in the SMEs that support the core technologies of Japanese manufacturing facing business risks due to erring in the direction of technology development, or refraining from developing technologies due to the excessive fear of such risks, causing technological innovation in Japan to lag as a result. This is a problem that not only concerns individual enterprises, but also the very bedrock that sustains and develops the competitiveness of Japanese manufacturing.

In light of this, the authorities should proceed with the development of mechanisms that give guidelines for each field of technology to provide pointers on development to such enterprises, and that enable the sharing and exchange of information between markets.

At the same time, SMEs themselves need to become more resilient and forward-looking. Next, therefore, we survey the general state of Japanese manufacturing SMEs’ competitiveness compared with East Asian enterprises in two areas: market competition and technological capability.

Section 2 Trends in market competition and technological superiority to East Asian products

1. Trends by category of end product

The globalization of business affects not only those SMEs that themselves establish production operations overseas or enter foreign markets. It also affects enterprises that only have operations in Japan and target only the domestic market.

Thus enterprises that do business only in the domestic market can also be affected by globalization, regardless of the location of their manufacturing operations, if there is an influx of foreign products into the domestic market. Now that there are developing international divisions of labor, as observed in Part II, Chapter 1, enterprises are having to think about their international competitiveness in East Asia when they do business even if they have no intention of expanding internationally.

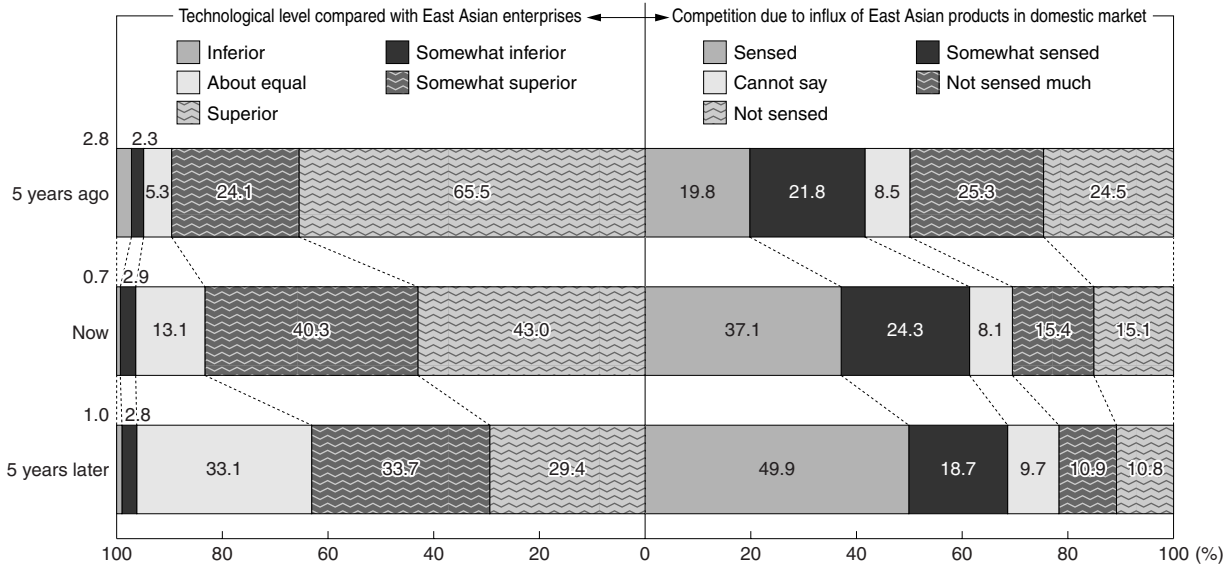
In Part II, Chapter 2, trends among SMEs that were themselves establishing operations in East Asia were examined. But what of reverse developments, i.e., the state of competition with East Asian products in the domestic market (right-hand graph of Fig. 2-3-15)? The proportion of enterprises that sense competition has increased dramatically in the past five years, and this

trend is expected to continue to strength.

While there has thus been an increase in competition due to the influx into the domestic market of East Asian products, an examination of Japanese SMEs’ technological competitiveness compared with that of East Asian enterprises reveals that the proportion of enterprises that sense themselves to be technologically superior to East Asian enterprises has not changed much in the past five years (left-hand graph of Fig. 2-3-15), indicating that the growth in market competition observed above is proceeding more rapidly than East Asian enterprises are catching up technologically. It would seem, therefore, market competition in Japan has revolved to date around price competition. Looking ahead, however, the existence of numerous enterprises that consider East Asian enterprises to be technologically on a par with themselves suggests that competition will grow fiercer.

If we look at the speed of market competition and technological catch-up by East Asian countries over the past five years broken down according to field of related end product, we find that there has been a rapid surge in market competition and technological catch-up over the

Fig. 2-3-15 Technological level compared with East Asian enterprises and state of competition due to influx of East Asian products in domestic market
Competition developing more rapidly than technological catch-up of competitors

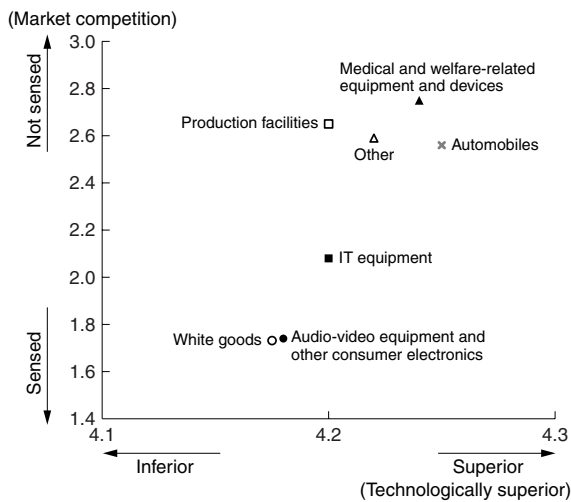


Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

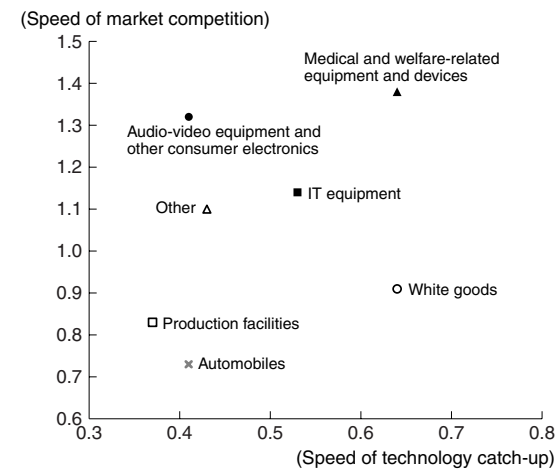
Note: Manufacturers and processors of parts, semi-finished products, and formed and fabricated materials with 300 or fewer workers.

Fig. 2-3-16 Technological superiority and state of market competition by product category
Conspicuous market competition in white goods, audio-video goods, and other consumer electronics. Whereas the white goods market was competitive five years ago, the markets for medical and welfare-related products, IT equipment, and audio-video equipment and other consumer electronics have grown more competitive in the past five years.

1) Technological superiority and state of market competition according to product category



2) Market competition and speed of technology catch-up by product category (now compared with 5 years ago)



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

Notes: 1. Manufacturers and processors of parts, semi-finished products, and formed and fabricated materials with 300 or fewer workers.
 2. Regarding their core field of technology, enterprises were asked whether they presently sensed market competition due to the influx of East Asian products in the domestic market (5. No, 4. Not much, 3. Neither, 2. Somewhat, 1. Yes) and whether they were technologically superior to East Asian enterprises (5. Superior, 4. Somewhat superior, 3. Neither, 2. Somewhat inferior, 1. Inferior). The values now were then deducted from those five years ago to obtain the "speed."
 3. Regarding Fig. 2), enterprises giving exactly the same responses five years ago and now that responded "1." or "5." were excluded from the calculations.

past five years in the medical and welfare-related equipment field (Fig. 2-3-16). This suggests that there was hardly any competition in this field five years ago, and that competition with East Asia in this field began to emerge in the past five years.

Regarding white goods, conversely, it appears that while the speed of technology catch-up in the past five years was rapid, market competition increased only moderately. Five years ago, however, there was already serious competition from East Asia in the white goods market, and so the evidence probably only indicates that market competition was well advanced from before then.

In the automobile and production facility fields, there appears to have been little technology catch-up, and market competition, too, has not intensified. While both product fields are characterized by a strong tendency to depend on local supporting industries (which means that there is little international trade in parts and intermediate

products), these results also provide some indication of Japanese manufacturing's strong competitiveness in the automobile sector.

2. Trends according to field of core manufacturing technology

(1) Field of core technology and product structure

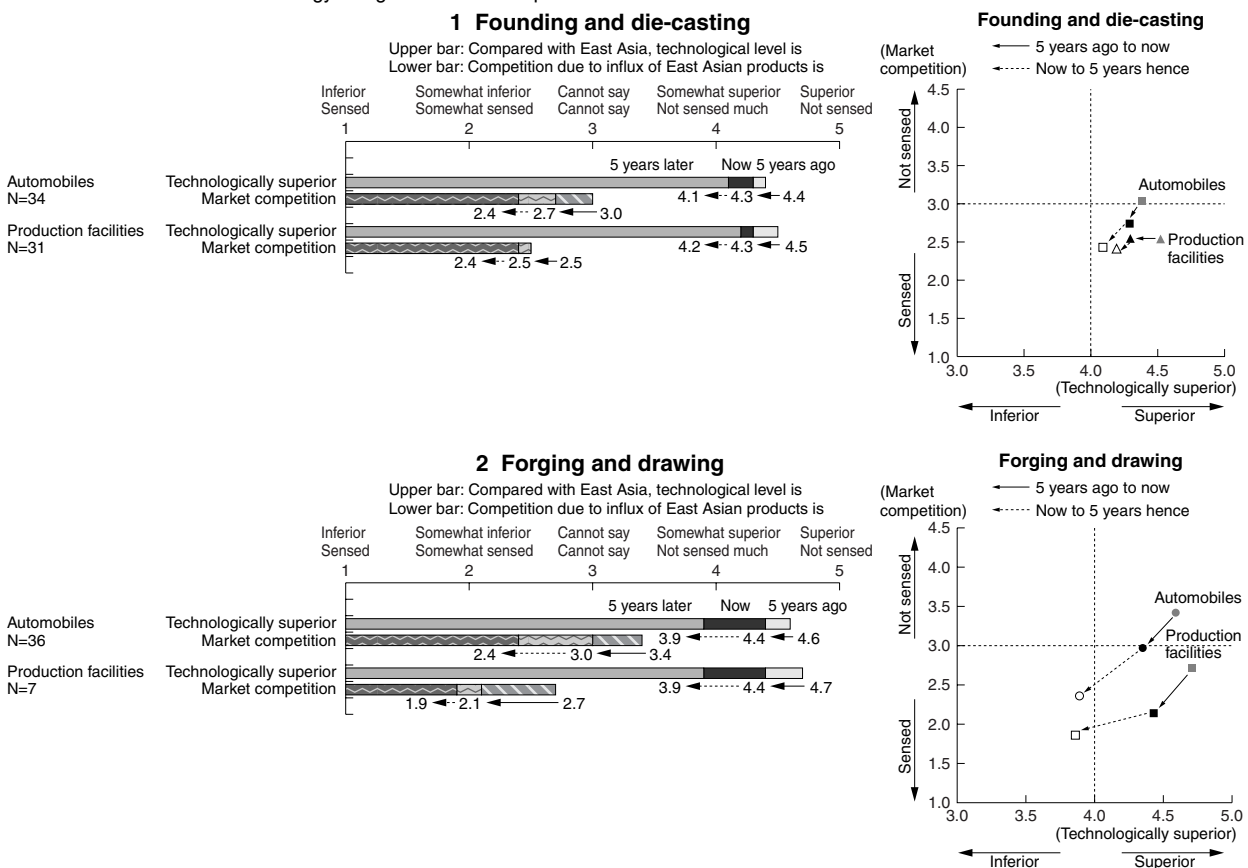
We now take a more detailed look at trends in market competition and technological superiority compared with East Asia by examining individual categories of core technology, such as die making, casting, pressing, plating, and polishing (Fig. 2-3-17).

The first thing one notices when one compares 1) automobiles and production facilities and 2) white goods, audio-video consumer electronics, and IT equipment is that there tends in the first group (which we

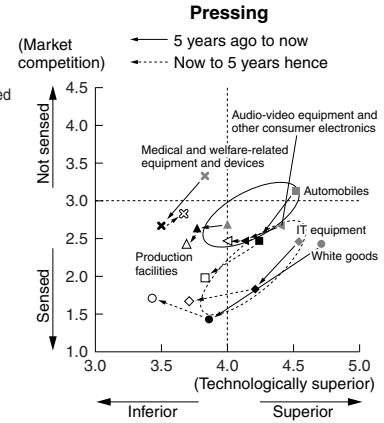
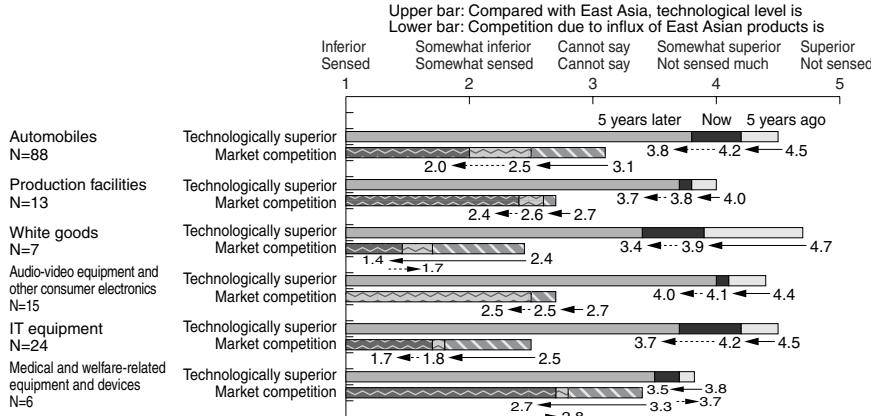
Fig. 2-3-17 State of market competition and technological superiority by category of technology and product

Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

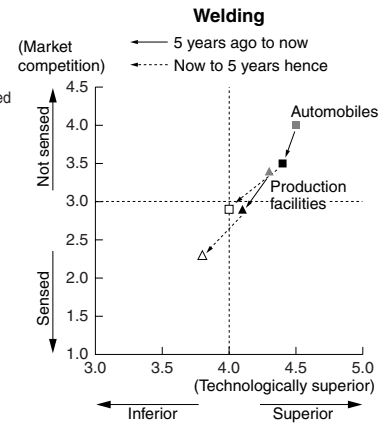
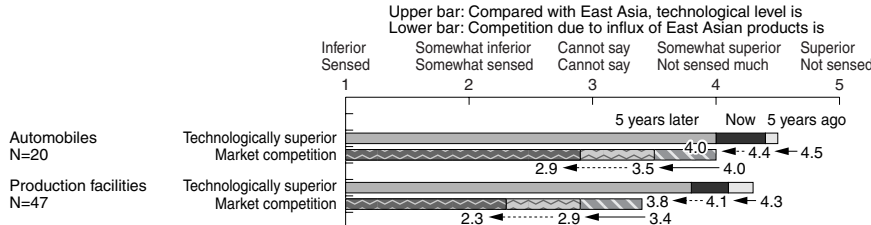
- Notes:
1. Manufacturers and processors of parts, semi-finished products, and formed and fabricated materials with 300 or fewer workers.
 2. Regarding their core field of technology, enterprises were asked whether they presently sensed market competition due to the influx of East Asian products in the domestic market (5. No, 4. Not much, 3. Neither, 2. Somewhat, 1. Yes) and whether they were technologically superior to East Asian enterprises (5. Superior, 4. Somewhat superior, 3. Neither, 2. Somewhat inferior, 1. Inferior).
 3. "Other" was excluded regarding both product and technology categories.
 4. Product and technology categories whose sample size was less than five are not shown.



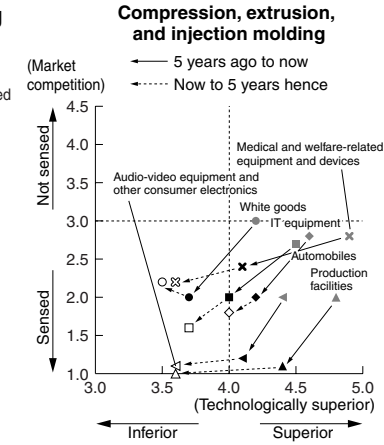
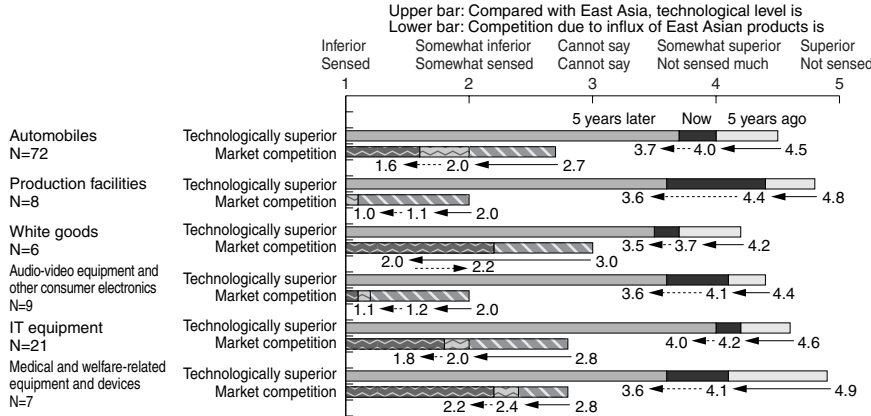
3 Pressing



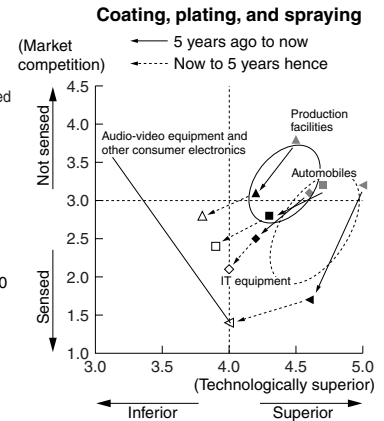
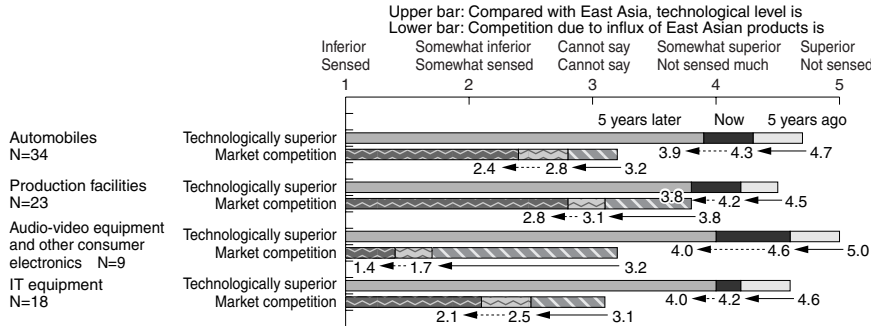
4 Welding



5 Compression, extrusion, and injection molding

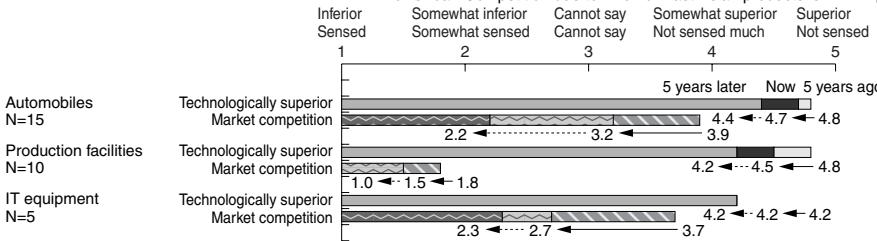


6 Coating, plating, and spraying



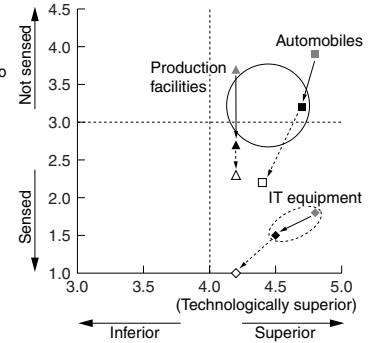
7 Rolling, wire drawing, and plate working

Upper bar: Compared with East Asia, technological level is
 Lower bar: Competition due to influx of East Asian products is



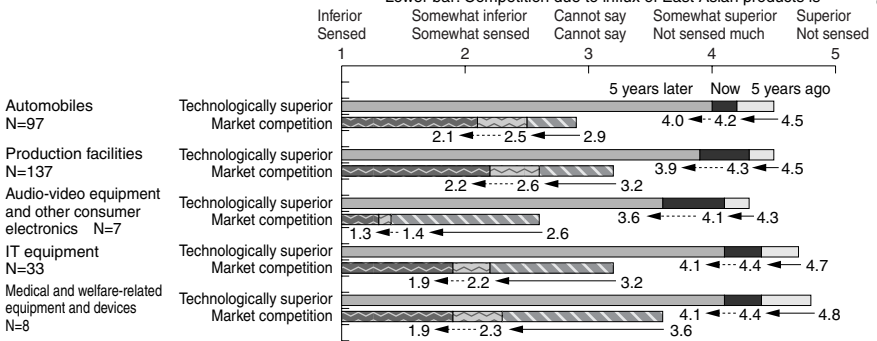
Rolling, wire drawing, and plate working

(Market competition)
 — 5 years ago to now
 - - - - Now to 5 years hence



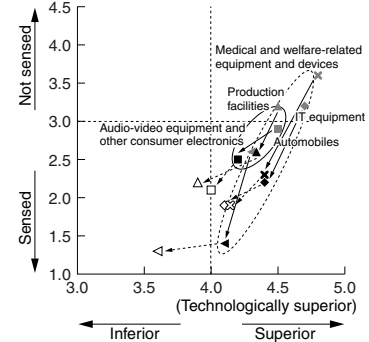
8 Cutting and drilling

Upper bar: Compared with East Asia, technological level is
 Lower bar: Competition due to influx of East Asian products is



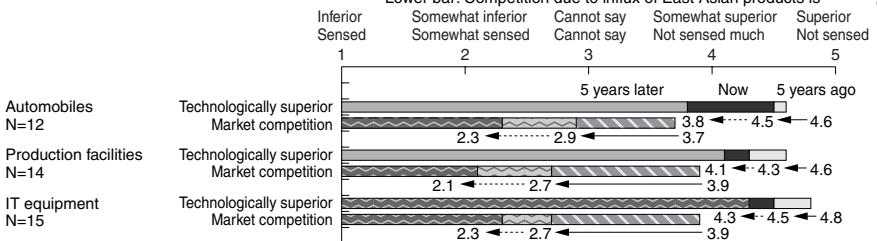
Cutting and drilling

(Market competition)
 — 5 years ago to now
 - - - - Now to 5 years hence



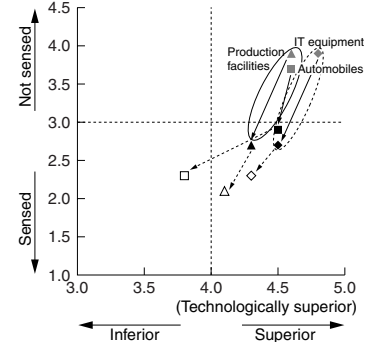
9 Polishing

Upper bar: Compared with East Asia, technological level is
 Lower bar: Competition due to influx of East Asian products is



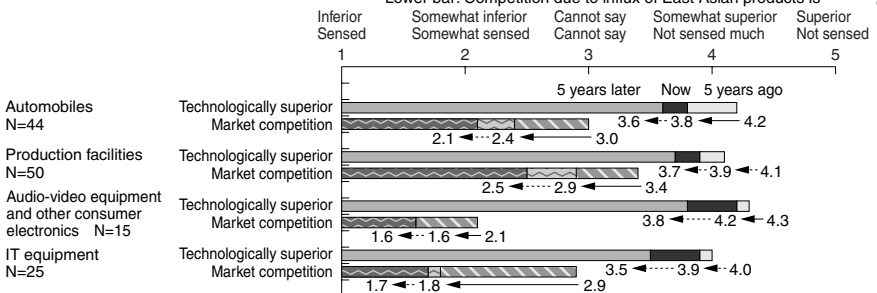
Polishing

(Market competition)
 — 5 years ago to now
 - - - - Now to 5 years hence



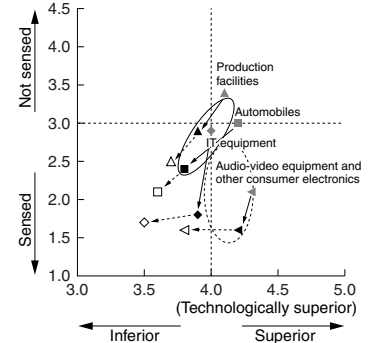
10 Assembly

Upper bar: Compared with East Asia, technological level is
 Lower bar: Competition due to influx of East Asian products is

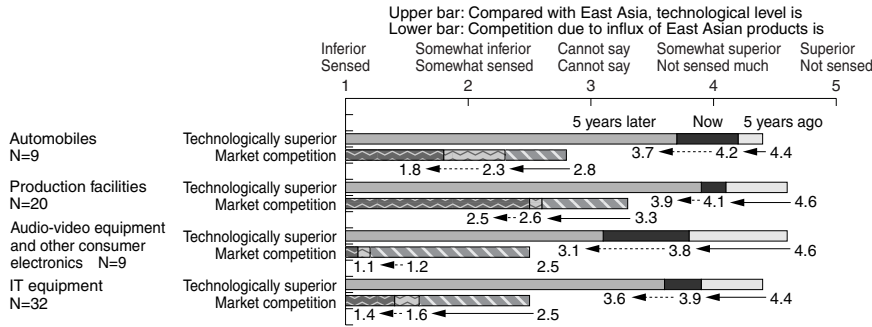


Assembly

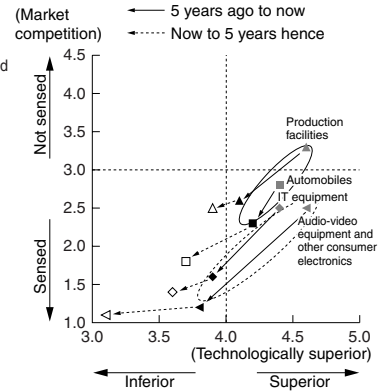
(Market competition)
 — 5 years ago to now
 - - - - Now to 5 years hence



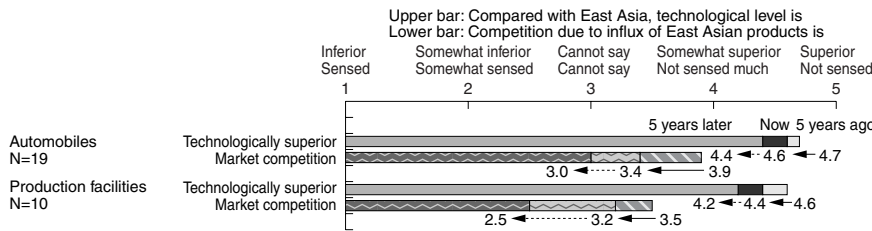
11 Electronics fabrication and mounting



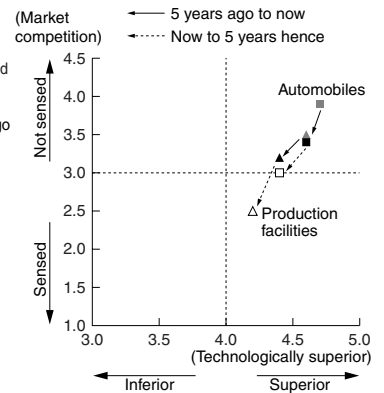
Electronics fabrication and mounting



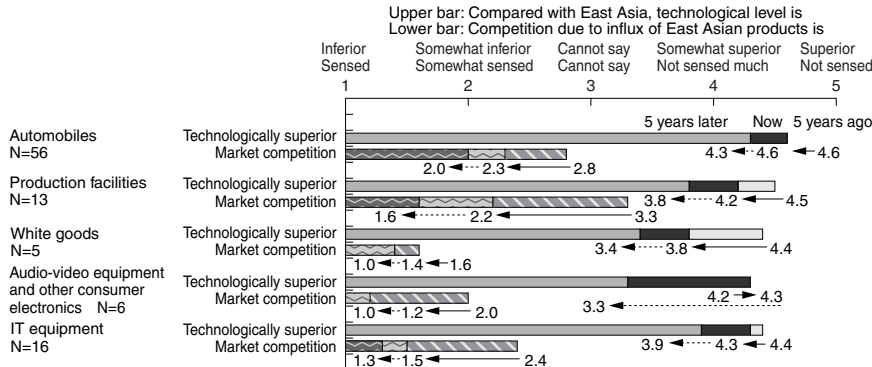
12 Heat treatment



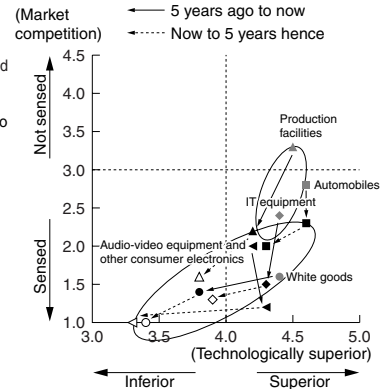
Heat treatment



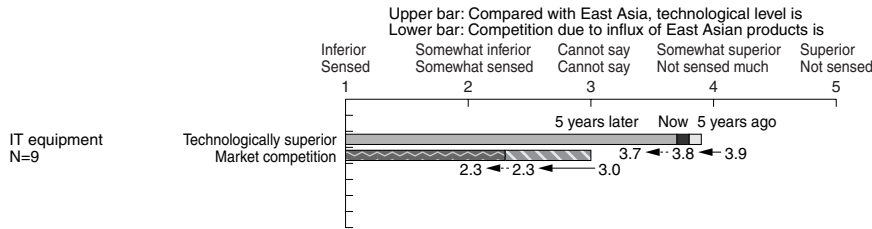
13 Die making



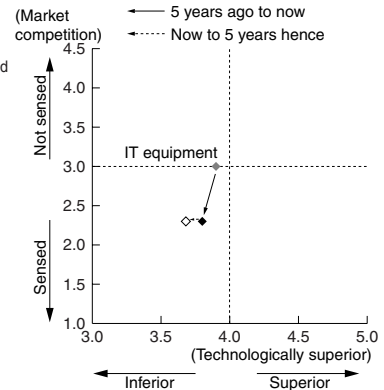
Die making



14 Testing and measuring



Testing and measuring



shall call the “automobile group”) to be less of a sense of market competition than in the second group (the “consumer electronics group”), and regarding technological capability as well, there tends to have been less catching up over the past five years. Secondly, the “consumer electronics group” is characterized by a stronger sense of market competition despite enterprises maintaining their technological superiority.

Underlying this difference appears to be the existence of changes in product architecture.

In the consumer electronics and IT equipment sectors, open modularization⁷⁾ of product structures is increasing, due, it is thought, to the increasing computerization and digitalization of products and the increased importance of shorter lead times until products and parts are brought to market. With products that have become more computerized, interconnections and data transfers between products and parts are of definitive importance; standardization not only makes the necessary connections technically simpler, but also reduces the time consumed adjusting and integrating parts. This consequently makes it possible to bring products to market without missing rapidly changing market trends and the window of opportunity for short-lived products.

In the traditional stereotypical subcontracting structure, there existed a system of cooperation between parent enterprises and subcontractors such that subcontractors receiving stable orders would respond to parent enterprises’ rising demands for more complex processes and shorter delivery times by working to improve their technologies, quality, and pricing. In other words, information and technologies were shared and competitiveness increased by performing everything – from R&D to production, procurement of parts, sales, and provision of after-sale service – in an integrated manner within the same business group.

With product architectures now more modularized, however, there is no need for everything to be arranged within the same group, and also no need to rely on all processes being performed in nearby areas. As individual parts are standardized from the outset to allow interconnection, there is additionally no need for integration and adjustment in order to combine them into products. All that is required is that each process be differentiated and allocated to enterprises under a division labor that enables each individual part to be optimally procured.

As a consequence, there is less need to maintain traditional long-term, stable business relations. In other words, as enterprises are able to pursue low costs without being worrying about existing customers or patterns of transactions, they are now able to use cheap

East Asian products and establish manufacturing overseas manufacturing operations with a view to local procurement in East Asia.

Particularly in core technology fields that are labor intensive or in which standardization is more advanced and entry is comparatively easier, the transformation of conventional business relations in order to pursue lower costs appears to be easier. In practice, the movement of assembly and processing operations overseas led by large enterprises has set off a chain reaction as SMEs involved in related processes follow in their wake, creating gaps in the division of labor in manufacturing within Japan. There has at the same time occurred a growing transfer of technologies to the locations overseas that have been the target of Japanese investment, which appears to have helped East Asian enterprises to catch up to an extent technologically.

In the automobile industry, on the other hand, it is not simply a question of efficiently producing the desired functions by pursuing greater standardization between products and parts. Instead, elements of performance also have to be incorporated, such as fuel economy, ride quality, quietness, and handling, through the adjustment and integration of a total of more than 30,000 parts. Automaking is therefore less amenable to modularization. Rather than change suppliers frequently on the basis of price, therefore, one would expect enterprises to place a greater emphasis on accumulating know-how together through continued tight integration.

The production equipment field, too, is characterized by comparatively little standardization, and also revolves around domestic manufacturing. These features of each product field appear to be reflected in the differences in trends in market competition between the “automobile group” and “consumer electronics group” observed above.

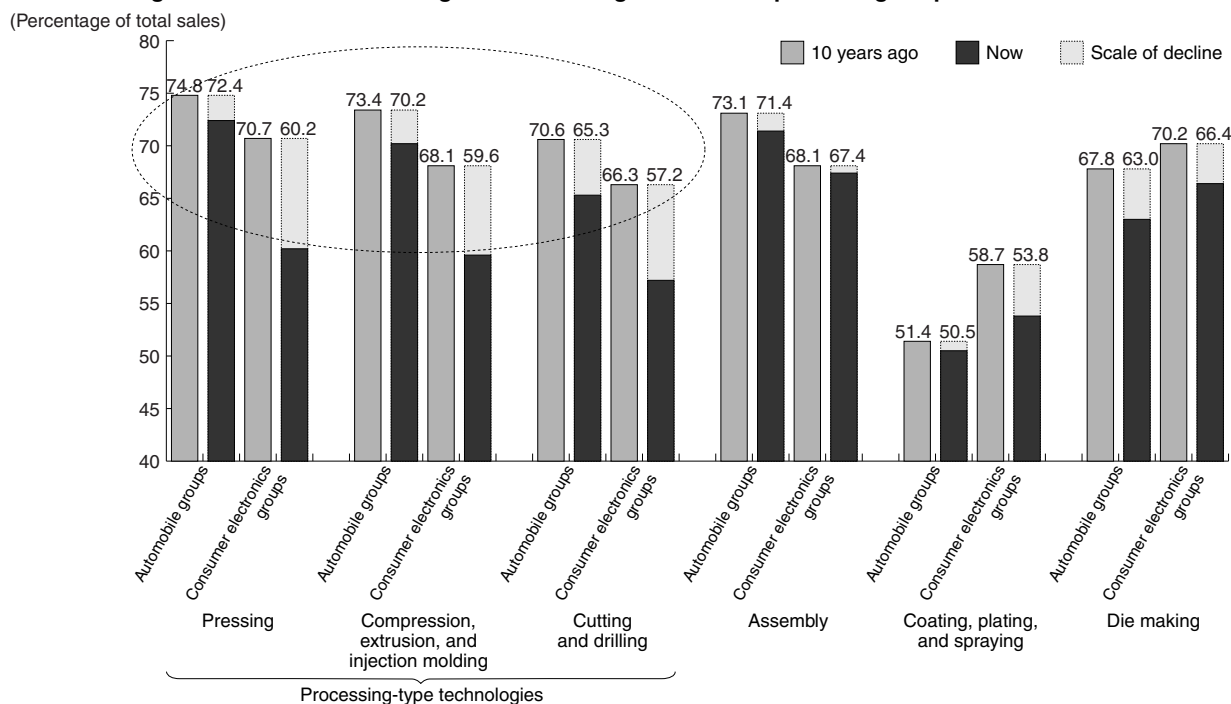
Based on these differences in product architecture, we consider next certain individual fields of core technology focusing on the following due to their comparatively large sample sizes, which allow detailed analyses to be performed: “pressing,” “compression, extrusion, and injection molding,” “cutting and drilling,” “assembly,” “coating, plating, and spraying,” and “die making.”

Breaking down changes in the proportion of total sales accounted for by the three largest customers in the past 10 years according to category of core technology, we discover a comparatively large decline in the proportion of sales to the “consumer electronics group” in processing-type core technology fields such as pressing, injection molding, and cutting. This would indicate that the “meshing” of transactions resulting from the modularization of product architectures is having a

7) Open modularization refers to the division of products combining complex functions (such as personal computers) into several modules according to function (such as hard disks, CPUs, and memory) and adoption of unified standards between enterprises on interconnectivity so that the desired functions can be achieved simply by procuring the individual parts separately and assembling them.

Fig. 2-3-18 Proportion of total sales accounted for by sales to top three customers by type of manufacturing technology

Large decline in field of processing-type technologies for “consumer electronics groups,” and signs of increase in “meshing” of business against backdrop of change in product structure



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

- Notes:
1. Manufacturers and processors of parts, semi-finished products, and formed and fabricated materials with 300 or fewer workers.
 2. The “automobile group” consists of enterprises involved in automobile and production facilities, and the “consumer electronics group” consists of enterprises involved in white goods, audio-video and consumer electronics equipment, and IT equipment.

particularly marked impact on enterprises involved in these processing-type core technologies (Fig. 2-3-18).

In coating, plating, and spraying, sales to large customers have been low in both the “automobile group” and the “consumer electronics group,” regardless of period. This is due to the fact that, by its very nature, the coating and plating business will not pay without large orders for parts, and it is difficult to do business at a distance because of the cost of transporting parts, as a consequence of which a wide range of business is done with nearby enterprises.

(2) Technology fields and market competition

Let us look at Fig. 2-3-19. If core technologies are divided into those provided mainly to the “automobile group” and those provided mainly to the “consumer electronics group,” and the current levels of technological superiority and market competition plotted against each other, it can be seen that whereas overall enterprises involved mainly in providing core technologies to the “automobile group” do not sense market competition, enterprises involved in core technologies for the “consumer electronics group” do sense market competition. Among the core technology

fields observed above, however, enterprises involved in die making and compression, extrusion, and injection molding for the “automobile group” sense the same level of competition as enterprises involved in core technologies for the consumer electronics group.

What should we make of this? To answer this question, we focus on an analysis of die making, which is frequently cited as the archetypal core technology of Japanese manufacturing.

In die making for the “automobile group,” it can be seen that there is a stronger tendency for clients to demand “development proposal ability” and “ability to cope with new technologies and materials” compared with other core technology fields (Fig. 2-3-20). Die making in Japan is considered to be extremely technologically demanding. At the same time, however, an examination of the relationship with East Asian products shown in Figs. 2-3-17(13) and 2-3-19 indicates that many enterprises sense market competition from East Asian products regardless of the fact that many Japanese die-making SMEs feel that they are technologically superior to their East Asian counterparts.

This suggests that there exists a dual structure in the die market. On the one hand, there is demand in the

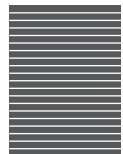
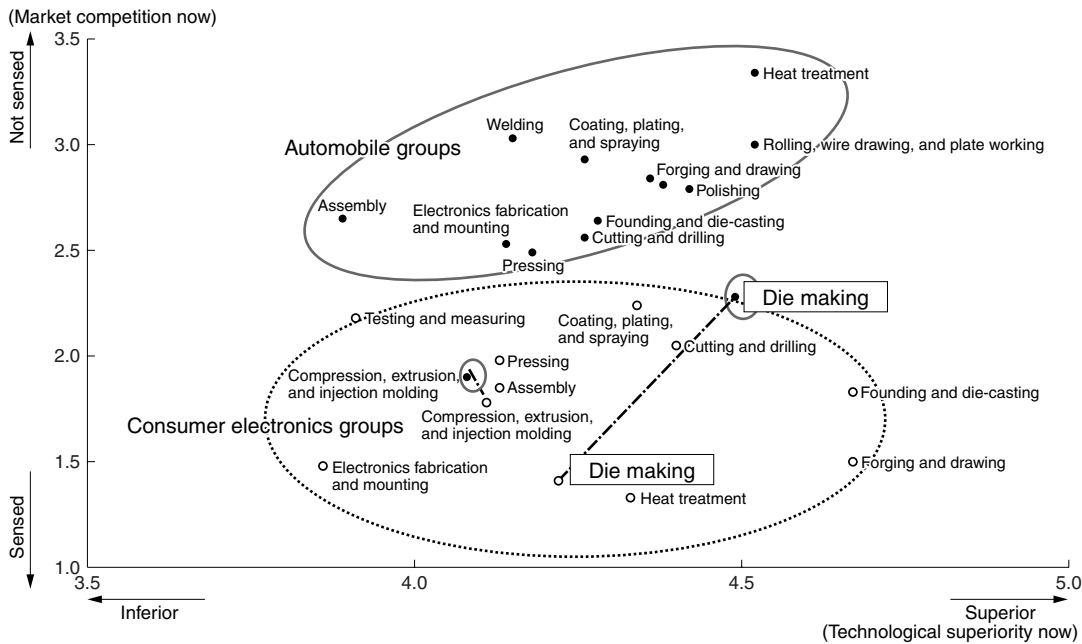


Fig. 2-3-19 Present level of technological superiority and market competition in each core technology field by product group

Tendency for less market competition to be felt by “automobile group” than “consumer electronics group”, but market competition felt in both groups regarding die making and compression, extrusion, and injection molding



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

- Notes:
1. Manufacturers and processors of parts, semi-finished products, and formed and fabricated materials with 300 or fewer workers.
 2. The “automobile group” consists of enterprises involved in automobile and production facilities, and the “consumer electronics group” consists of enterprises involved in white goods, audio-video and consumer electronics equipment, and IT equipment.
 3. Regarding their core field of technology, enterprises were asked whether they presently sensed market competition due to the influx of East Asian products in the domestic market (5. No, 4. Not much, 3. Neither, 2. Somewhat, 1. Yes) and whether they were technologically superior to East Asian enterprises (5. Superior, 4. Somewhat superior, 3. Neither, 2. Somewhat inferior, 1. Inferior).

domestic market for high-performance dies requiring the use of new technologies and new materials, and high intangible value added through the ability to provide development proposals, and on the other, there exists demand for products that do not require such high performance, and for these enterprises are now turning to cheaper East Asian markets.

As a result, it is possible, as we shall see later on, that differences in whether or not enterprises have core competences give rise to differences in the state of market competition among SMEs involved in die making.

Regarding actions relating to the implementation of business policy over the past 10 years, as much as 46.8% of die makers serving the “automobile group” specialized in processes in fields of expertise that were core competences, and the average state of market competition among these enterprises was 2.7 points, indicating that there was comparatively little sense of

market competition. On the other hand, the average for enterprises that did not specialize in processes in fields of expertise was 1.9 points, indicating a large gap in the extent to which market competition is perceived (Fig. 2-3-21).

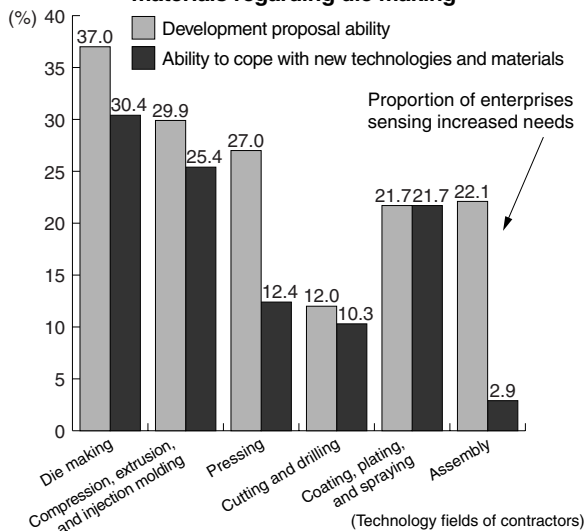
A feature of die making is that, overall, there is a strong sense of market competition for its high technological level in comparison with other core technologies. Within die making, however, the state of market competition differs between die making for the “automobile group” and die making for the “consumer electronics group” (shown by the dotted line in Fig. 2-3-19). This is thought to be related to differences in the materials used, with metalworking dies being widely used in the “automobile group,” and plastic-molding dies being widely used in the “consumer electronics group.”⁸⁾

There appear to be three differences that lower the barriers to entry by East Asian enterprises to the plastic mold business and generate market competition with

8) Shinkin Central Bank Research Institute (2003). As dies are intrinsically unsuited to obtaining manufacturing economies of scale and require a high degree of expertise to make, the die-making industry consists of many micro businesses. Owing to the rising trend toward process industrialization with the spread of IT in recent years, however, smaller enterprises are finding it more difficult to survive.

Fig. 2-3-20 Needs of client enterprises in the “automobile group”

In the “automobile group,” there has been a particularly strong increase in demand for development proposal ability and ability to cope with new technologies and materials regarding die making



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

- Notes:
1. Manufacturers and processors of parts, semi-finished products, and formed and fabricated materials with 300 or fewer workers.
 2. The “automobile group” is the combined total of enterprises involved in automobiles and production facilities.
 3. Subcontractors were questioned about client needs that they felt had increased compared with 10 years ago.

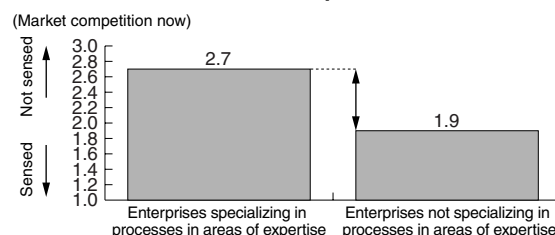
East Asian die makers.⁹⁾ These are as follows:

- 1) Plastic-molding dies have to cope with fewer new plastics than dies for molding metal materials such as steel sheet, which makes them more attractive targets of capital investment than metalworking dies in terms of both payback efficiency and risk.
- 2) The machine tools used to make plastic-molding dies require relatively little investment, lowering the hurdle of capital investment.
- 3) Plastic-molding dies generally demand less precision than metalworking dies, and do not require manual finishing by skilled workers, unlike in the case of metalworking dies.

9) Koichi Hirota (2003).

Fig. 2-3-21 Specialization in processes in area of expertise and market competition (die making)

More enterprises in the “automobile group” sense market competition due to the influx of East Asian products into the domestic market in die making than other core technology fields in the same group, but enterprises that consider themselves to have an edge in their core areas of expertise sense relatively less market competition



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

- Notes:
1. Manufacturers and processors of parts, semi-finished products, and formed and fabricated materials with 300 or fewer workers.
 2. Enterprises were asked about their performance in relation to the business policy in the past 10 years, and categorized accordingly.
 3. Regarding their core technical field, enterprises were asked whether they currently sense market competition due to the influx in the domestic market of East Asian products (5. Not sensed, 4. Not sensed much, 3. Cannot say, 2. Somewhat sensed, 1. Sensed).

3. Competition with East Asian enterprises and the sources of Japanese manufacturing SMEs’ competitiveness

As observed thus far, Japanese manufacturing SMEs face intensifying market competition, especially in the consumer electronics and IT equipment industries, as a result of the influx of East Asian products onto the domestic Japanese market. What strengths can Japanese manufacturing SMEs therefore leverage in order to bolster their competitiveness?

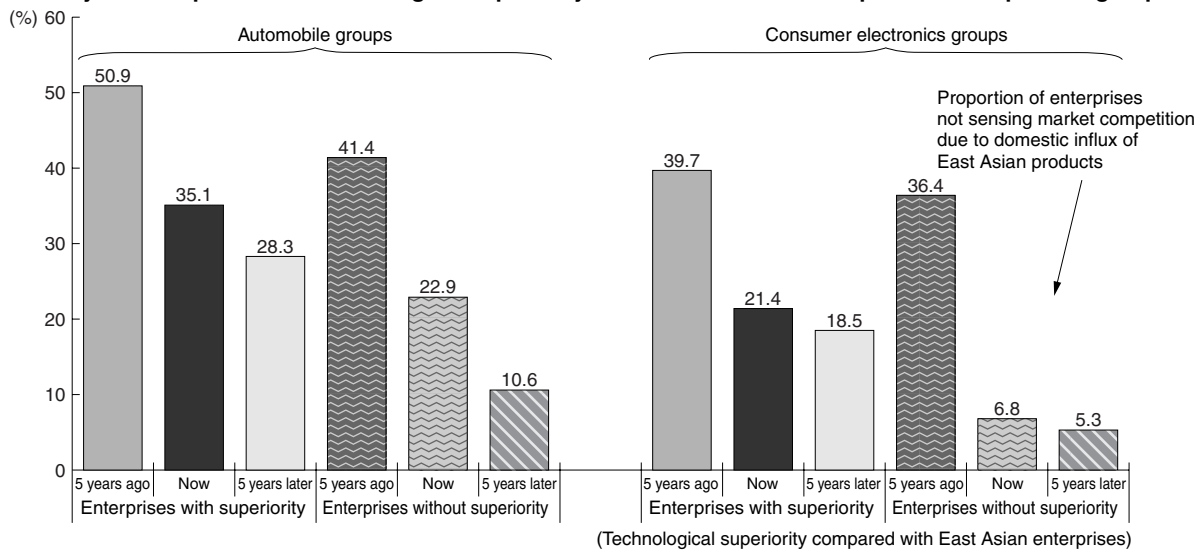
Looking at Fig. 2-3-22, it can be seen that enterprises with a technological advantage over East Asian enterprises are less likely than those that do not to sense market competition, and competition is also developing less rapidly. Even taking into account the price competition aspect, it is apparent that maintaining a technological advantage can translate into greater market competitiveness.

Below, then, we focus on what gives enterprises that are technologically superior to East Asian enterprises their advantage.

Enterprises with a technological advantage over East Asian enterprises were examined to determine from

Fig. 2-3-22 Technological superiority compared with East Asian enterprises and proportion of enterprises not sensing market competition

Tendency for enterprises with technological superiority not to sense market competition in all product groups



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

- Notes:
1. Manufacturers and processors of parts, semi-finished products, and formed and fabricated materials with 300 or fewer workers.
 2. Regarding their core field of technology, enterprises were asked whether they presently sensed market competition due to the influx of East Asian products in the domestic market (5. No, 4. Not much, 3. Neither, 2. Somewhat, 1. Yes) and whether they were technologically superior to East Asian enterprises (5. Superior, 4. Somewhat superior, 3. Neither, 2. Somewhat inferior, 1. Inferior).
 3. "Enterprises with superiority" is the combined total of enterprises that said that their technologies were "5. Superior" or "4. Somewhat superior" to those of East Asian enterprises, and "Enterprises without superiority" is the combined total of enterprises that said that their technologies were "3. About equal," "2. Somewhat inferior" or "1. Inferior."
 4. "Enterprises not sensing market competition" is the combined total of enterprises that responded "5. Not sensed" or "4. Not sensed much" regarding market competition due to the influx of East Asian products into the domestic market.

which of the following three broad categories their superiority was derived: 1) the performance of the manufacturing equipment and machine tools that they used; 2) the skills of their employees; and 3) their ability to research and develop new technologies. An analysis of technological superiority and market competitiveness according to their responses revealed that enterprises whose superiority was derived from "ability to research and develop new technologies" were more likely than enterprises that derived their superiority from "performance of manufacturing equipment and machine tools" or "skills of workers" to maintain a high level of both technological superiority and market competitiveness (Fig. 2-3-23).

Manufacturing equipment and machine tools have required increasingly technical skills in recent years due to demand for greater precision and the growing use of IT,¹⁰⁾ and even if an enterprise manages to obtain a technological advantage from its manufacturing equipment, machine tools or workers' skills, one would expect this gap to be easily closed to a certain extent by East Asian enterprises' introduction of high performance, cutting-edge facilities.

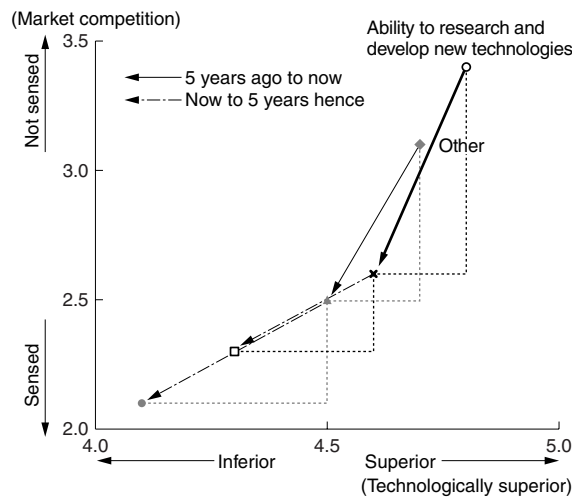
As far as the skills of employees are concerned, there can be little doubting that though manufacturing equipment may improve in performance, it is the "skill of the artisan" – those skills of workers on the manufacturing frontline acquired through years of experience and intuition, such as the ability allow for the minute thermal contraction that occurs during processing – that enables the most to be got out of this equipment. And while it might be possible to process products using computer-controlled machinery requiring little experience to use, skilled workers are still needed to devise the programs required to actually control such machinery and to perform difficult processing work.

If they are to continue competing with East Asian enterprises on an equal footing, then Japanese manufacturing SMEs will have to accept the fact that East Asia will draw closer and closer technologically as a result of the introduction of higher performance manufacturing equipment and the increasing experience of local workers. Ultimately, it is by constantly pursuing the "research and development of new technologies" by which Japanese manufacturing SMEs can best maintain their edge. In this regard, it is also important that stress

10) Regarding the issue of the "technologization of skills" and transfer of skills within the workforce, see the latter half of Part III, Chapter 2.

Fig. 2-3-23 Source of technological superiority to East Asian enterprises and trends in technological superiority and market competition

Enterprises whose superiority is derived from “ability to research and develop new technologies” tend to retain both technological superiority and market competitiveness



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

- Notes:
- Regarding their core field of technology, enterprises were asked whether they presently sensed market competition due to the influx of East Asian products in the domestic market (5. No, 4. Not much, 3. Neither, 2. Somewhat, 1. Yes) and whether they were technologically superior to East Asian enterprises (5. Superior, 4. Somewhat superior, 3. Neither, 2. Somewhat inferior, 1. Inferior).
 - Enterprises with 300 or fewer workers engaging in production or processing of parts, semi-finished products or formed and fabricated materials that said that they were currently technologically “superior” or “somewhat superior” to East Asian enterprises.
 - The figure shows a comparison of trends in technological superiority and market competition according to the source of enterprises’ technological superiority to East Asian enterprises.
 - “Other” consists of the combined total of enterprises that responded that their technological superiority to East Asian enterprises derived from “performance of manufacturing equipment and machine tools (developed or modified by own company),” “performance of manufacturing equipment and machine tools (commercial products including custom-made),” and “employees’ skills.”

Section 3 Changes in transaction patterns and approaches of manufacturing SMEs

In the preceding section, it was shown that while raising technological superiority translates into market competitiveness beyond simply price competitiveness, quite a few enterprises have a technological edge but fail to convert this into improved business performance (Fig. 2-3-24). Recently, there has been a reevaluation of the significant technological capabilities of the manufacturing SMEs that, by providing a wide core technological base, act as the source of Japan’s manufacturing strength, prompting large enterprises to start investing once again in Japan, and it is important that individual SMEs ascertain trends in the transaction

environment and their own position in it, and take action so as to take advantage of these trends.

With enterprises finding it increasingly difficult to determine what direction technology development should take due to changes in transaction patterns, it will grow ever more important that development work should be directed toward applying limited business resources to enterprises’ next moves and that action be taken to gather information to indicate what direction development should take.

environment and their own position in it, and take action so as to take advantage of these trends.

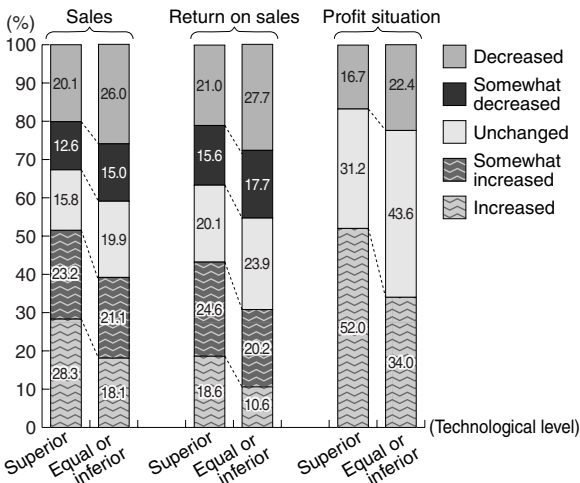
Below, we consider the approaches being taken by SMEs in response to changes in transaction patterns and their performances.

1. Improvement of production processes

We begin by looking once again at the relationship between actions by contractors regarding “quality, cost, and delivery” (QCD) – reaffirmed in Section 1 as forming the basis of production management – and

Fig. 2-3-24 Technological capabilities and business performance

While technologically advanced enterprises tend overall to exhibit superior performance, quite a few enterprises find that technological superiority does not translate into better performance



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

- Notes:
1. Manufacturers and processors of parts, semi-finished products, and formed and fabricated materials with 300 or fewer workers.
 2. "Superior" is the combined total of enterprises that said that they were presently technologically "superior" or "somewhat superior" to East Asian enterprises, and "equal or inferior" is the combined total of those that they are "about equal" "somewhat inferior" or "inferior."
 3. Performance regarding sales, return on sales, and profit situation was over the past 10 years.
 4. The above key does not apply to the bars showing profit situation, and instead indicate, from the top down, "in the red," "in equilibrium," and "in the black."

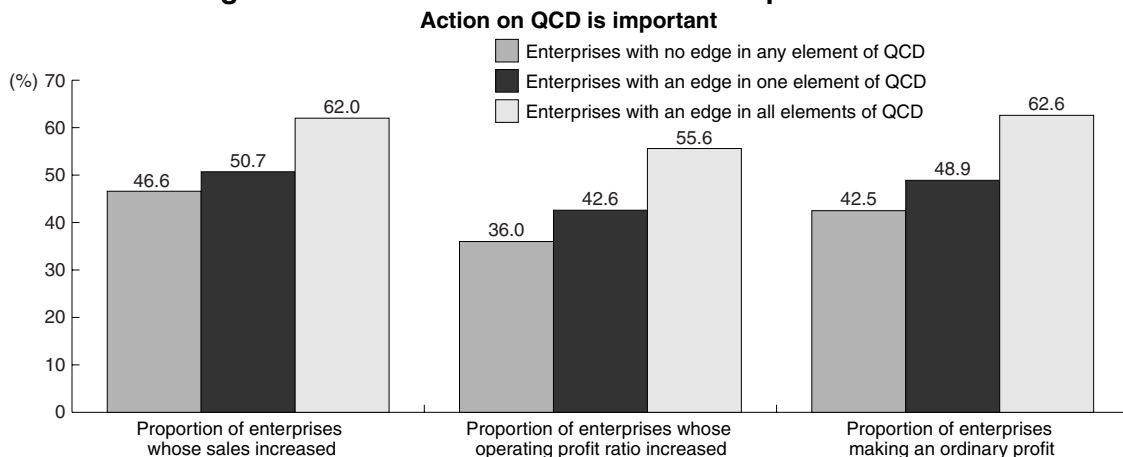
business performance in terms of sales, operating profit, and ordinary profit or loss. Fig. 2-3-8 showed that clients evidenced a strong need for elements relating to QCD, and as can be seen from Fig. 2-3-25, enterprises with an edge in QCD exhibit better business performance than enterprises with no edge in any element of QCD.

Next, we look at the relationship with business performance of high mix, small lot production, which is most sought by clients after QCD and business stability. With the shift of production of mass-produced articles to East Asia in recent years, the need for enterprises in Japan to be able to meet demand for high mix, small lot production has been frequently noted. However, does this have a positive effect on an enterprise's business? According to the results of one survey, enterprises with an edge in high mix, small lot production exhibit poorer performance than enterprises without such an edge (Fig. 2-3-26).

As manufacturing economies of scale cannot be obtained when producing large varieties of products in small lots, it is inevitably necessary to switch between a broad range of product types and constantly tweak procurement and management of materials, and reducing costs – both financially and time-wise – is a key concern. Enterprises thus need to be able to handle new production processes, and in practice, enterprises with a simultaneous edge in both "cost-cutting ability" and "high mix, small lot production capability" tend to exhibit better business performance.

With the need to cater to demand for high mix, small lot production now becoming commonplace, one would expect the extensive use of facilities and jigs whose use

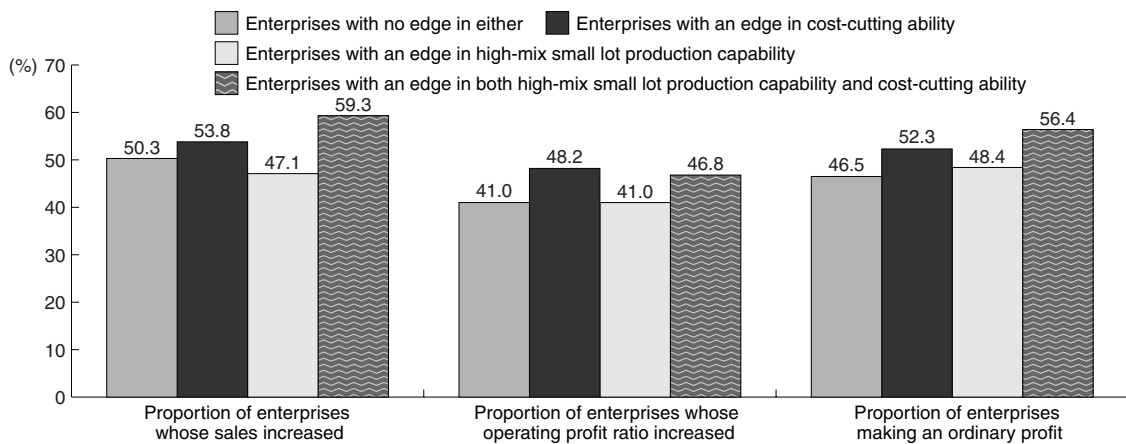
Fig. 2-3-25 Action on QCD and business performance



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

- Notes:
1. Manufacturers and processors of parts, semi-finished products, and formed and fabricated materials with 300 or fewer workers.
 2. Performance regarding sales, return on sales, and profit situation was over the past 10 years.
 3. "Enterprises whose sales increased" are enterprises that said that their sales "increased" or "increased somewhat," and "enterprises whose operating profit ratio increased" are enterprises that said that their operating profit ratio "increased" or "somewhat increased."
 4. Enterprises are categorized according to what has given them the edge when doing business with first-time customers over the previous 10 years, and these categories then not overlaid.
 5. QCD here means "quality of products and processing," "stability of quality," "cost-cutting ability," "ability to cater to quick deliveries," and "reliable observance of delivery deadlines."

Fig. 2-3-26 High-mix small lot production capability and business performance
Cost reductions and other improvements to production processes have to be made in conjunction



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

- Notes:
1. Manufacturers and processors of parts, semi-finished products, and formed and fabricated materials with 300 or fewer workers.
 2. Performance regarding sales, return on sales, and profit situation was over the past 10 years.
 3. “Enterprises whose sales increased” are enterprises that said that their sales “increased” or “increased somewhat,” and “enterprises whose operating profit ratio increased” are enterprises that said that their operating profit ratio “increased” or “somewhat increased.”
 4. Enterprises are categorized according to what has given them the edge when doing business with first-time customers over the previous 10 years, and these categories then not overlaid.
 5. “Enterprises with an edge in both high-mix small lot production capability and cost-cutting ability” are enterprises that responded regarding both high-mix small lot production capability and cost-cutting ability.

is limited to certain product types to result in “replacement loss” when switching from production of one product type to another. With product lives also now shortening, there is a risk that facilities and jigs installed for limited uses may not be usable for long.

Having identified exactly what they themselves have to offer, enterprises need to improve their production processes by, for example, modifying facilities and jigs, reviewing production management itself, and possibly even introducing cell production methods¹¹⁾ (see Case 2-3-1).

2. Creation of core competences

In the markets in which SMEs do business, competition with East Asian products is increasing, East Asian enterprises are catching up technologically, and SMEs are having to cope with more advanced needs in the domestic market as well as overseas.

Under these conditions, one way in which SMEs can pursue better business performance and survive is by developing strengths backed by unique know-how and technologies so as to develop core competences.

Concentrating on processes in areas of expertise and creating and extending strengths can be reasonably expected to generate synergies with a variety of other measures.

For example, Fig. 2-3-27 shows the business performance of enterprises that “expanded activities in a non-traditional field” based on a survey of activities relating to business policy in the past 10 years of SMEs involved in core manufacturing technologies. As can be seen, enterprises that expanded their business in a different product field performed better than enterprises that did not. However, enterprises that simultaneously “specialized in processes in field of expertise” performed even better. This would consist of, for example, an enterprise’s expansion from processing of parts for IT equipment to production for automobiles by leveraging its core competences.

An analysis was also made of synergies between various measures and “specialized in processes in field of expertise.” This suggests that the edge derived from specializing in processes in field of expertise generates synergies with the performance of various other measures (see Cases 2-3-2 and 2-3-3).

11) “Cell production” is a method of production that produces highly finished items on a single compact production line called a “cell,” within which one or more workers are responsible for production of a single product.

Compared with conventional conveyor-belt production systems, cell production offers a variety of advantages that can contribute in many cases to improvements in productivity. These include the following: 1) product types can be easily changed simply by reshuffling parts and machine tools; 2) as lead times can be shortened, inventories can be reduced; 3) rapid discovery of defects should they occur, and rapid response to them; 4) as each cell is self-contained, there is less risk of problems such as defects having a knock-on effect; 5) workers are more motivated as they are responsible for a product all the way through to its completion; and 6) innovations are generated, leading to improvements in the production line.

However, it has also been noted that 1) workers must be more multi-skilled, 2) there is a dependence on workers’ motivation, and 3) cell production is not always suitable depending on the work process and line of product.

**Case
2-3-1**

Successfully acquired new customers by meeting customers' needs for prototypes and high mix, small lot production

Established in 1971 in Aichi Prefecture and with a workforce of 59 employees, Honeston Co., Ltd. manufactures customized die parts and machine parts. A feature of Honeston's operations is its manufacture of high mix, small lot products that meet the customer specifications. While the average order of dies placed with the company is under 1.4 units, it processes as many as around 9,000 vouchers a month.

As a result of its ability to undertake this high mix, small lot production, it has around 1,000 customers, most of which are automotive manufacturers in the Tokai region. This high mix, small lot production capability requires some innovation on the production process side. Based on "single-item manufacture," Honeston has introduced the cell method of production whereby a single technician completes a whole series of

tasks, such as cutting, polishing, finishing and testing, made possible by a training program that teaches a wide range of skills to all employees. To raise employees' awareness of cost, it also produces graphs showing who has produced x number of rejects and at what cost. These graphs are put up in spots where customers can see them as well. The intent behind this is not punitive. Rather, it is to create a system that makes the productivity and defect ratio of each employee obvious at a glance for the purpose of reducing the ratio of defective products generated. Honeston has installed cutting-edge equipment seen at only a few other locations in Aichi. The company also makes employees aware of costs by putting up sheets showing the monthly cost of leasing each machine, and the hourly cost of those operating eight hours a day.

Increasing one's company's strengths and entering a new and different product field also broadens the routes by which information is acquired due to involvement in new and different business networks, and this is enormously significant to discovering the needs that will produce an enterprise's "next" strengths and embarking on further R&D and new challenges.

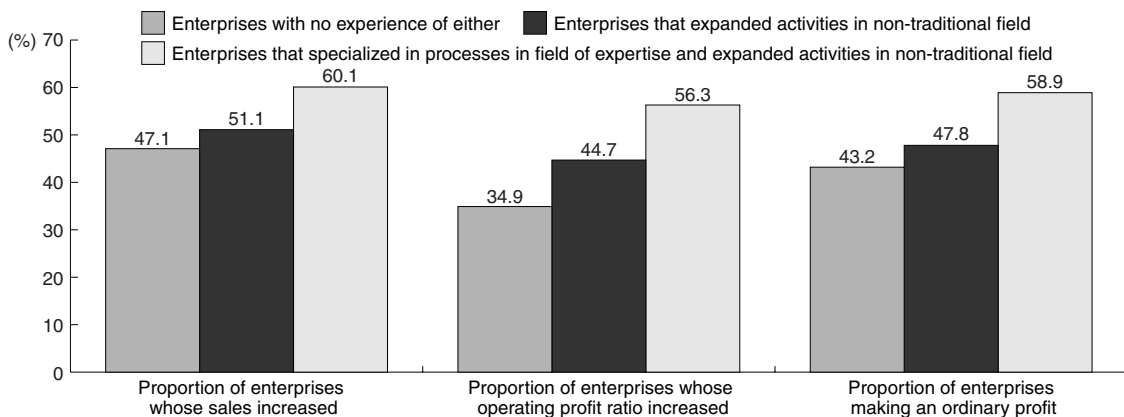
Thus specializing in processes in fields of expertise and generating and extending strengths in the form of proprietary know-how and technologies can produce synergies with other activities. As SMEs tend to be relatively lacking in business resources, however, not all can embark on such a course of action acting alone

simply by adopting a "let's do it now" approach. As described in the next chapter (Part II, Chapter 4), a more realistic approach is collaboration between SMEs in different industries or producing different end products so as to build a framework by which each complements the other's strengths and weaknesses (see Case 2-3-4).

3. Protecting ideas and know-how

By pursuing approaches such as the above, enterprises can accumulate new ideas and know-how, leading in turn to the creation of further strengths. In this sense, these accumulated ideas and know-how could be regarded as

Fig. 2-3-27 Creation of core business strengths and business performance
Specialization and strength in field of expertise can be expected to generate synergies with other measures



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

- Notes:
1. Manufacturers and processors of parts, semi-finished products, and formed and fabricated materials with 300 or fewer workers.
 2. Enterprises were classified according to performance regarding business policy in the previous 10 years, and each of the enterprise groups not overlaid.
 3. Performance regarding sales, return on sales, and profit situation was over the past 10 years.
 4. "Enterprises whose sales increased" are enterprises that said that their sales "increased" or "increased somewhat," and "enterprises whose operating profit ratio increased" are enterprises that said that their operating profit ratio "increased" or "somewhat increased."

Case 2-3-2

Achieving good results by boosting strengths through specializing

Yamamoto Seisakusho, Inc. is located in Saitama Prefecture and has a workforce of 230. It was established in 1967 by the current president of the company. At the time of its inception it was a specialist die manufacturer, though orders for its die work were not steady. This prompted it to venture into the machining field as a means of receiving a stable flow of orders. It also succeeded in gaining a competitive edge by specializing in press technology known as fine blanking. Because fine blanking is very good for punching thick plates, 80 percent of the company's customers are engaged in the automotive industry. However, the company does not rely on specific affiliated manufacturers, but is striving to expand its business as an independent manufacturer.

Unperturbed by the shift overseas of the operations of customers and other companies in the industry since the 1990s, the company had the foresight to build plants in Japan with cutting-edge equipment and to invest in fine blanking in terms of both equipment and human resources.

This strategic concentration on core technology paid off, as the company established a high earnings foundation and already had its sights on listing on the stock exchange. Today, the company has established a technical research center called the Fine Blanking Center within the grounds of the Nippon Institute of Technology, which is located in the same area. Having taken such measures to further upgrade core technologies and train personnel, the company indeed lives up to its reputation as a leader in fine blanking in Japan.

Although circumstances are said to be tough for the press forming industry, the company's annual capital investments and its focus on employee training have gradually paid off. Companies that make sudden capital investments just because they have a good year struggle in subsequent years because their costs end up out of proportion. There is a big difference between companies that make annual investments in equipment and staff training and those that take it easy and don't make capital investments. Having a long-term strategy is important.

Case 2-3-3

Specializing in processes where it has the most expertise gives the company a core technology that forms the heart of its business, taking it beyond mere subcontracting and adding value, leading to successful acquisition of customers and entry into other product fields

SYVEC Corporation is located in Nagano Prefecture and has a workforce of 47. It was founded in 1973 by the current president, who first worked for a watch manufacturer and then a metal stamping manufacturer and sensed the future potential of press machines. In its sixth year of operation, it made unusually large capital investments for an SME. By installing a high-quality wire cutting electric discharge machine made in Japan it managed to begin the manufacture of high-precision metal dies. Later, taking advantage of the metal die and stamping technologies it had accumulated making electrical and electronic products, it entered the automotive industry in 1999. Today, it has earned the deep trust of leading automobile manufacturers.

The company was the first to develop progressive cold forming technology in Japan. Today, this technology for making three-dimensional shapes by changing sheet pressure is its core technology. The die must be hard in order to be punched by this sort of three-dimensional shaping press, and one factor for the company's competitiveness is that it has the capability to make these precision dies in-house. Specializing in this core technology has enabled the company to manufacture very small, ultra-precision products. As a result, it has expanded the fields it

manufactures for. It began producing electrical and electronic parts and computer peripherals for the IT industry, branched out into the automotive industry, which was using increasing amounts of electronic parts, and then into medical equipment and devices, the environmental sector, and fuel cells.

Aspiring to be a development-oriented manufacturer, in April 2000 it established its own Institute of Value Technology for working exclusively on research and development. SYVEC's president also serves as president of the Institute, which has nine employees. The Institute conducts research and development in six areas of press dies: 1) ultra-fine stamping & laser technology; 2) three-dimensional forming; 3) ultra-precision machining technology; 4) compound stamping; 5) magnesium forming; and 6) measurement systems for internal dimensions of dies. It undertakes what it calls "Value Engineering," which differs from value-added engineering in that the company commits to customers from the design and development stage, providing proposals that offer value. It adheres to the concept of "value technology," which has two meanings: one being "value for the customer" and the other "value for the company." Thus, its goal is to make customers happy at the same time as creating technologies that have value for the company.

the assets that provide SMEs with their future bread and butter. It is therefore important that individual SMEs

simultaneously take action to protect these assets.

Nowadays more than ever, the spread of IT and ease

with which implicit knowledge can be converted to explicit knowledge make it easy to transmit even intangible ideas and know-how that have taken considerable effort to accumulate.

For example, drawings of parts and CAD/CAM data are embodiments – in numbers and unique modes of expression – of an enterprise's unique ideas and know-how. When these are delivered with manufactures to a client, however, it is almost as if these ideas and know-how are being leaking from the company, creating the

risk that they could then spread further and further afield. If this happens, then these carefully nurtured ideas and know-how will cease to serve to differentiate an enterprise from its competitors in business, and, if they become widely known in markets overseas, price competition could also be accelerated.

In this example, it would be better not to hand over drawings and data directly to a customer without careful consideration, and, if they are provided, a written agreement should be concluded to ensure the

Case 2-3-4

Success in getting new customers from an open market by sharing technical expertise with other SMEs

Located in Kumamoto Prefecture with a workforce of 50, Preceed Co., Ltd. was established in 1989 as a spin off by its present president, who used to work for a leading local machine manufacturer. Since then, it has grown as an independent company that designs and manufactures automated labor-saving machines and equipment.

There are more than a few SMEs in Kumamoto that, like Preceed, started up as spin offs from the same leading machine manufacturer, and these also specialize in the design and manufacture of equipment such as automated machines. However, the spin off companies are venture companies without a specific parent company. As a result, unlike an SME that contents itself to be a subcontractor but enjoys the benefit of stable orders, these companies live hand to mouth not knowing where tomorrow's work will come from. Although this situation requires that they disseminate and leverage information, because they develop and manufacture production equipment for companies, theirs is a low-key existence, which

makes it hard to establish a public profile. Moreover, because they haven't been established for long, it is all the more necessary that they cope with whatever comes their way by themselves.

It was in response to these circumstances that Preceed established a production technology development cooperative association with six other spin off companies. The aim is for these companies, each having its own design and development capabilities and its own assembly facilities, equipment, and technical expertise to expand opportunities for orders through sharing each other's know-how and drive. The companies have realized that it is more advantageous to undertake marketing activities as a group in order to disseminate information to reach a wider customer base. The cooperative association has been able to exhibit at an industrial machine trade fair held in Shanghai. Exhibiting in trade fairs overseas is not inexpensive, but the six companies in the association have been able to keep costs down by joining forces.

Case 2-3-5

Manufacturing company actively protecting its intellectual property

ELM, Inc. is located in Kagoshima Prefecture and has a workforce of 32. Established in 1980, it designs and makes electronic equipment, labor-saving industrial equipment, and automated testing equipment. With technicians comprising 25 of its full-time workforce of 32, it is a development-based company.

Its mainstay products are optical disc repair machines that repair scratches on the reading surfaces of music, program, and game CD-ROMs and DVDs. ELM was the first in the world to develop a fully-automated machine capable of repairing 50 discs consecutively, which it has sold in Japan as well as 23 countries in Europe and North America. It adopts the "wet" process, which takes less than one-tenth the repair time than the conventional "dry" process. It has lodged a patent application for flat surface repair technology, which allows DVDs, considered more difficult to repair than CDs, to be repaired ten or more times. ELM's development is highly rated by the market, and with its products comprising 85% or more of the world market for fully automated machines, it is

regarded as the global leader in its field.

ELM has already obtained ten patents and has lodged applications for at least thirty more. Due to the almost immediate appearance of imitations overseas, it is endeavoring to protect its intellectual property by actively applying for patents overseas.

Optical disc repair machines also have an advantage in that, in addition to sales of the machines themselves, manufacturers can continue to sell consumables. Sales of consumables already account for more than ten percent of ELM's sales, and it expects to increase this several-fold. For this reason, when developing optical disc repair machines, the company also keeps a close eye on the implications for the growth of its consumable business, applying for patents for the configuration of consumables and ensuring that other companies cannot easily come up with similar products.

It also applies for patents jointly when collaborating with large companies, making sure that its own intentions are reflected.

confidentiality of ideas and know-how.

As a means of protecting ideas and know-how in general, acquiring patents and utility model rights is one option. However, the patent system necessarily entails the disclosure of details of ideas and know-how, and in the case of really innovative ideas and know-how, an

alternative might instead be to establish a strict management system binding employees as well as management to ensure that they are kept as trade secrets. It is also important that several methods of protection be employed appropriately and strategically as the situation demands (see Case 2-3-5).

Section 4 The importance of constant action on reform (summary of Chapter 3)

The pattern of transactions engaged in by the SMEs upon which Japanese manufacturing depends for its core technologies – such as the production and processing of parts and materials – is changing. As we have observed, however, the change is not simply one of SMEs’ moving away from subcontracting and becoming instead independent enterprises, as the phrase “collapse of subcontracting patterns” might suggest. Instead, subcontracting continues to survive as a way of doing business, but with enterprises reducing their tight dependence on a limited number of customers and instead acquiring a relatively broader clientele.

According to the *Transaction Environment Survey*, only 1.4% of enterprises that engaged in subcontracting business 10 years ago are not currently so engaged. During this decade, clients have called on subcontractors to strive to attain high QCD levels and make other improvements, and many contractors have met these calls.

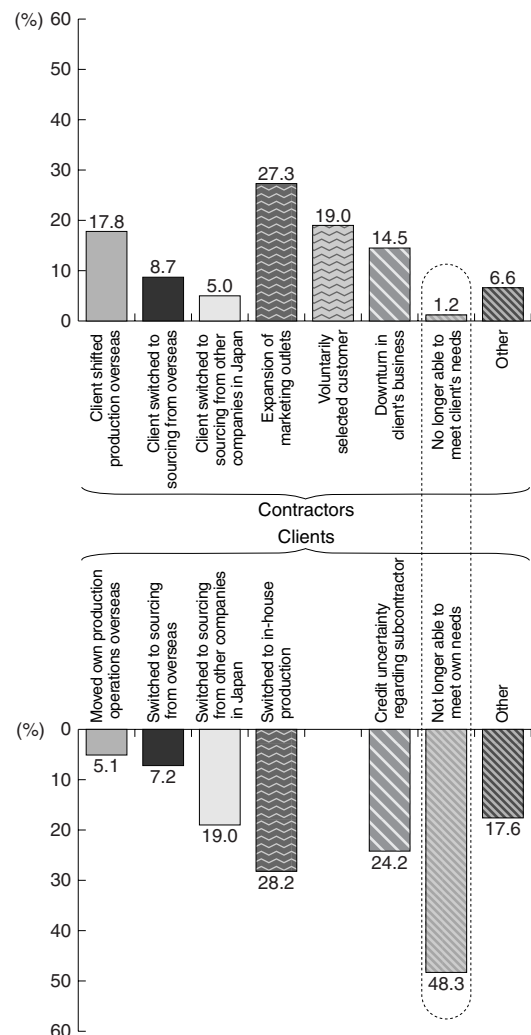
However, asking both contractors and clients that have actually terminated (or had terminated) their subcontracting in the past 10 years the reasons therefor reveals interesting differences.

Almost one in two subcontractors (46.3%) consider themselves to have terminated the subcontracting relationship positively and actively for reasons such as the expansion of marketing outlets and selection of customers. On the other hand, only 1.2% of enterprises believe that their subcontracting business was terminated due to their inability to meet customers’ needs. In contrast, almost half (48.3%) of the clients polled said that they terminated their business with a subcontractor as the subcontractor failed to meet the client’s needs. There is thus a large perception gap between clients and subcontractors (Fig. 2-3-28).

As client enterprises were allowed to give multiple answers, direct comparisons with the responses of contractors cannot be made. It nevertheless seems important that contractors recognize the changes in transaction patterns that they confront and their own position in the market from a greater variety of angles, and that they take action in response.

In addition, regarding the technological capabilities of the SMEs that underpin Japanese manufacturing, the proportion of enterprises responding that they derive

Fig. 2-3-28 Reasons for termination of subcontracting relationship seen from perspectives of contractors and clients
Large gap in perception between contractors and clients

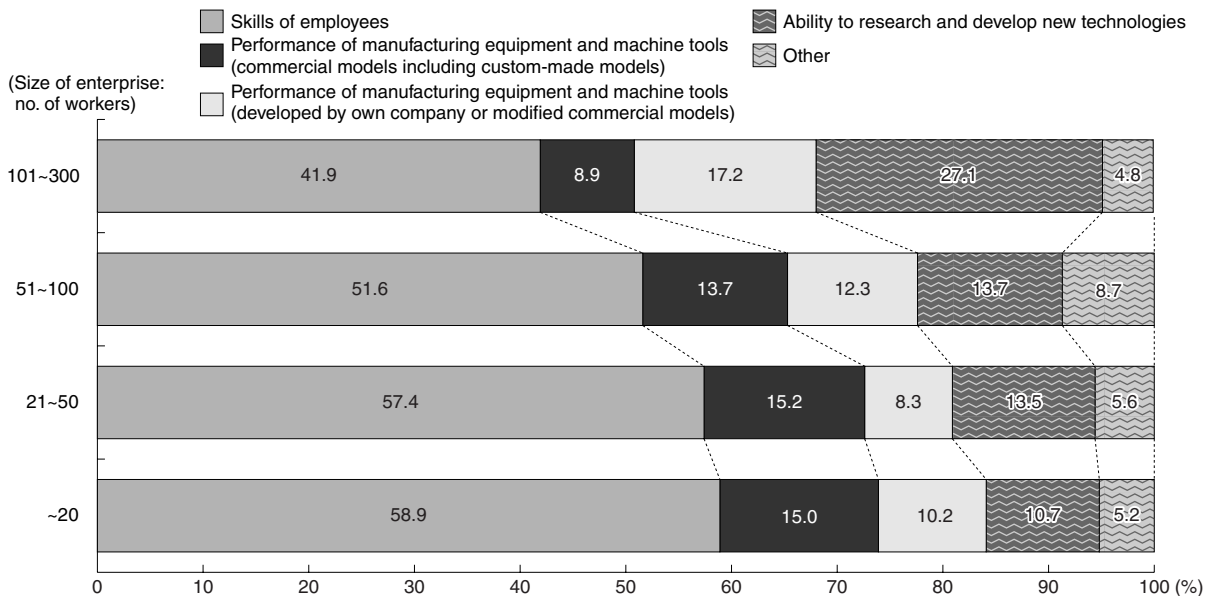


Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

Notes: 1. Contractors are defined as enterprises with 300 or fewer workers that manufacture or process parts, semi-finished products, or formed and fabricated materials, and clients are enterprises of all sizes that manufacture or process finished products, end products, parts and semi-finished products, or formed and fabricated materials.
2. In the lower graph, totals exceed 100 as multiple responses were allowed.

Fig. 2-3-29 Sources of technological superiority by size of enterprise

Smaller enterprises are more likely to derive their technological superiority from the skills of their employees



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

Note: Enterprises with 300 or fewer workers that manufacture or process parts, semi-finished products or formed and fabricated materials and responded that they were currently technologically “superior” or “somewhat superior” to East Asian enterprises.

their edge from the “skills of employees” increases as size decreases (Fig. 2-3-29).

As the baby boomers that have formed the mainstay of the manufacturing shop floor reach retirement age en masse, it is becoming increasingly important that Japanese SMEs, if they are to maintain their superiority, not only continue with the business activities that they have pursued to date, but also tackle problems such as the question of how to further raise employee skill levels and ensure the smooth transition of skills to younger workers.¹²⁾

Naturally, the business interests of SMEs are diverse, and the changes in the transaction environment facing individual enterprises cannot be put down solely to the growing international development of labor. Moreover,

the approaches that they should adopt also vary widely according to the specific trading conditions that they face. But while smaller enterprises in particular may be keenly aware of the need to embark on management reforms, such as by entering new fields of business, developing new products, and acquiring new customers, at this difficult time of dwindling orders and earnings, many enterprises can become absorbed in the present again when work picks up again – “danger past, God forgotten,” one might say. Precisely because domestic investment in manufacturing is now heading up, all SMEs need to re-ascertain and reassess their strengths and weaknesses and do what they can in response on a constant and regular basis.

12) See the latter half of Part III, Chapter 2.

Chapter 4 Changes in the business environment due to the globalization of industry and regional industrial clusters

With the economies of East Asia growing rapidly, regions throughout Japan are having to compete with regions in East Asia to attract investment. The infrastructure and labor force situation in East Asian countries is improving rapidly, and regions in Japan are finding it increasingly difficult to maintain cost competitiveness in particular in comparison with East Asia.

In order to revitalize the regions against this backdrop, it is important that maximum use be made of each region's own distinctive accumulated resources

(regional resources). One regional resource useful for revitalizing the regional economies is the functions of "industrial clusters."

The purpose of this chapter is twofold: 1) to examine the functions performed by industrial clusters to date and how they have changed amid the growing international division of labor and market globalization; and 2) to analyze what are the present functions of industrial clusters and how they can be used in the future to secure enterprises' competitive advantage in each region.

Section 1 Types of regional industrial cluster and framework of analysis

The siting of numerous enterprises in close geographical proximity in the same particular region and formation of relations between enterprises, such as the receipt and placement of orders, exchange of information, and collaboration, is known as "clustering."¹⁾

Industrial clusters can be grouped into several types according to how they formed historically and their characteristics. Here, we analyze four types of industrial cluster: 1) company town clusters, 2) production region clusters, 3) mixed urban clusters, and 4) mixed invitation clusters.²⁾

1) Company town clusters

These are clusters formed by the siting of numerous subcontractor groups around the mass-production plant of a particular large enterprise. Typical examples include the Hiroshima region around Mazda, the area around Toyota City in Aichi, which has Toyota Motor at its heart, and the Kitakyushu region in Fukuoka Prefecture, which has formed around Yawata Steel (now operated by Nippon Steel Corporation).

2) Production region clusters

Clusters of this kind are formed by enterprises belonging to a specific industry (such as consumer goods) concentrating in a particular region, and they have grown through their members' mutual use of raw materials and technologies that have accumulated in the region. Typical examples include the Tsubame-Sanjo region in Niigata Prefecture, where cutlery and blade manufacturers have clustered, the spectacle-making cluster in the Sabae region of Fukui Prefecture, and the furniture-making cluster around Asahikawa City in Hokkaido.

3) Mixed urban clusters

These clusters have formed in urban areas around

prewar production bases or munitions plants, or wartime factories set up to disperse production, around which have concentrated related enterprises. There are many such clusters in the machinery and metalworking industries, and there often occur divisions of labor between enterprises in the same cluster and business relations that cut across traditional industry groupings. Typical examples include the Jonan region in Tokyo, Ota region in Gunma Prefecture, Suwa region in Nagano Prefecture, Hamamatsu region in Shizuoka Prefecture, and Higashiosaka region in Osaka Prefecture.

4) Mixed invitation clusters

These clusters are formed as a result of local government efforts to attract enterprises and the implementation of industrial relocation plans. Many of the enterprises invited belong to industry groups outside the cluster, and collaboration within such clusters is often not very advanced. Typical examples include the Kitakamigawa basin region, the Kofu region, and the Kumamoto region.

This classification cannot easily be applied to specific types of cluster in all cluster regions throughout Japan, and many clusters also exhibit multiple attributes. The Hamamatsu region, for example, can be classified as a mixed urban cluster, but it also exhibits the characteristics of a company town cluster, such as those formed around Yamaha, Honda, and Suzuki. The Kofu region, on the other hand, is classified as a mixed invitation cluster due to the extensive growth of the Keihin region during the high-growth period and active efforts to lure enterprises from the 1980s, but it could instead be regarded as a production region cluster producing jewelry. For convenience in this analysis, therefore, cluster regions with multiple attributes were

1) 2000 White Paper on Small and Medium Enterprises in Japan.

2) There exist various views on how clusters should be categorized. See, for example, 2000 White Paper on Small and Medium Enterprises in Japan, Ide (2002), Matsushima (1998), and JASME (2002).

categorized according to the above contributes. Analyses of company town clusters and production region clusters also often only focus on a particular industry, but in the case of this analysis no such limitation is adopted.

For the analysis, the following 10 typical regions were chosen from cluster regions throughout Japan:

Company town clusters

- 1) Hiroshima region (Hiroshima City and Fuchu Town, Hiroshima Prefecture)
- 2) Kitakyushu region (Kitakyushu City, Fukuoka Prefecture)

Production region clusters

- 3) Sabae region (Sabae City and Echizen City, Fukui Prefecture)
- 4) Tsubame-Sanjo region (Tsubame City and Sanjo City, Niigata Prefecture)

Mixed urban clusters

- 5) Ota region (Ota City and Oizumi Town, Gunma Prefecture)

- 6) Suwa region (Suwa City, Okaya City, and Shimosuwa Town, Nagano Prefecture)
- 7) Hamamatsu region (Hamamatsu City, Shizuoka Prefecture)
- 8) Higashiosaka region (Higashiosaka City, Osaka Prefecture)

Mixed invitation clusters

- 9) Kitakamigawa basin region (Kitakami City, Hanamaki City, Esashi City, and Kanegasaki Town, Iwate Prefecture)
- 10) Kofu region (Kofu City, Showa Town, and Tamaho Town, Yamanashi Prefecture)

The functions played by these industrial cluster regions and changes in their functions were then analyzed using data from surveys including the “Survey of Industrial Clusters”³⁾ conducted by the Research Institute for Industrial Location Co., Ltd. (RIIL) in December 2005.

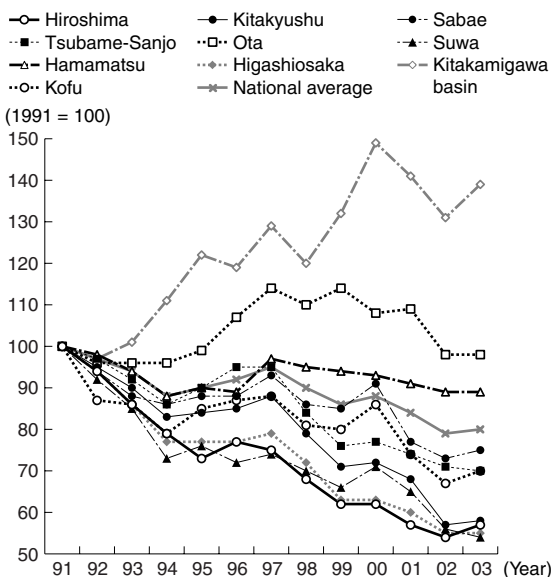
Section 2 Trends among regional industrial clusters

We start by ascertaining overall trends among industrial cluster regions using various statistical data

(Figs. 2-4-1, 2-4-2, 2-4-3, 2-4-4).

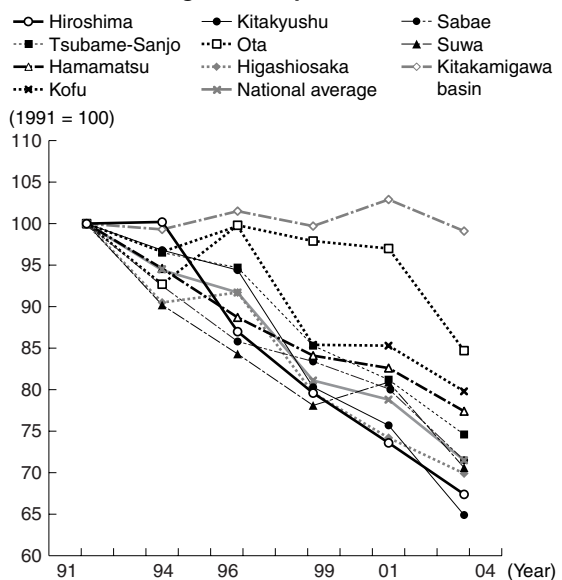
Nationally, both the value of shipments of

Fig. 2-4-1 Trends in value of shipments of manufactured goods by region
Higher than national average declines in all cluster regions except the Kitakamigawa basin, Ota, and Hamamatsu regions



Source: Recompiled from METI, *Census of Manufactures*.
Notes: 1. See Appended Note 2-4-1 regarding the actual values of shipments.
2. Converted to an index with the value in 1991 equaling 100.

Fig. 2-4-2 Trends in number of workers in manufacturing
Decline in number of manufacturing workers in all regions compared with 1991



Source: Recompiled from MIC, *Establishment and Enterprise Census of Japan*.
Notes: 1. See Appended Note 2-4-2 regarding the actual values of shipments.
2. Converted to an index with the value in 1991 equaling 100.

3) This was a survey of SMEs located in 10 regions selected from among cluster regions throughout Japan, and investigated principally changes in the business environment over the past 20 years.

Fig. 2-4-3 Number of business establishments by industry (private enterprises in non-primary industry by cluster in 1986)

	Hiroshima	Kita-kyushu	Sabae	Tsubame-Sanjo	Ota	Suwa	Hamamatsu	Higashi-osaka	Kitakami	Kofu
Mining	68	38	4	5	4	25	13	0	17	6
Construction	4,370	4,591	1,113	659	1,033	898	2,643	1,462	923	1,052
Manufacturing	4,295	3,188	3,425	5,178	2,151	2,316	6,635	10,815	979	1,879
Food and tobacco	548	469	114	68	66	137	341	143	124	170
Textiles	37	32	770	18	406	142	1,373	148	40	90
Apparel and other textile products	248	170	67	50	119	21	303	423	72	127
Wood and wood products (excluding furniture)	219	125	133	168	25	42	216	125	56	59
Furniture and fixtures	401	220	119	74	69	66	273	315	72	131
Pulp, paper, and paper products	107	67	151	73	28	11	85	363	18	30
Printing and allied industries	529	327	70	69	62	81	292	590	52	150
Chemicals	54	57	22	1	6	13	24	129	11	9
Petroleum and coal products	6	19	1	0	4	0	4	6	2	0
Plastic products	106	65	69	199	153	35	170	917	18	32
Rubber products	42	18	6	9	22	7	65	148	1	2
Leather tanning, leather products, and fur skins	17	3	5	8	6	1	11	218	9	16
Ceramic, stone, and clay products	122	155	68	13	30	13	76	82	45	40
Iron and steel	49	109	9	119	18	17	65	263	21	4
Non-ferrous metals and products	28	24	7	13	6	35	100	168	3	8
Fabricated metal products	554	434	156	3,669	319	290	895	2,921	78	123
General machinery	464	377	128	468	352	437	714	2,171	70	90
Electrical machinery, equipment, and supplies	154	157	35	23	173	251	186	590	69	87
Electric components and devices	9	23	21	5	17	102	75	61	106	47
Transportation equipment	289	84	2	38	168	51	925	349	12	27
Precision instruments and machinery	36	29	1,016	52	15	473	17	104	34	45
Other manufacturing industries	276	224	456	41	87	91	425	581	66	592
Electricity, gas, heat supply, and water	22	32	7	7	5	7	9	7	8	4
Information communications	336	163	28	22	21	53	118	42	29	67
Transport	1,458	1,832	105	62	174	89	487	794	167	151
Wholesale and retail trade	20,911	21,351	3,150	3,424	3,199	2,840	10,566	10,197	3,316	5,801
Wholesale trade	6,786	4,275	717	1,213	869	638	3,079	2,417	474	1,347
Retail trade	14,125	17,076	2,433	2,211	2,330	2,202	7,487	7,780	2,842	4,454
Finance and insurance	1,008	1,179	156	139	158	151	485	353	140	311
Real estate	2,952	4,878	167	387	353	506	993	1,390	346	750
Eating and drinking places, accommodations	10,049	9,650	848	857	1,310	1,241	4,123	4,607	1,503	2,982
Medical, health care, and welfare	1,968	2,172	250	183	271	305	864	882	288	480
Education, learning support	1,393	1,525	148	136	291	262	799	724	163	412
Compound services	185	146	53	34	26	44	148	52	109	56
Services (not otherwise classified)	9,202	9,325	1,463	1,144	1,436	1,233	4,512	3,686	1,839	2,471
Non-primary industry total	62,512	63,258	14,342	17,415	12,583	12,286	39,030	45,826	10,806	18,301

Source: Recompiled from MIC, *Establishment and Enterprise Census of Japan*.

- Notes: 1. Data were recompiled based on the revised March 2002 system of industrial classification.
2. The shaded boxes indicate the distinctive industries of each cluster.
3. "Kitakami" indicates the Kitakamigawa basin region.

manufactured goods and number of workers have declined continuously since peaking in 1991, and by 2003, the value of shipments of manufactured goods had sunk to around 80% of its peak, and the number of workers had slumped to roughly 70%. An examination of trends in the value of manufactured goods in each cluster region shows that, with the exception of three regions (the Kitakamigawa basin region, Ota region, and Hamamatsu region), shipments are declining by more than the national total, and in the Higashiosaka region, Hiroshima region, Kitakyushu region, and Suwa region, where the scale of the decline has been particularly large, the number of workers is also falling considerably.

Amid the downward trend in manufacturing as a whole, significant downsizing is observable in

production region clusters and company town clusters. Among mixed urban clusters and mixed invitation clusters, on the other hand, although downsizing is notable, some regions, such as the Kitakamigawa basin region and Ota region, have managed to maintain at least a certain size.

Fig. 2-4-4 Number of business establishments by industry (private enterprises in non-primary industry by cluster in 2004)

	Hiroshima	Kita-kyushu	Sabae	Tsubame-Sanjo	Ota	Suwa	Hamamatsu	Higashi-osaka	Kitakami	Kofu
Mining	4	23	4	5	2	8	2	0	13	0
Construction	4,613	4,209	1,003	593	934	773	2,573	1,501	1,003	1,059
Manufacturing	3,011	2,180	2,374	3,434	1,506	1,572	4,180	7,879	984	1,209
Food and tobacco	359	287	75	48	54	80	228	108	123	117
Textiles	16	13	293	5	50	14	432	47	9	8
Apparel and other textile products	122	102	135	33	175	39	151	242	65	77
Wood and wood products (excluding furniture)	65	35	86	112	17	19	89	49	40	13
Furniture and fixtures	220	118	72	60	28	42	162	239	61	64
Pulp, paper, and paper products	74	42	120	69	18	5	67	316	22	19
Printing and allied industries	407	235	84	71	60	66	211	536	61	105
Chemicals	54	63	20	2	4	10	13	127	17	9
Petroleum and coal products	6	14	3	0	3	1	3	5	4	0
Plastic products	97	55	90	128	118	31	183	720	34	20
Rubber products	39	13	4	10	7	7	49	117	5	1
Leather tanning, leather products, and fur skins	4	3	1	7	3	0	8	110	7	13
Ceramic, stone, and clay products	77	122	58	8	21	12	42	56	47	19
Iron and steel	37	70	9	75	22	16	44	184	13	5
Non-ferrous metals and products	18	28	11	17	6	25	54	120	7	8
Fabricated metal products	383	311	130	2,280	208	200	597	2,151	115	76
General machinery	401	298	112	378	277	392	604	1,649	127	64
Electrical machinery, equipment, and supplies	148	132	38	27	132	153	178	377	44	41
Electric components and devices	15	35	20	6	23	99	48	44	59	43
Transportation equipment	198	44	4	31	199	66	679	232	38	20
Precision instruments and machinery	35	24	704	29	19	232	34	102	31	24
Other manufacturing industries	236	136	305	38	62	63	304	348	55	463
Electricity, gas, heat supply, and water	25	35	5	4	3	7	10	8	6	5
Information communications	674	322	48	26	66	71	260	86	63	112
Transport	1,253	1,542	125	67	214	105	497	995	255	154
Wholesale and retail trade	15,637	15,030	2,565	2,614	2,685	1,964	7,770	7,388	2,689	4,122
Wholesale trade	5,290	3,056	644	981	651	517	2,263	2,388	505	1,120
Retail trade	10,347	11,974	1,921	1,633	2,034	1,447	5,507	5,000	2,184	3,002
Finance and insurance	925	819	143	119	151	141	421	255	160	297
Real estate	3,036	3,556	186	341	640	691	1,237	1,239	394	919
Eating and drinking places, accommodations	7,788	7,117	823	751	1,382	951	3,506	3,629	1,503	2,219
Medical, health care, and welfare	2,807	2,779	300	259	401	323	1,221	1,313	463	625
Education, learning support	1,503	1,306	232	191	281	258	877	619	269	411
Compound services	193	155	55	32	30	35	128	55	112	73
Services (not otherwise classified)	10,167	8,901	1,574	1,176	1,705	1,231	5,047	3,782	2,144	2,772
Non-primary industry total	51,636	47,974	9,437	9,612	10,000	8,130	27,729	28,749	10,058	13,977

Source: Recompiled from MIC, *Establishment and Enterprise Census of Japan*.

- Notes: 1. Industries are classified according to the revised March 2002 system of industrial classification.
 2. The shaded boxes indicate the distinctive industries of each cluster.
 3. "Kitakami" indicates the Kitakamigawa basin region.

Section 3 Change in roles of industrial clusters

1. The roles played by industrial clusters

A comparison of typical industrial cluster regions revealed differences between regions in the downward trend in size. So what gives rise to this difference? Beginning with the above 10 regions, we confirm the archetypal functions originally played by clusters (from the late 1980s to the early 1990s) according to each cluster type.

(1) Company town clusters

Clusters of this type are dependent on a specific large

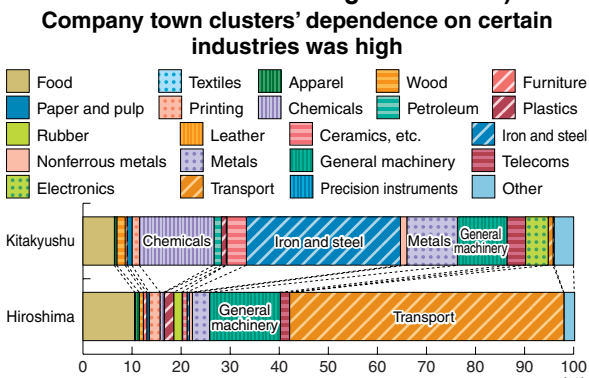
enterprise, and a breakdown of the value of shipments of manufactured goods in 1991 (Fig. 2-4-5) reveals that certain industries account for an extremely large proportion of shipments; manufacture of transportation equipment accounts for 55.9% of shipments in the Hiroshima region, and the iron and steel industry accounts for 31.4% in the Kitakyushu region. Even compared with other cluster regions, the proportion of sales to enterprises within the same cluster is high (Fig. 2-4-6), suggesting that business was made possible by being within a business grouping. Cluster regions may be said to have typically developed as a result of

enterprises' minimization of the cost of expensive tasks such as production management and the acquisition of new customers, and their specialization in certain production processes.

(2) Production region clusters

Clusters of this kind are dependent on specific industries, and a breakdown of the value of shipments of manufactured goods in 1991 (Fig. 2-4-7) shows that in the Tsubame-Sanjo region, metal product manufacturers account for an extremely high proportion (51.7%) of sales. While in the spectacle-producing Sabae region the proportion of sales accounted for by precision instruments manufacturers is not especially high (10.5%)

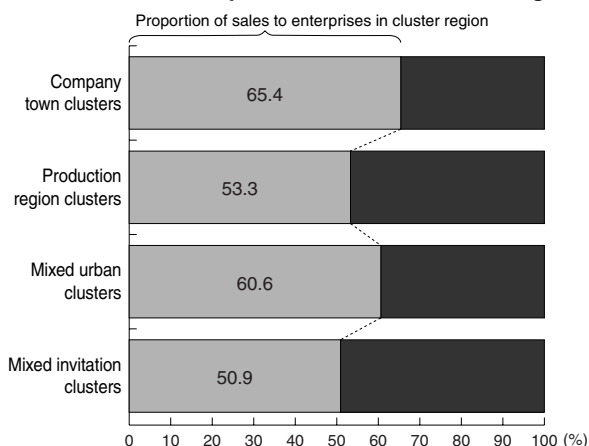
Fig. 2-4-5 Industrial profiles of company town clusters (based on value of shipments of manufactured goods in 1991)



Source: Recompiled from METI, *Census of Manufactures* (1991).
 Notes: 1. Data were recompiled based on the revised March 2002 system of industrial classification.
 2. See Appended Note 2-4-3 regarding the abbreviations of industry names.

Fig. 2-4-6 Composition of sales by location of buyer

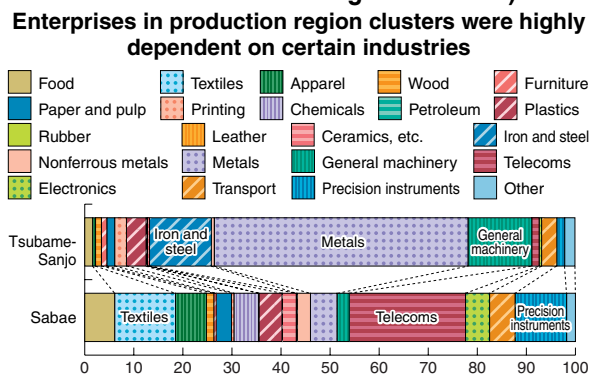
Particularly high proportion of sales in company town clusters are to enterprises in the same cluster region



Source: Research Institute for Industrial Location Co., Ltd., *Survey of Industrial Clusters* (December 2005).
 Note: Average proportion of sales to enterprises within cluster region by enterprises that are members of clusters.

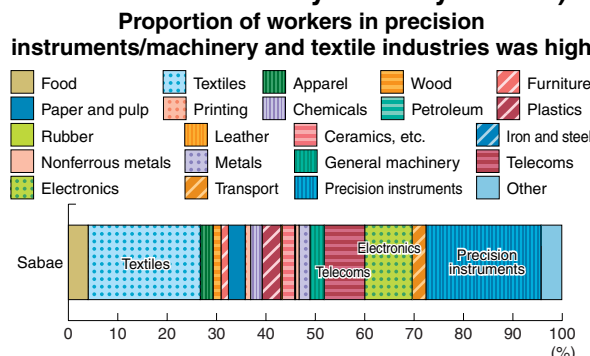
due to the low unit price of spectacles themselves, a breakdown of the number of workers by industry (Fig. 2-4-8) reveals that such manufacturers account for 23.3%, reflecting the region's high dependence on this industry. Asked about the advantages of the business environment 20 years ago (Fig. 2-4-9), a higher proportion of enterprises than in other types of cluster gave "greater ability to meet large-volume orders through division of labor," "stable, cheap supply of raw materials," and "ease of receiving orders from outside region through joint order-taking system" as advantages of being located in a production region cluster. During the high-growth period, such clusters were probably heavily dependent on European and North American markets, and there developed as a result arrangements for manufacturing cheap, high quality, mass-produced goods.

Fig. 2-4-7 Industry profiles of production region clusters (based on value of shipments of manufactured goods in 1991)



Source: Recompiled from METI, *Census of Manufactures* (1991).
 Notes: 1. Data were recompiled based on the revised March 2002 system of industrial classification.
 2. See Appended Note 2-4-3 regarding the abbreviations of industry names.

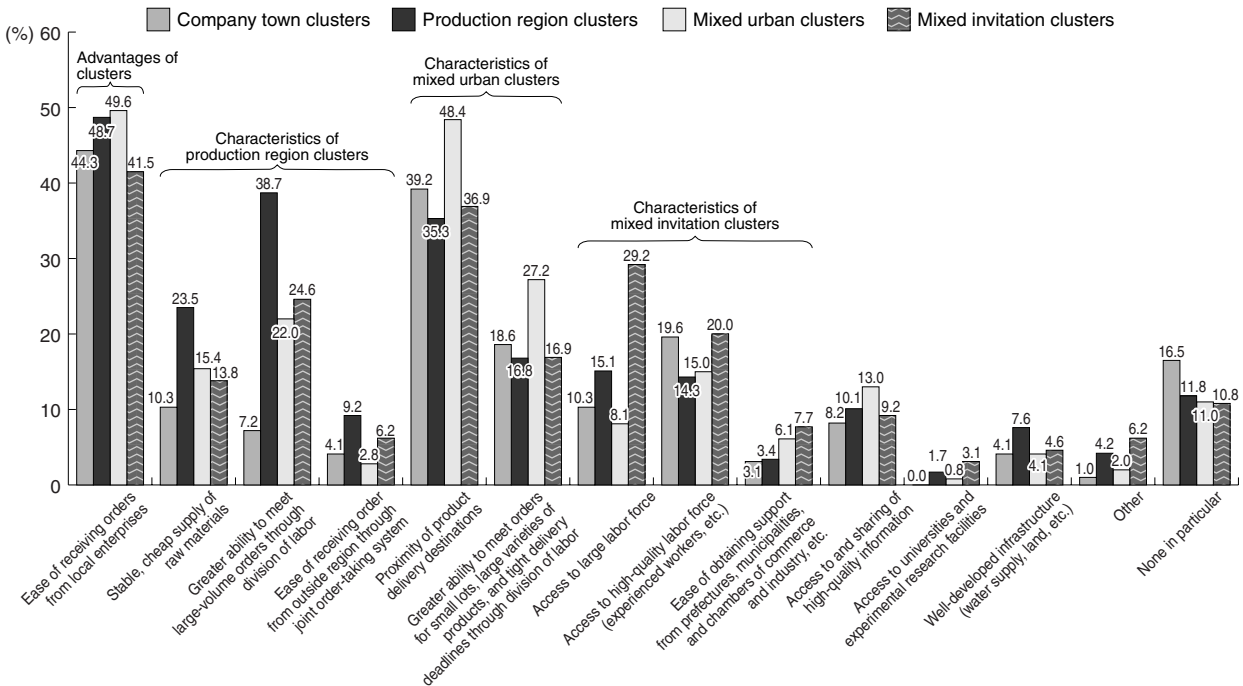
Fig. 2-4-8 Industry profile of Sabae region (based on number of workers by industry in 1991)



Source: Recompiled from MIC, *Establishment and Enterprise Census of Japan* (1991).
 Notes: 1. Data were recompiled based on the revised March 2002 system of industrial classification.
 2. See Appended Note 2-4-3 regarding the abbreviations of industry names.

Fig. 2-4-9 Advantages of business environment in cluster regions (20 years ago)

The advantages of the business environment perceived by enterprises differed according to type of cluster



Source: Research Institute for Industrial Location Co., Ltd., *Survey of Industrial Clusters* (December 2005).

Notes: 1. Only enterprises that have been doing business in the same cluster region for at least 20 years are included.
2. Totals exceed 100 due to multiple responses.

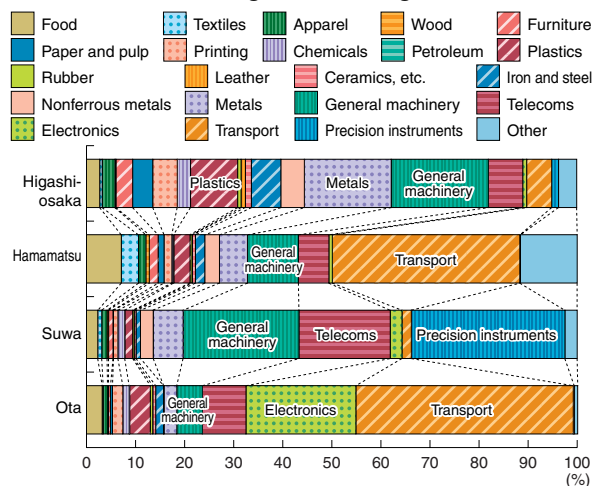
(3) Mixed urban clusters

The features of mixed urban clusters differ from region to region. The Higashiosaka and Suwa regions are made up of a variety of industries, while in the case of the Ota and Hamamatsu regions, manufacturing shipments are skewed toward transportation equipment due to their high unit price (Fig. 2-4-10). Looking at the number of workers in the Ota and Hamamatsu regions by industry (Fig. 2-4-11), it can be seen that while transport equipment manufacturing unsurprisingly accounts for the highest proportion, there is also considerable depth in industries such as general machinery, metal products, electronic components and devices, and information and communications equipment, reflecting the diverse industrial structure of these clusters.

Regarding the advantages of the business environment 20 years ago, a higher proportion of enterprises in these clusters than other types gave “greater ability to meet orders for small lots, large varieties of products, and tight delivery deadlines through division of labor” and “proximity of product delivery destinations” as advantages. This indicates that production functions in such clusters are based on flexible divisions of labor⁴⁾ as a result of the clustering of diverse industries and technologies. It could be said due to the relatively high cost of land and labor in mixed

Fig. 2-4-10 Industrial profiles of mixed urban clusters (based on value of shipments of manufactured goods in 1991)

Particularly wide variety of industries were clustered in the Higashiosaka region



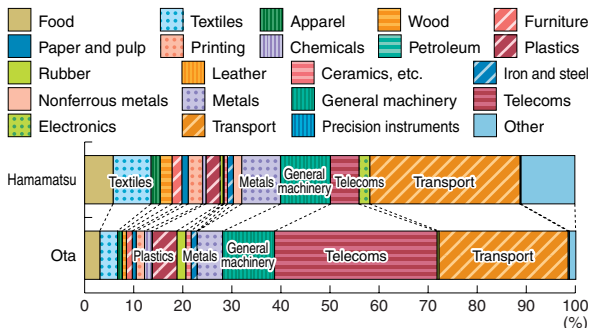
Source: Recompiled from METI, *Census of Manufactures* (1991).

Notes: 1. Data were compiled based on the revised March 2002 system of industrial classification.
2. See Appended Note 2-4-3 regarding the abbreviations of industry names.

4) In a study of industrial clusters such as Ota Ward in Tokyo, Nukada (1998) observed that numerous enterprises clustered in close proximity to one another, creating a fine division of labor by which each specialized in its own niche while tightly bound to other enterprises. Enterprises are thus able to function as a group to supply reasonably priced products despite diverse variations in demand in terms of both quantity and quality, allowing cluster members to cater flexibly to widely varying orders.

Fig. 2-4-11 Industrial profiles of Hamamatsu and Ota regions (based on number of workers by industry in 1991)

Both regions exhibited depth in industries such as the fabricated metal product and general machinery industries as well



Source: Recompiled from MIC, *Establishment and Enterprise Census of Japan* (1991).

- Notes:
1. Data were recompiled based on the revised March 2002 system of industrial classification.
 2. See Appended Note 2-4-3 regarding the abbreviations of industry names.

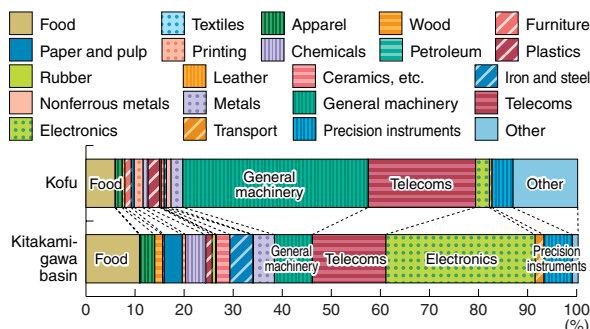
urban clusters, which makes it difficult to establish systems of mass production, clusters of this kind function by specializing in high value-added products.

(4) Mixed invitation clusters

As clusters of this type are formed mainly by enterprises that have been deliberately attracted to the area, the composition of manufacturing shipments reflects the characteristics of these enterprises (Fig. 2-4-12). In the Kitakami region, industries such as electrical machinery, information and communications equipment, and electronic components and devices account for a high proportion of shipments, while in the Kofu region, industries such as general machinery, electric machinery, and information and communications equipment

Fig. 2-4-12 Industrial profiles of mixed invitation clusters (based on value of shipments of manufactured goods in 1991)

Regions reflected the characteristics of enterprises attracted



Source: Recompiled from METI, *Census of Manufactures* (1991).

- Notes:
1. Data were recompiled based on the revised March 2002 system of industrial classification.
 2. See Appended Note 2-4-3 regarding the abbreviations of industry names.

represent a high proportion. Due in part to the location of labor-intensive plants such as assembly plants in these clusters, large numbers of enterprises gave “access to large labor force” and “access to high-quality labor force” as advantages of the business environment in these clusters 20 years ago. Compared with other types of cluster, “well-developed infrastructure (water supply, land, etc.)” and “ease of obtaining support from prefectures, municipalities, and chambers of commerce and industry, etc.” were also widely cited as advantages of the business environment 20 years ago, reflecting the characteristics of mixed invitation clusters.

We can surmise that when industry as a whole was steadily growing before the appreciation of the yen, the concentration of business resources on specific industries and enterprises in industrial clusters was a highly efficient business model.

2. Present roles of industrial clusters

Having now ascertained the functions of regional industrial clusters before the impact of the appreciation of the yen, collapse of the bubble, and rise of the East Asian region, we consider next whether such business models continue to function effectively today. We begin by examining the current composition of sales and business environment according to cluster type.

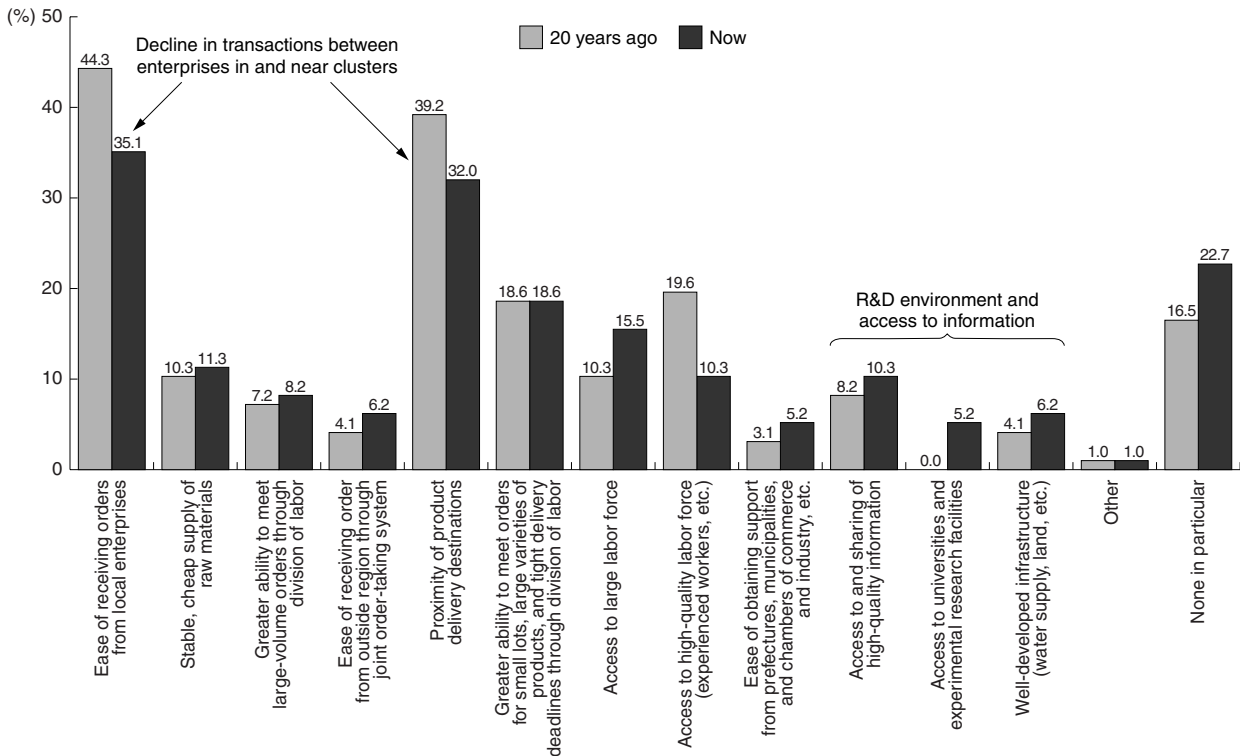
(1) Company town clusters

Owing to the high level of dependence on specific large enterprises and industries, clusters of this type are often affected by the ups and downs experienced by these enterprises and industries. The Hiroshima region, for example, is susceptible to trends affecting Mazda, and the Kitakyushu region is impacted by the rise and decline of the iron and steel industry. Looking at the advantages of the business environment compared with 20 years ago (Fig. 2-4-13), there has been a decline in the number of enterprises answering “ease of receiving orders from local enterprises” and “proximity of product delivery destinations,” indicating that the traditional business model of depending on certain enterprises and industries and sticking to doing business within clusters is not functioning as well as it used to. On the other hand, the number of enterprises citing “access to and sharing of high-quality information” and “access to universities and experimental research facilities” as advantages of the business environment has increased. The evidence thus suggests that there is developing an environment in such clusters that allows individual enterprises to determine what direction the market is taking and to introduce products and technologies that meet these needs.

(2) Production region clusters

As they are centers of mass production of consumer goods such as blades, metal cutlery, and spectacles,

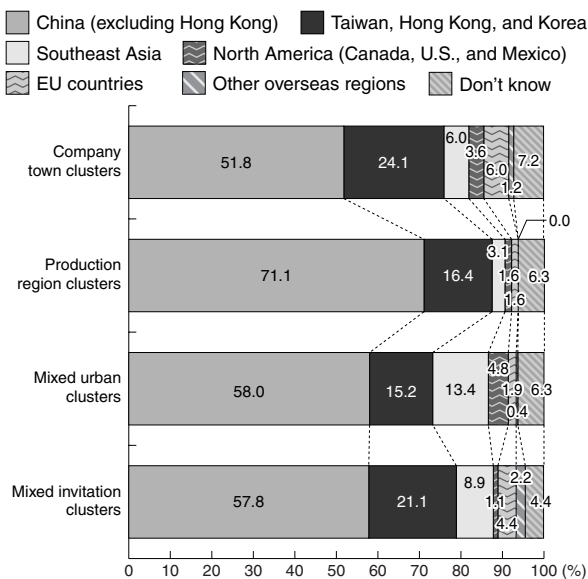
Fig. 2-4-13 Differences in advantages of business environment (company town clusters)
Collapse of traditional business models and emergence of new business environment indicating direction of market



Source: Research Institute for Industrial Location Co., Ltd., *Survey of Industrial Clusters* (December 2005).
 Notes: 1. Only enterprises that have been doing business in the same cluster region for at least 20 years are included.
 2. Totals exceed 100 due to multiple responses.

many enterprises in the Tsubame-Sanjo and Sabae regions presently sense direct competition from China

Fig. 2-4-14 Overseas regions perceived as biggest competitors
High proportion of enterprises in production region clusters sense competition from China



Source: Research Institute for Industrial Location Co., Ltd., *Survey of Industrial Clusters* (December 2005).

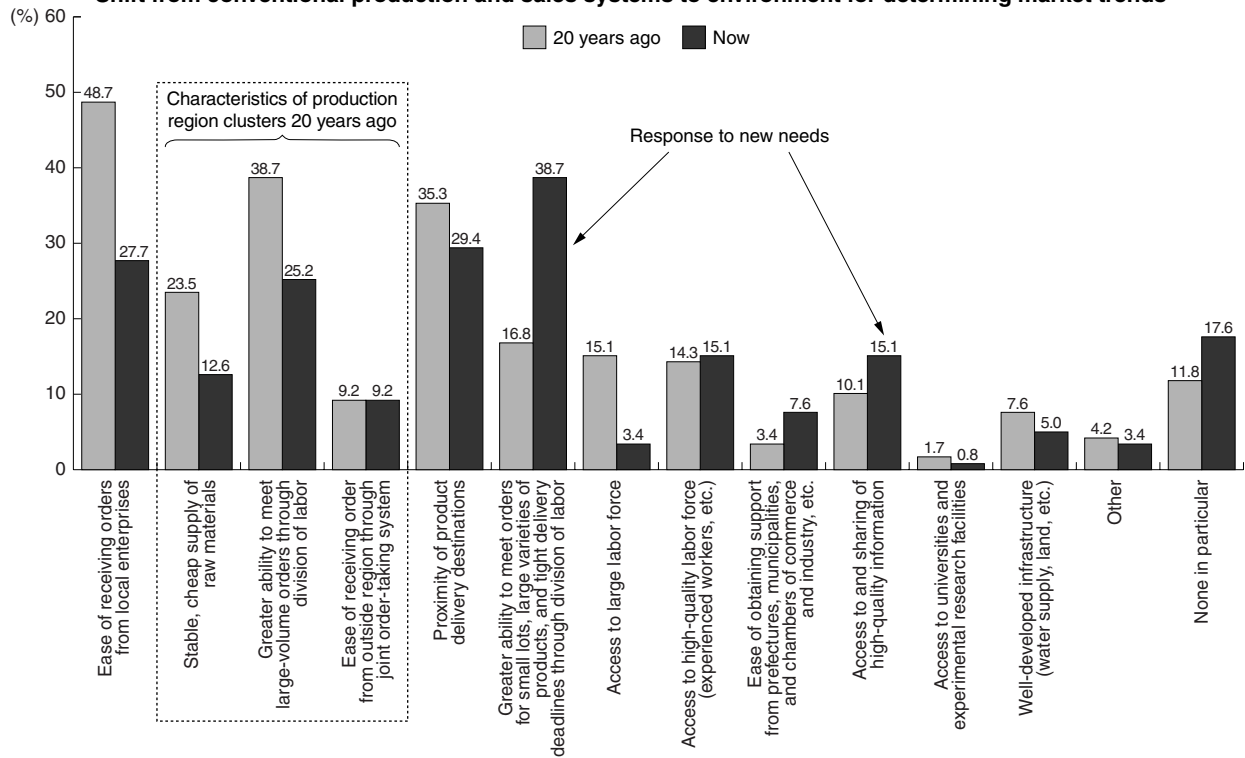
(Fig. 2-4-14), and there has been a decline in the large number of enterprises that selected “stable, cheap supply of raw materials” and “ability to meet large-volume orders through division of labor” as advantages of the business environment 20 years ago (Fig. 2-4-15). As there has also been a decline in the proportion of mass-produced goods (Fig. 2-4-16), systems of mass producing items such as consumer goods appear to be performing less well. In addition, because of production region clusters’ heavy dependence on certain industries and highly segmentalized specialization in production processes, more enterprises than in other cluster regions believe that their clusters have lagged in responding to new needs (Fig. 2-4-17).

On the other hand, there has been an increase in the number of enterprises giving “greater ability to meet orders for small lots, large varieties of products, and tight delivery deadlines through division of labor” and “access to and sharing of high-quality information” as advantages of the present-day business environment, suggesting that enterprises are having to ascertain market trends and so on untethered by conventional systems of production and distribution.

(3) Mixed urban clusters

Comparing the business environment now and 20 years ago (Fig. 2-4-18) reveals a large drop in the

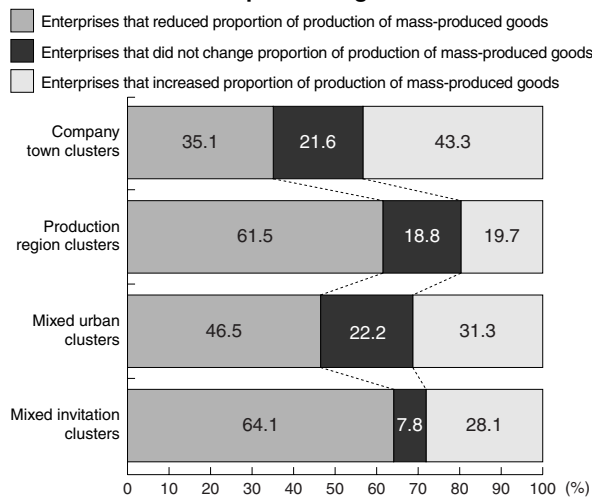
Fig. 2-4-15 Differences in advantages of business environment (production region clusters)
 Shift from conventional production and sales systems to environment for determining market trends



Source: Research Institute for Industrial Location Co., Ltd., *Survey of Industrial Clusters* (December 2005).
 Notes: 1. Only enterprises that have been doing business in the same cluster region for at least 20 years are included.
 2. Totals exceed 100 due to multiple responses.

Fig. 2-4-16 Proportion of enterprises that reduced production of mass-produced goods

Large proportions of enterprises in production region and mixed invitation clusters reduced production of mass-produced goods

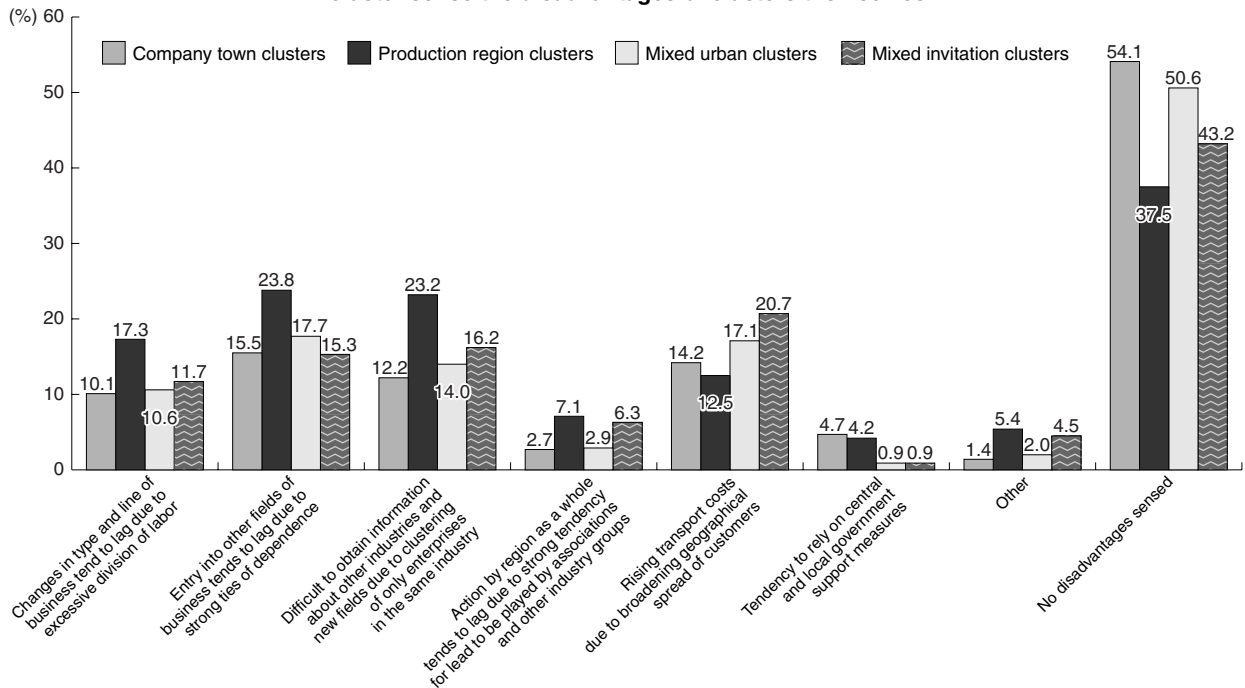


Source: Research Institute for Industrial Location Co., Ltd., *Survey of Industrial Clusters* (December 2005).
 Notes: 1. Only enterprises that have done business in the same cluster for at least 20 years are included.
 2. Enterprises that are members of clusters were asked about their proportion of production of mass-produced goods now compared with 20 years ago.

proportion of enterprises giving “proximity of product delivery destinations” and “ease of receiving orders from local enterprises” as advantages, indicating that the decline in market size in cities is forcing enterprises to cast their nets wider for customers. On the other hand, there has been an increase in the proportion of enterprises giving stereotypical merits of mixed urban clusters – i.e., “access to universities and experimental research facilities” and “well-developed infrastructure (water supply, land, etc.)” – as current advantages of their business environments.

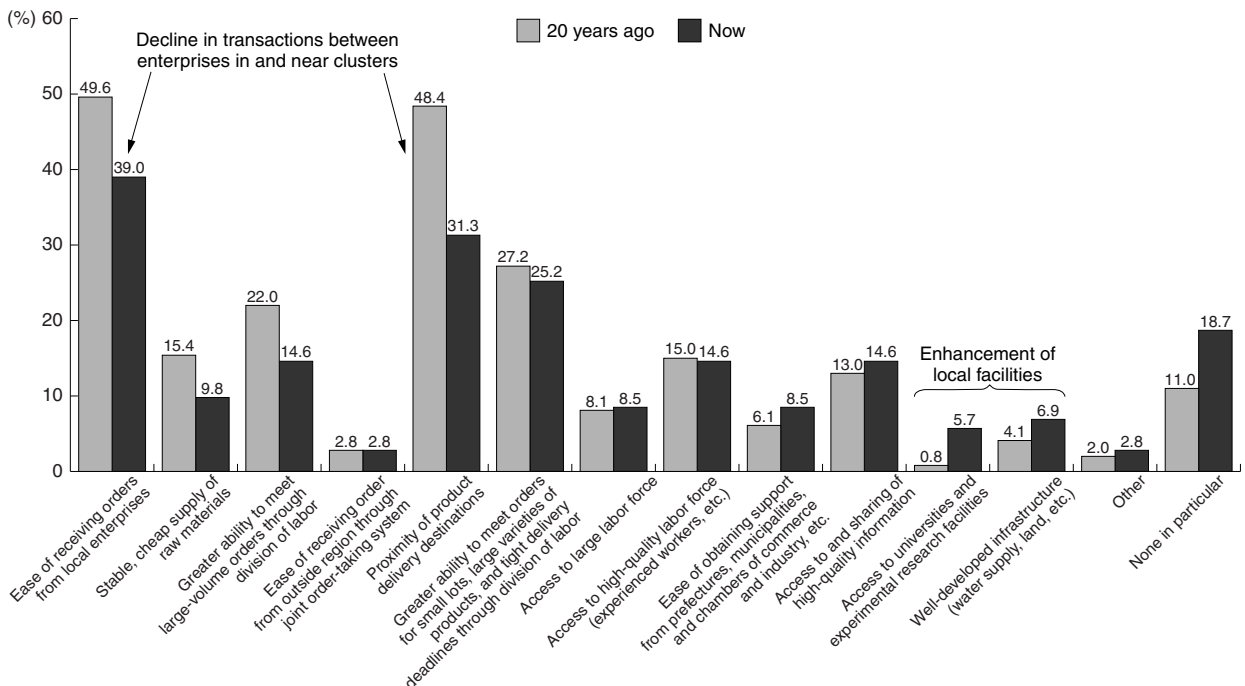
A comparison of the proportion of enterprises that changed their biggest shipping product line (in value terms) reveals that a high proportion did so in mixed urban clusters (Fig. 2-4-19). It can be concluded from this that mixed urban clusters’ character as clusters of varied industries and technologies has maintained a system that allows enterprises to respond to varied needs. Consequently, mixed urban clusters have been able to respond flexibly as regions to changes in the industrial structure since the collapse of the bubble. Further, the Ota region and Hamamatsu region, which were successful in incorporating buoyant industries such as the automobile industry, were able to maintain their size as regions as a whole.

Fig. 2-4-17 Disadvantages of clusters
 Higher proportion of enterprises in production region clusters than other types of cluster sense the disadvantages of clusters themselves



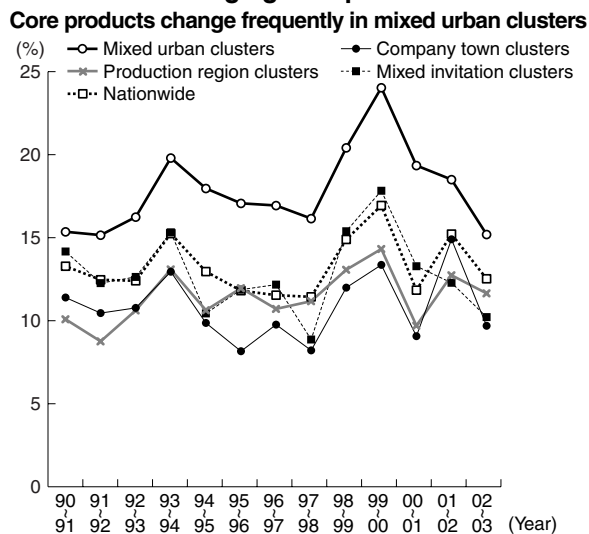
Source: Research Institute for Industrial Location Co., Ltd., *Survey of Industrial Clusters* (December 2005).
 Notes: 1. Totals exceed 100 due to multiple responses.
 2. Members of clusters were asked whether the functions of clusters had a negative effect.

Fig. 2-4-18 Differences in advantages of business environment (mixed urban clusters)
 Geographical scope of markets is spreading and traditional model of depending heavily on certain markets is being transformed



Source: Research Institute for Industrial Location Co., Ltd., *Survey of Industrial Clusters* (December 2005).
 Notes: 1. Only enterprises that have been doing business in the same cluster region for at least 20 years are included.
 2. Totals exceed 100 due to multiple responses.

Fig. 2-4-19 Trends in proportion of enterprises changing core product



Source: Recompiled from METI, *Census of Manufacturers*.

- Notes:
1. Business establishments with four or more workers.
 2. Proportion of enterprises changing core product = number of business establishments whose most shipped product (in value) changed / number of continuing business establishments
 3. "Continuing business establishments" are business establishments that can be traced in year t and t-1.
 4. "Business establishments whose most shipped product (in value) changed" are continuing business establishments showing most shipped manufactured product in terms of value was different in year t and t-1.
 5. Changes in manufactured product are based on changes in the six-digit product category code.

(4) Mixed invitation clusters

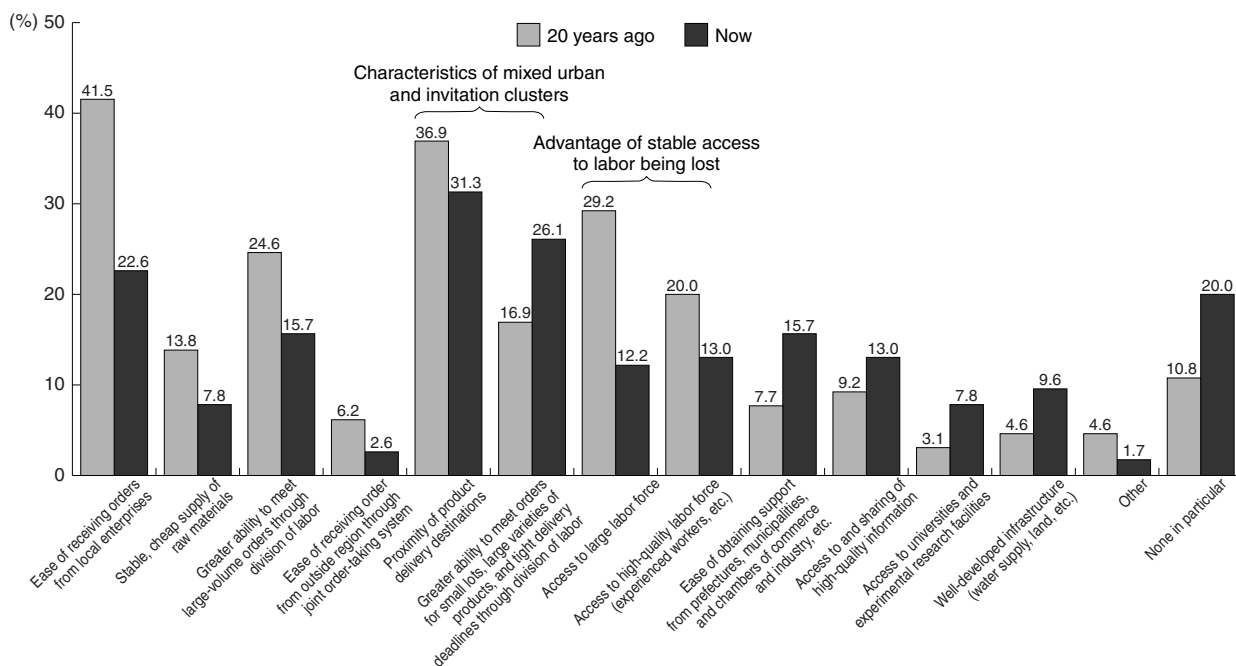
Mixed invitation clusters have developed as a result of the locating of labor-intensive plants attracted by being able to receive orders from enterprises already in the region and comparatively cheap labor, which were advantages when they were first lured to the region.

A comparison of the advantages of the business environment compared with 20 years ago (Fig. 2-4-20) reveals a large decline in the proportion of enterprises responding "access to large labor force," "access to high-quality labor force," and "ease of receiving orders from local enterprises," indicating that the merits enjoyed when enterprises were first attracted to such clusters are gradually fading. On the other hand, the proportion of enterprises giving "greater ability to meet orders for small lots, large varieties of products, and tight delivery deadlines through division of labor" as advantages of the current business environment has increased. This suggests that enterprises are being increasingly attracted to such clusters, transforming them into more complex clusters that are not dependent on a specific industry.

(5) Changes common to all types of cluster

Major changes in the business environment, such as the rapid appreciation of the yen following the Plaza Accord and the collapse of the bubble, have led large enterprises in particular to shift production to East Asia and elsewhere, and this has had a significant impact on cluster regions in Japan as well as SMEs. In all types of cluster, the proportion of sales to enterprises in the same

Fig. 2-4-20 Differences in advantages of business environment (mixed invitation clusters)
Mixed invitation clusters increasingly resemble mixed urban clusters as core industries develop

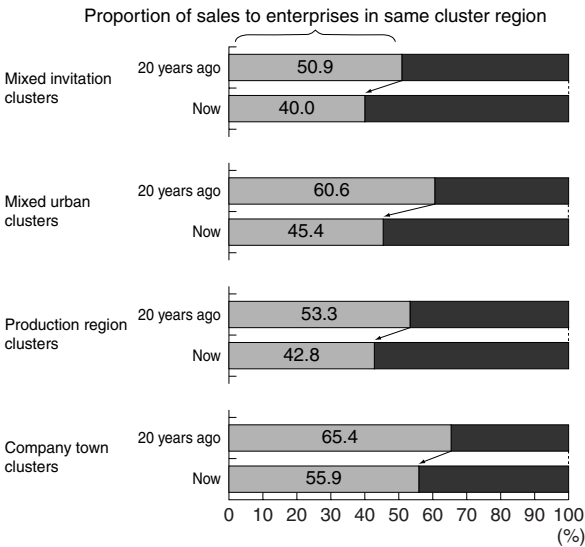


Source: Research Institute for Industrial Location Co., Ltd., *Survey of Industrial Clusters* (December 2005).

- Notes:
1. Only enterprises that have been doing business in the same cluster region for at least 20 years are included.
 2. Totals exceed 100 due to multiple responses.

Fig. 2-4-21 Changes in composition of sales by location of customer (by type of cluster)

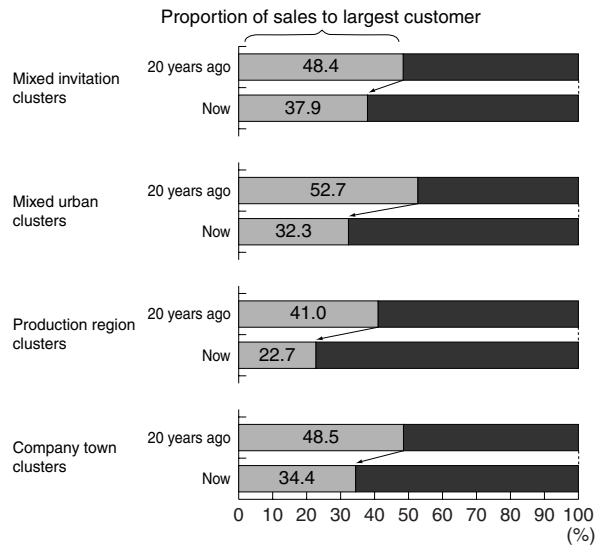
Proportion of sales to enterprises in cluster regions is declining regardless of cluster type



Source: Research Institute for Industrial Location Co., Ltd., *Survey of Industrial Clusters* (December 2005).
 Note: Average proportion of sales by enterprises in clusters to other enterprises in the same cluster region.

Fig. 2-4-22 Dependence on largest customer (by type of cluster)

Declining dependence on major customers in clusters of all types

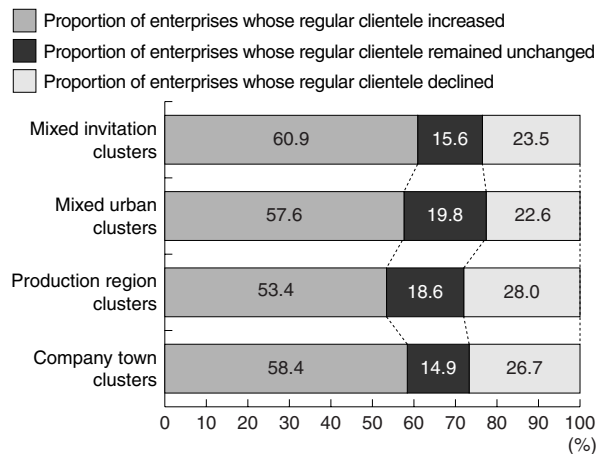


Source: Research Institute for Industrial Location Co., Ltd., *Survey of Industrial Clusters* (December 2005).
 Note: Average of proportion of sales to customer accounting for largest proportion of sales of each cluster member.

cluster region and dependence on sales to certain enterprises have both fallen (Figs. 2-4-21, 2-4-22). Regular customers are both growing in number and becoming more dispersed (Fig. 2-4-23), indicating that amid the increasingly rapid rise and fall of enterprises and industries, the model of business based on stereotypical subcontracting relations dependent on a small number of industries and enterprises is becoming increasingly untenable.

Fig. 2-4-23 Proportion of enterprises that increased their regular clientele

High proportion of enterprises do regular business with more customers than 20 years ago



Source: Research Institute for Industrial Location Co., Ltd., *Survey of Industrial Clusters* (December 2005).
 Note: Only enterprises that have been doing business in the same cluster region for at least 20 years are included.

Section 4 Approaches of enterprises with growing earnings

We have seen how in typical clusters in Japan, major changes in the business environment have been accompanied by the collapse of conventional business relations and rendered it difficult to do business depending solely on certain industries, enterprises, and products. At the level of individual products if not industries, sales will inevitably eventually decline, even though they may presently be growing strongly. With product and technology lifecycles currently shrinking, enterprises need to be able to move into new fields without relying on existing business partners and technologies.

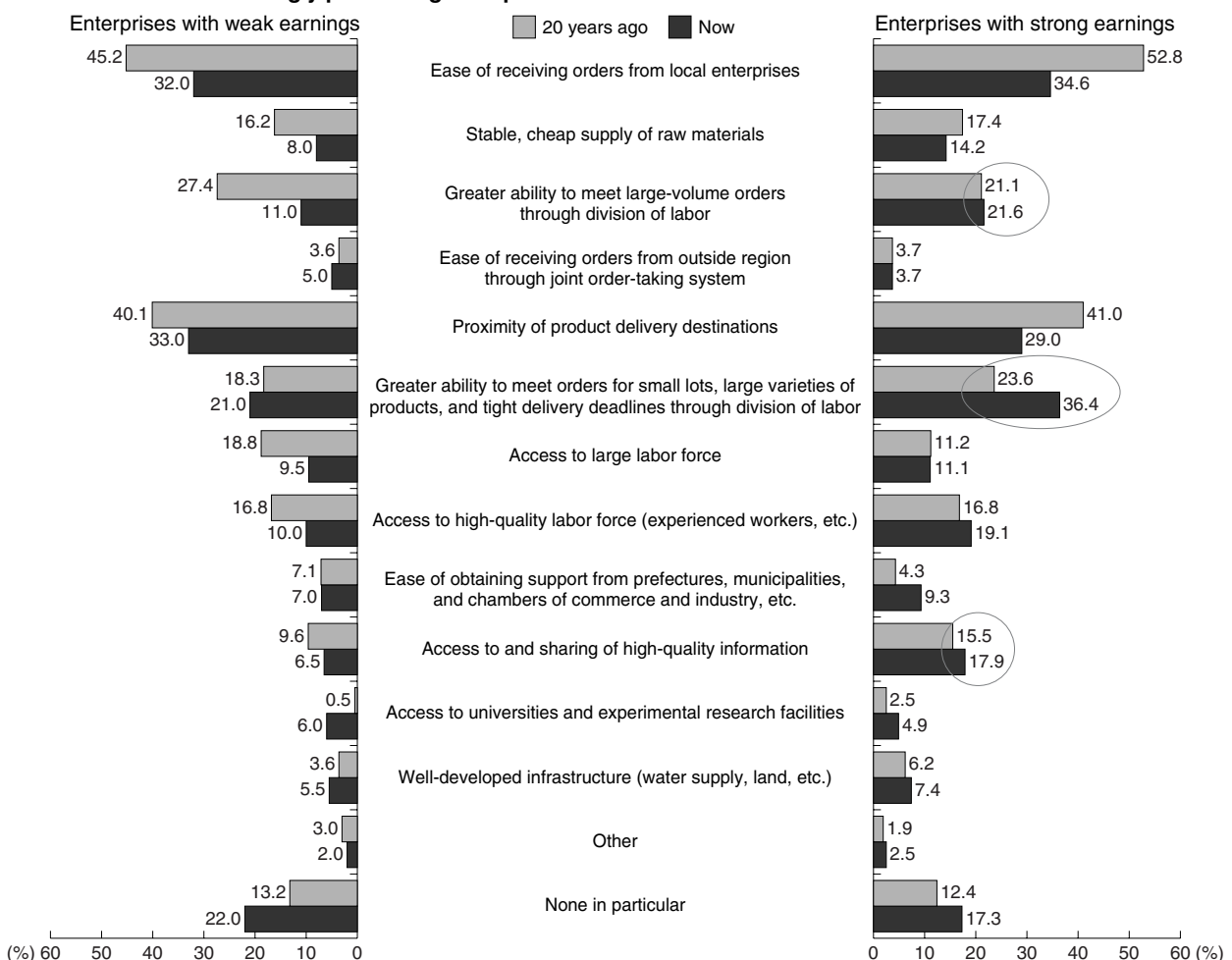
As was observed in Part II, Chapter 3, moreover, it is important that SMEs, with their limited business resources, simultaneously focus their business resources on their fields of expertise and establish their own core competences.

In this section, then, we turn our attention to individual SMEs in clusters that are performing strongly in order to analyze whether in the present business environment they benefit from being in clusters and, if so, how the benefits of clusters are functioning.

If we look at what one enterprise is doing (Case 2-4-1), we find that with the business “pie” in its cluster shrinking, it is managing to win orders from automotive product manufacturers with which it formerly had only very weak ties thanks to concentrating its business resources on technologies in which it occupies a dominant position. By also actively taking advantage of opportunities such as participation in an inter-industry exchange, it is working to acquire information on dynamic industries and enterprises.

Fig. 2-4-24 shows a comparison of the advantages of

Fig. 2-4-24 Differences in advantages of business environment according to earnings status
Strongly performing enterprises make effective use of clusters’ functions



Source: Research Institute for Industrial Location Co., Ltd., *Survey of Industrial Clusters* (December 2005).

- Notes:
1. Only enterprises that have been doing business in the same cluster region for at least 20 years are included.
 2. Totals exceed 100 due to multiple responses.
 3. “Enterprises with strong earnings” are respondents that considered their earnings status to be “good” or “somewhat good,” and “enterprises with weak earnings” are respondents that considered their earnings status to be “poor” or “somewhat poor.”

**Case
2-4-1**

Responding to changing needs by outsourcing companies in the same regional cluster

Uepura Co., Ltd., located in Ota City, Gunma Prefecture, has a workforce of 64 and capital of ¥39.6 million. It is a manufacturer of plastic parts that specializes in plastic sheet forming using vacuum, pneumatic, and press forming techniques. It manufactures plastic covers for a diverse range of industries, including the light electrical, housing, and automotive industries, in suburban Kanto, and over the years has dealt with around 200 customers annually.

Enhancing technical capabilities for specialist techniques and use of outsourcing companies

Due to factors such as the shift overseas of production of light electrical appliances and the decline in new housing construction starts, it has become increasingly difficult for Uepura to maintain its customer base of 200 companies in the Kanto region and surrounding areas alone. Consequently, instead of simply making mass-produced items, it has developed techniques in its specialist areas of vacuum, pneumatic, and press forming to manufacture products with high added value. At the same time, it has worked hard to obtain unit orders from its customers, which involve the assembly of parts requiring multiple processes and techniques,

thus placing considerable demands on the company. As a result, the company has broadened its customer base focusing on automotive-related companies, and has continued to maintain its customer numbers at around the 200 level.

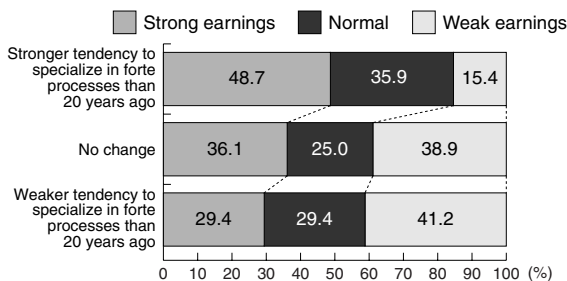
The company concentrates its business resources on improving the quality of its plastic forming techniques, and has been able to meet unit orders by outsourcing upstream and downstream processes to enterprises within the cluster. Previously, when the company had outsourced work to enterprises in the cluster, it was quite common for the products not to be up to standard. However, improvements in their standards mean that today the cluster is able to supply items with a satisfactory level of quality. This is one factor that has enabled Uepura to maintain its customer base of around 200.

As far as acquiring new customers is concerned, while wholesalers and material manufacturers do give referrals to good companies, the company also obtains information on "target" industries and companies by attending meetings held among companies from different industries located in the same cluster. Thus, these meetings have become an effective means of developing new customers for the company.

the business environment now and 20 years ago as perceived by enterprises with weak earnings, from which it can be seen that while there has been a slight increase in the proportion of enterprises that responded "greater ability to meet orders for small lots, large varieties of

products, and tight delivery deadlines through division of labor," clusters are losing their luster across the board, led by items such as "ease of receiving orders from local enterprises" and "greater ability to meet large-volume orders through division of labor". By contrast, a comparison of the advantages of the business environment now and 20 years ago perceived by enterprises with growing earnings reveals a large jump in the proportion of enterprises answering "greater ability to meet orders for small lots, large varieties of products, and tight delivery deadlines through division of labor." Increases have also occurred in the proportion of enterprises answering "greater ability to meet large-volume orders through division of labor" and "access to and sharing of high-quality information." An analysis of enterprises that responded "greater ability to meet large-volume orders through division of labor" (Fig. 2-4-25) shows that, in comparison with enterprises that have not particularly specialized in "forte" processes, a high proportion of enterprises specializing in forte processes are enterprises with growing earnings. In the age of mass production and mass consumption, clusters provided an efficient means of establishing mass-production systems. Now, however, this business model is collapsing, making it important that individual enterprises respond by specializing in forte processes, and that clusters as a whole make use of the various seeds that they have accumulated to meet a diversity of needs.⁵⁾

Fig. 2-4-25 Specialization in forte processes and response to large-volume orders through division of labor in clusters
Focusing on specialist processes and making use of a division of labor in clusters offers an effective means of improving earnings performance



Source: Research Institute for Industrial Location Co., Ltd., *Survey of Industrial Clusters* (December 2005).

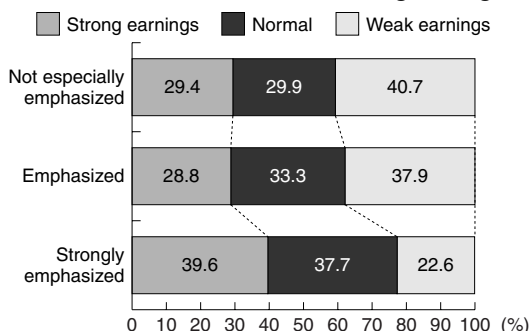
- Notes:
1. Enterprises that responded "greater ability to meet large-volume orders through division of labor" regarding the present advantages of the business environment.
 2. "Strong earnings" refers to respondents that considered their earnings status to be "good" or "somewhat good," and "weak earnings" refers to respondents that considered their earnings status to be "poor" or "somewhat poor."

5) See Part II, Chapter 3.

In view also of the above case, two effective ways in which SMEs with limited business resources can increase the business that they do with enterprises with which they have not previously had relations are by (1) gathering the information they need on expanding into new fields from within their clusters, and (2) skillfully utilizing enterprises in their clusters that have increased their technological level.

Fig. 2-4-26 Importance of information obtained in clusters

High proportion of enterprises that value the information obtainable within clusters have strong earnings

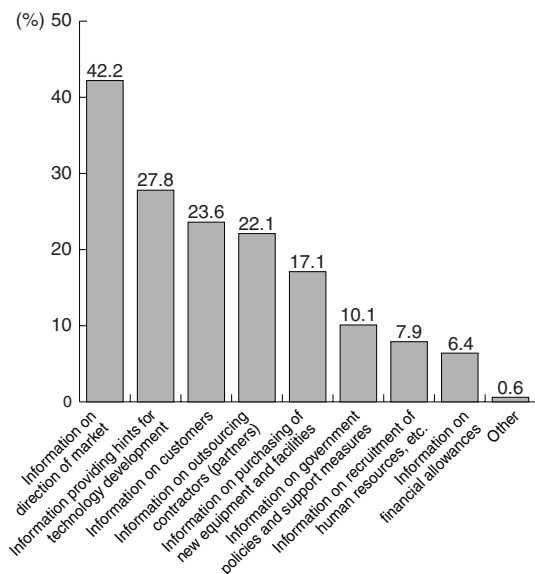


Source: Research Institute for Industrial Location Co., Ltd., *Survey of Industrial Clusters* (December 2005).

Note: "Strong earnings" refers to respondents that considered their earnings status to be "good" or "somewhat good," and "weak earnings" refers to respondents that considered their earnings status to be "poor" or "somewhat poor."

Fig. 2-4-27 Information obtainable within clusters

Information on new markets and technology development is obtained within clusters



Source: Research Institute for Industrial Location Co., Ltd., *Survey of Industrial Clusters* (December 2005).

Notes: 1. Enterprises that responded that they "emphasized" or "strongly emphasized" information obtainable within clusters were asked about the types of information available in clusters.
2. Totals exceed 100 due to multiple responses.

(1) Use of information from within clusters

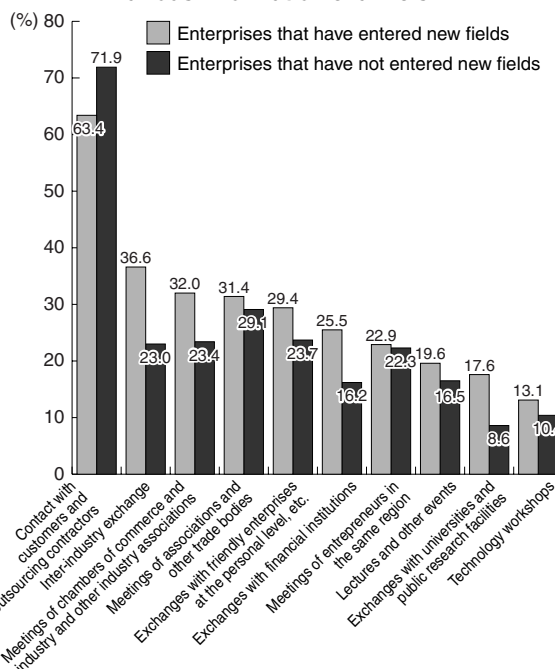
Let us consider how members of clusters can use information obtained from within their clusters.

Fig. 2-4-26 shows that a high proportion of enterprises that stress the importance of information acquired from within their clusters are enterprises that are enjoying healthy earnings growth. These enterprises that emphasize their clusters as sources of information tend in particular to obtain the following forms of information: "information on direction of market," "information providing hints for technology development," and "information on customers" (Fig. 2-4-27). It is evident from this that clusters function as "places" in which enterprises obtain information in order to expand into new markets.

If we look at the places for gathering information emphasized by enterprises that enter new fields (Fig. 2-4-28), we discover that although a high proportion say "contact with customers and outsourcing contractors," the proportion is lower than among enterprises that have not entered new fields. Conversely, items that were cited more than by enterprises that had not entered new fields

Fig. 2-4-28 Information channels emphasized by enterprises entering new fields

Enterprises that have entered new fields emphasize various information channels



Source: Research Institute for Industrial Location Co., Ltd., *Survey of Industrial Clusters* (December 2005).

Notes: 1. Enterprises that responded that they "emphasized" or "strongly emphasized" information obtainable within clusters were asked about the types of information available in clusters.
2. Totals exceed 100 due to multiple responses.
3. "Enterprises that have entered new fields" are enterprises that answered "entered new field using conventional technologies" or "launched business operation" in response to the question of how they had responded to changes in the business environment.

included “inter-industry exchange,” “meetings of chambers of commerce and industry and other industry associations,” and “universities and public experimental research facilities.” It would appear that enterprises that enter new fields are highly sensitive to information, and also emphasize information exchanges arising from opportunities outside the normal run of business. One could say that these enterprises are taking advantage of the continuing benefits of clusters in that they provide opportunities for contact and exchanges with sources of information other than everyday business contacts.

(2) Business collaboration among cluster members

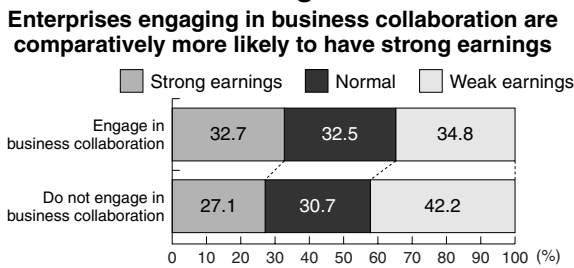
Next, let us focus on collaboration among enterprises as a means of accessing external “seeds.”

An examination of the state of engagement in business collaboration (Fig. 2-4-29) indicates that enterprises that do not engage in such collaboration tend to perform worse earnings-wise than enterprises that do engage in collaboration.

In particular, it can be seen that among the various types of collaboration engaged in within clusters, enterprises that collaborate with enterprises with different fields of expertise tend to have higher earnings (Fig. 2-4-30). Given that over 60% of enterprises that entered new fields did so through business collaboration (Fig. 2-4-31), it may be concluded that rather than depending on certain technologies and industries as in the past, clusters must now offer a diversity of technologies and industries.

Looking at the types of partners that enterprises used in business collaboration (Fig. 2-4-32), there appears not to be any major difference in earnings status regardless of whether they are from the same cluster or from beyond. It would seem, then, that the important thing in

Fig. 2-4-29 State of business collaboration and earnings status



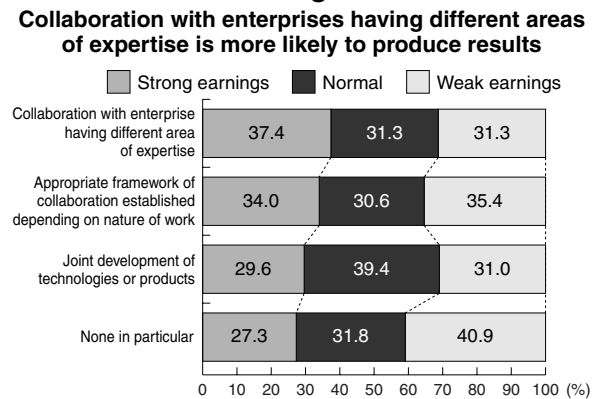
Source: Research Institute for Industrial Location Co., Ltd., *Survey of Industrial Clusters* (December 2005).
 Notes: 1. Enterprises that “engage in business collaboration” are defined as those that engaged in business collaboration with enterprises the same cluster region, another region, or overseas in response to changes in the business environment.
 2. “Strong earnings” refers to respondents that considered their earnings status to be “good” or “somewhat good,” and “weak earnings” refers to respondents that considered their earnings status to be “poor” or “somewhat poor.”

business collaboration is to find a partner that is really appropriate, regardless of whether that partner is located in the same cluster or elsewhere.

The next question we consider is whether or not clusters make any contribution to business collaboration.

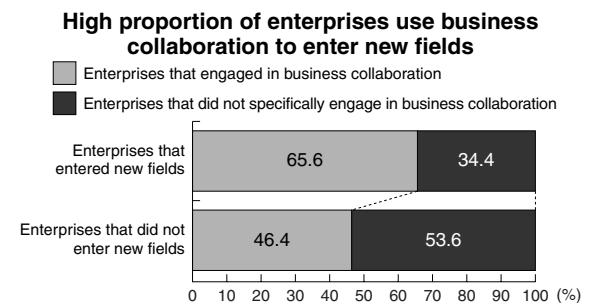
Here it can be seen that proximity is important to finding partners for business collaboration. If we look at the business collaboration partners of enterprises actually engaging in “new partnerships”⁶⁾ under the Law for Facilitating New Business Activities of Small and Medium Enterprises⁷⁾ (Fig. 2-4-33), we find that almost

Fig. 2-4-30 Policy on business collaboration and earning status



Source: Research Institute for Industrial Location Co., Ltd., *Survey of Industrial Clusters* (December 2005).
 Notes: 1. Respondents were asked what kind of action they took regarding collaboration with enterprises in the same cluster.
 2. “Joint order taking system established,” “joint development of marketing outlets,” and “other” were excluded due to the small number of responses.
 3. “Strong earnings” refers to respondents that considered their earnings status to be “good” or “somewhat good,” and “weak earnings” refers to respondents that considered their earnings status to be “poor” or “somewhat poor.”

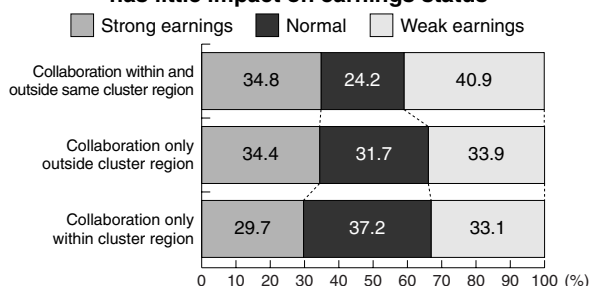
Fig. 2-4-31 Expansion into new fields and business collaboration



Source: Research Institute for Industrial Location Co., Ltd., *Survey of Industrial Clusters* (December 2005).
 Note: “Enterprises that entered new fields” are enterprises that responded “entered new field using conventional technology” or “launched new business operation” to the question of how they responded to changes in the business environment.

6) The number of approvals of “new partnerships” between the law’s entry into effect in April 2005 and the end of February 2006 was 162.
 7) See footnote 12 in Part I, Chapter 1.

Fig. 2-4-32 Partners in business collaboration
The location of partners in business collaboration has little impact on earnings status

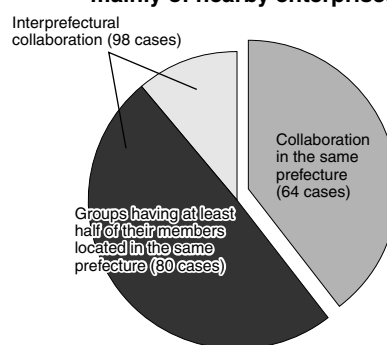


Source: Research Institute for Industrial Location Co., Ltd., *Survey of Industrial Clusters* (December 2005).

- Notes:
1. "Collaboration only within cluster region" refers to enterprises that responded only that they "engaged in collaboration with an enterprise in the same cluster region."
 2. "Collaboration within and outside same cluster region" refers to enterprises that said that they "engaged in business collaboration with an enterprise in the same region" and also responded affirmatively to either or both of "engaged in collaboration with a foreign enterprise outside the same cluster region" or "engaged in collaboration with an enterprise overseas."
 3. "Collaboration only outside cluster region" refers to enterprises that responded affirmatively to either or both of "engaged in collaboration with a foreign enterprise outside the same cluster region" or "engaged in collaboration with an enterprise overseas."
 4. "Strong earnings" refers to respondents that considered their earnings status to be "good" or "somewhat good," and "weak earnings" refers to respondents that considered their earnings status to be "poor" or "somewhat poor."

all such collaboration is between nearby enterprises. Among enterprises engaging in business collaboration

Fig. 2-4-33 Partners in new collaboration
Approximately 90% of partnership groups consist mainly of nearby enterprises



Source: Compiled by the SME Agency (as of end February 2006).

over a wide geographical area as well, the majority consist of nearby enterprises that use such collaboration as a means of procuring technologies and know-how that their clusters lack. Enterprises with no knowledge about the technologies or know-how of enterprises outside their clusters are also able to take advantage of outside "seeds" by participating in groups within their clusters.

In short, then, although there is no difference in earnings according to whether an enterprise collaborates with a partner from within or outside its cluster, clusters are serving a truly modern function by making it easier for their members to find partners for collaboration and assisting collaboration.

Section 5 Use of cluster functions to revitalize regional economies (summary of Chapter 4)

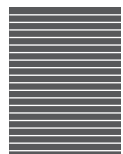
Increasing globalization in recent years has transformed the business environment, and the pace of change is accelerating as a result of advances in information technology and other fields. Under these conditions, the SMEs in each cluster must constantly innovate without relying on particular enterprises or industries, and seek out customers and business partners, whether from their own clusters or elsewhere. Given their limited business resources, however, it is difficult for SMEs to constantly engage single-handedly in business innovation. That is where effective use can be made by SMEs of the business resources in each region (i.e., local resources). As we have observed, the functions of industrial clusters, too, are one of the local resources that can be used. So also are agricultural, forestry, and fishery resources, and the technology seeds produced by universities and other institutions. In Hokkaido, new initiatives are emerging that utilize the

know-how of enterprises in the prefecture, agricultural resources, and industry-academic collaboration (Case 2-4-2). Even at the national level there have been few such initiatives, and it is hard to say that much experience has been accumulated, but such untapped and until now neglected local resources can probably be found in considerable depth throughout the country.

In order to revitalize the regional economies, it is important that active and effective use be made of these local resources at the level of individual enterprises.

Given this environment, then, how can best use be made of regional industrial clusters as local resources? When almost all industries are on the up and up as during the high-growth period, it is efficient to engage in business relying on specific industries and enterprises. Due to the changing business environment and rise and fall of enterprises and industries, however, the traditional "benefits enjoyed due to being located within a cluster,"⁸⁾

8) Japan Small Business Research Institute (2003).



such as access to cheap raw materials and a stable flow of orders, are fading.

However, from the point of view of responding to diverse and changing needs, clusters retain, as we have seen, certain functions that are growing in importance, i.e., (1) they enable the establishment of flexible divisions of labor, (2) they facilitate access to the

information that enterprises need in order to expand into new fields and establish new ventures, and (3) they assist collaboration with other enterprises and organizations on R&D and new ventures. And use has to be made of such “cluster functions” as one effective means of securing a comparative advantage in the business environment.

Case

2-4-2

Developing a new business using various regional resources

Hokkaido Bio-Industry Corporation, located in Sapporo City, Hokkaido, has a workforce of 13 and capital of ¥20.6 million. Established in 1997, it develops and manufactures health food products. Using functional northern plants growing in the wild in Hokkaido as ingredients, it aims to make “truly healthy” products that are “safe” and bring customers “peace of mind.” It has established a proprietary technique for activating the health benefits of onions and other plants in the allium genus. It conducts research and development on health foods and ingredients that are effective for the prevention of adult-onset diseases, verifies their functionality, and sells them nationwide.

The company commercializes products through its active involvement in alliances at various levels. For example, it conducts joint research with locally

based Hokkaido Tokai University, forms tie-ups with farmers for raw material procurement and with local food processors for food processing processes, and at the distribution stage makes effective use of the expertise of local transportation companies in foodstuff logistics.

In this way, Hokkaido Bio-Industry Corporation makes full use of the following four local resources: (1) Hokkaido's agricultural resources; (2) the food brand of the “Hokkaido” region; (3) techniques and expertise in agricultural processing and the distribution of agricultural products acquired from the cluster of companies; and (4) technical development by a university. The company's strategy, therefore, is to concentrate its own business resources on the fields of marketing and research and development.

Part III

SMEs at a time of demographic aging and population decline

Since the beginning of the modern era, Japan has developed under conditions of continued demographic growth. The total population, which at the time of the Meiji Restoration was around 30 million, has approximately quadrupled in just a little under a century and a half.

In a society whose population is growing, there are always more young people than old. Japan's business culture was molded during the postwar high-growth period, and elements such as seniority-based pay and across-the-board promotion all only function properly in an environment in which the next generation of subordinates is always more numerous than the last.

Now, however, the Japanese population is on the brink of decline. The reversal of this trend is bound to have a tremendous impact on SMEs' business strategies and also on the life plans of the workers at SMEs, which account for more than 70% of employment in Japan.

Chapter 1 provides a demographic snapshot of the Japanese population. In addition to summarizing long-term projections of the total population, we examine long-term trends such as the decline of the labor force population and growth in the proportion of the population aged 65 or over, and analyze the impact of these trends on the economy. We also provide an overview of social trends affecting SMEs, such as changes in local communities associated with population decline, and growth in the lifestyle support service industry at a time of population aging and declining birthrates.

In **Chapter 2**, we investigate challenges now emerging with the aging of the population. SMEs presently face the "double whammy" of the imminent retirement of the baby-boomer generation and the retirement of their own original founders, who established so many enterprises during the high-growth period, making this a critical time for both business successions and the transmission of the baby boomers' skills. We therefore analyze what measures SMEs are taking on two fronts – on the side of proprietors (business successions) and on the side of employees (transmission of skills) – to prevent the valuable business resources that Japanese SMEs have accumulated from being scattered and lost.

The purpose of **Chapter 3** is to examine the roles of SMEs in creating a more attractive society in which to have and raise children. Compared with large enterprises, SMEs provide an environment that is naturally more amenable to younger workers (for example, the barriers to a "freeter," i.e., job-hopping part-time worker, becoming a full-time employee are lower), and they also provide an environment in which it is easier to balance the demands of work and parenting (for example, the number of children per permanent female employee is high). By analyzing these factors, we explore the possibility of new measures targeted at SMEs, which account for 70% of employment in Japan, that can help reverse the decline in the birthrate.

In **Chapter 4**, we look at measures to sustain the vitality of provincial cities and regional economies amid population decline, falling birthrates, and population aging. With the concentration of urban functions – i.e., compact town development – presently being debated as a means of coping with population decline, we consider methods of restoring the hustle and bustle to central urban areas through the synergies generated by commercial and other urban functions, and analyze SMEs' role as leaders in the community businesses that are the "lubricant" of town life from the point of view of the involvement of central and local government.

By means of the above, in Part III we shall identify how SMEs should adapt and what roles they should play in responding to the greatest change since the Meiji restoration as Japanese society enters a period of falling birthrates, population aging, and demographic decline.

Chapter 1 Changes in demographic structure and the impact on SMEs

Japan's demographic structure is at a major turning point. The labor force is already in decline, having begun to fall in 1999, and the population as a whole too began to decrease in 2005. What changes in the socioeconomic

structure that has supported Japan to date will these demographic changes bring about? And how will they affect the business of SMEs?

Section 1 Summary of population decline

1. The total population and birthrate

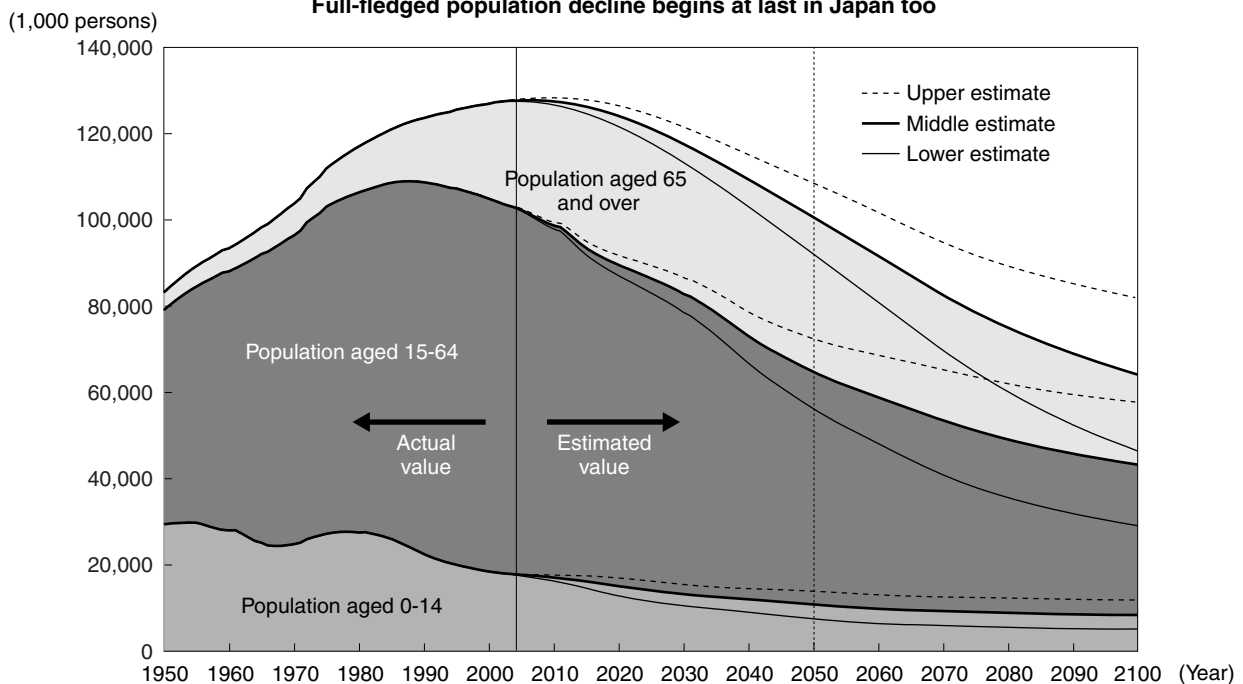
According to MIC's *Population Census*, the total population of Japan as of October 1, 2005 was 127,760,000, which represents a decline of approximately 20,000 compared with the estimated population (after retrospective correction)¹⁾ one year previously.

The decline of the Japanese population, beginning in 2005, is progressing at globally unprecedented speed.

This is due to the rapid decline in the total fertility rate (TFR) even in comparison with other industrialized countries. Japan's TFR has continued to decline since slipping below 2.00 in 1975, and presently stands at 1.29 (as of 2004). The number of live births is projected to decline dramatically in the years ahead, falling from 1,067,000²⁾ in 2005 to 914,000 in 2020, 753,000 in 2040, and 632,000 in 2060³⁾ (Fig. 3-1-1).

What then of trends in births in other industrialized countries? In the U.S., the TFR fell considerably

Fig. 3-1-1 Demographic change in Japan
Full-fledged population decline begins at last in Japan too



Source: MIC Statistics Bureau, *Projected Population of Japan up to 2000*, and the *Annual Report on Current Population Estimates for 2001-2004*.

Note: The figures for 1950-1971 do not include Okinawa.

1) Retrospective correction refers to the retroactive correction of past population estimates using the results of the *Population Census*. As the *Population Census* is conducted every five years, projections are retrospectively corrected in order to determine the population in non-census years.
 2) Official figures from MHLW, *Annual Estimates of Vital Statistics, 2005*.
 3) The figures for 2020, 2040, and 2060 are projections (middle estimates) by the National Institute of Population and Social Security Research published in 2002.

between the beginning of the 1960s and early 1970s, but since 1990, it has remained around the 2.00 mark. In Europe as well, the TFR has remained high at around 1.70-1.90 since 1980 in the U.K. and France. In Germany and Italy, the TFR has been around 1.3, as in Japan, though there has been something of an upturn in recent years⁴⁾ (Figs. 3-1-2, 3-1-3).

2. Labor force situation

The decline of the total population began in 2005. If we look at the situation by age group, however, we find that the population of productive age – i.e., people aged 15 to 64 – had already started to decline in 1996. A society in which the birthrate is falling and proportion of elderly is increasing is not only one whose overall population declines; due to the increase in the proportion of the elderly, it is also one in which the population of productive age⁵⁾ shrinks as a proportion of the overall population.

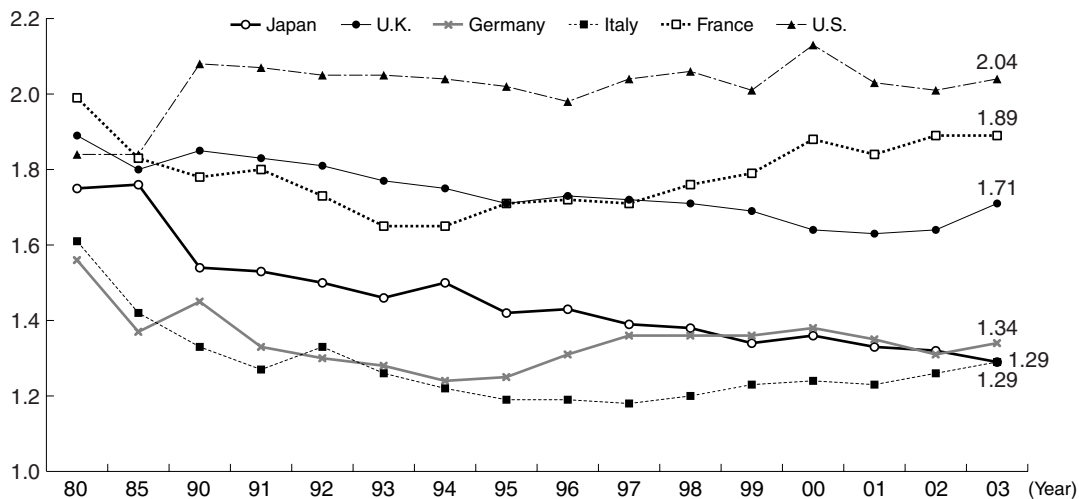
According to a report from the Institute for Employment Policy, the overall labor force participation rate assuming that there is no increase in labor force participation by women and the elderly and that labor force participation rates by sex and age remain the same

as in 2004 will decline compared with 2004 (60.4%) by 3.7% in 2015, and 6.8% in 2030. In addition, according to the MHLW’s *Employment Security Bureau Estimates*, the labor force population is projected to decline by roughly 420,000 in 2015 and 3,420,000 in 2025 compared with 2004 (66,420,000) (Fig. 3-1-4). As the labor force population declines, the number of employed persons, too, will steadily decline.⁶⁾

Using MIC’s *Employment Status Survey*, let us break down the changes in the number of employed persons in Japan⁷⁾ into those due to population changes and those due to changes in the employment rate.⁸⁾

As Fig. 3-1-5 shows, as the total population had until now continued to grow, this caused the number of employed persons to grow irrespective of changes in the rate of employed persons to the population of productive age. As the total population is projected to fall sharply in the years ahead, however, it is important that the rate of employed persons to the population of productive age be increased if the annual average rate of growth in the number of employed persons is to be maintained.

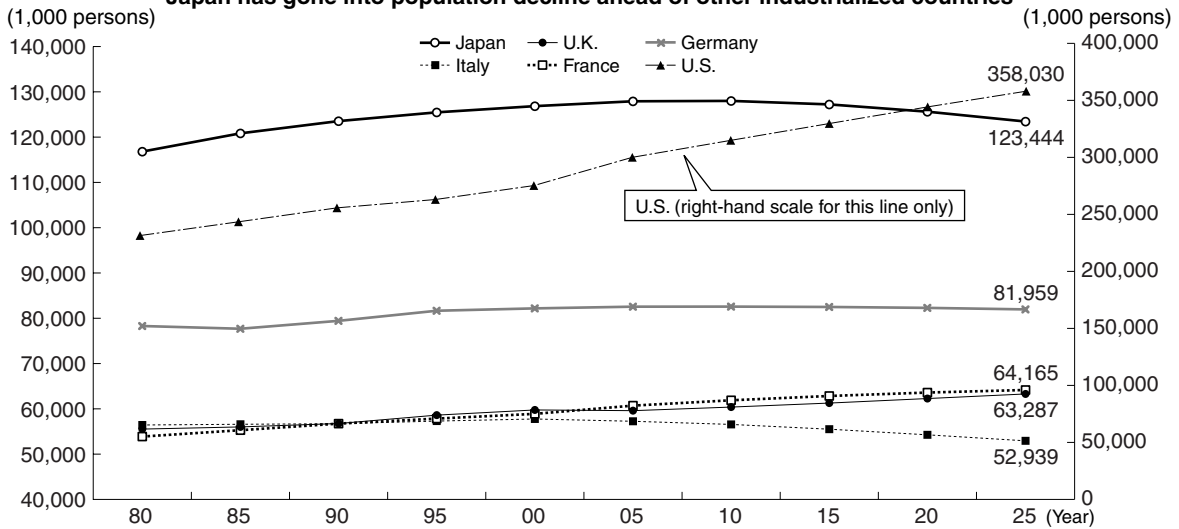
Fig. 3-1-2 Trends in the total fertility rates of major countries
Compared with other industrialized countries, Japan’s total fertility rate is low and continues to decline



Source: United Nations Department of Economic and Social Affairs, *Demographic Yearbook 2005 (Revised)*; TFR for Japan only calculated by the National Institute of Population and Social Security Research.

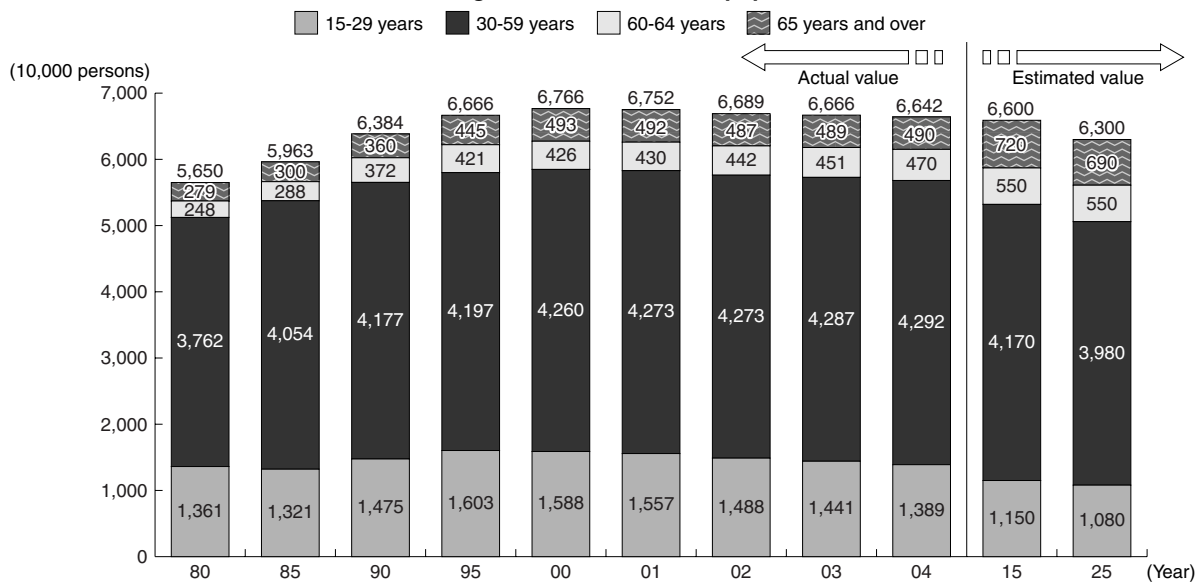
4) See Appended Note 3-1-1 regarding trends in the TFRs of major countries, and Appended Note 3-1-2 regarding population trends.
 5) Strictly speaking, the “population of productive age” and “employable population” are not the same. Even among the “elderly” aged 65 or over, there are people who can work or are working, and, conversely, a considerable number of people in their late teens and early twenties are students, making their employment unfeasible in practice. In this analysis, the population of productive age is treated as the approximate value for employable population.
 6) Labor force population = employed persons + unemployed persons
 7) In the *Employment Status Survey*, the terms “employed person” and “employment rate” are not used in order to make explicit differences from the *Labor Force Survey*. Instead, the terms “gainfully occupied person” and “gainful occupation rate” are used. Where the terms “employed person” and “employment rate” are used in the text citing the results of the *Employment Status Survey*, therefore, they refer to “gainfully employed person” and “gainful occupation rate.”
 8) For specific details of the calculation process, see Appended Note 3-1-3.

Fig. 3-1-3 Trends in total populations of major countries
Japan has gone into population decline ahead of other industrialized countries



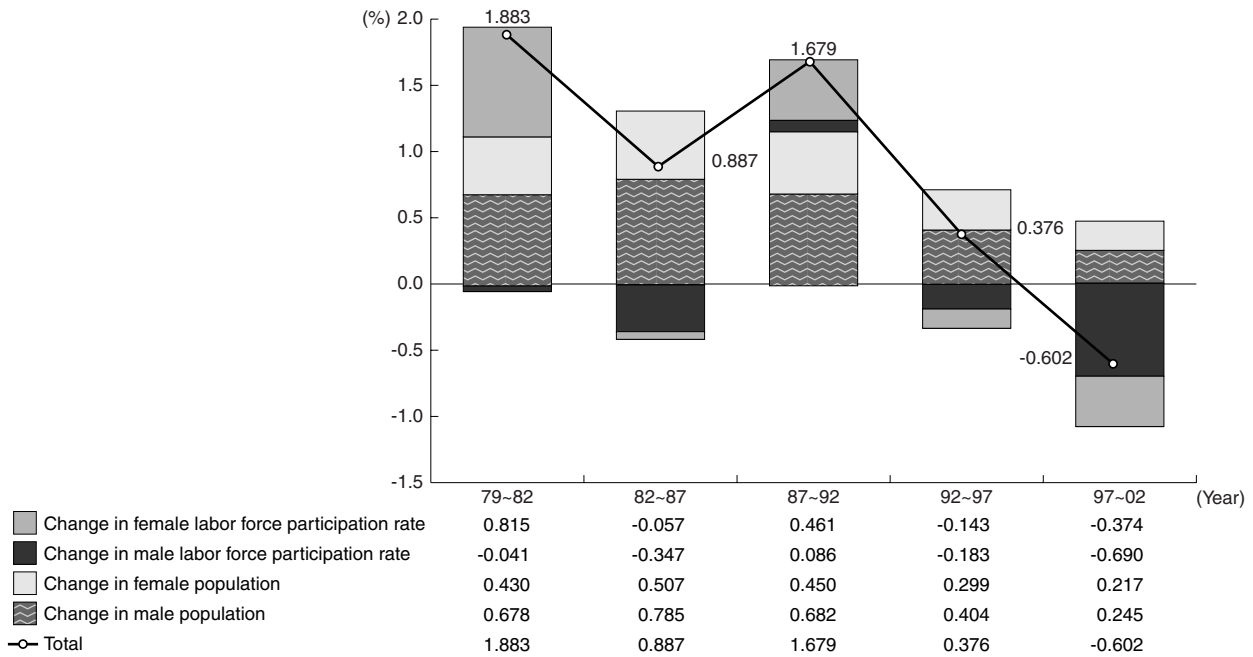
Source: United Nations Department of Economic and Social Affairs, *Demographic Yearbook 2005 (Revised)*.
 Note: Figures for 2005 onward are "middle estimates" of the demographic changes in each country.

Fig. 3-1-4 Trends in labor population
Worsening decline in labor force population



Source: MIC, *Labor Force Survey* up to 2004. MHLW, *Employment Security Bureau Estimates* (July 2002) from 2005 onward.
 Note: The labor force population is the combined total of employed persons and unemployed persons aged 15 years and over.

Fig. 3-1-5 Contribution to annual average rate of growth in number of employed persons
 Growth in the number of employed persons in Japan has to date been driven by population increase



Source: Recompiled from MIC, *Employment Status Survey*.

Section 2 Economic impact of population decline

1. Impact of decline in total population and labor force on economic growth

A decline in the total population will undoubtedly have a downward impact on gross domestic product (GDP). From the standpoint of individual citizens and SMEs, however, a declining population is not necessarily a bad thing provided that the wealth of individual citizens (e.g., GDP per capita) can be maintained.

If, however, the present situation is neglected, it may not be possible to maintain the wealth of individual citizens. As the population of productive age will decline as a proportion of the total population with the falling birthrate and population aging, the labor force participation rate in relation to the overall population will fall unless the labor force participation rate compared with the population of productive age increases. In a society in which the labor input is declining, there is a risk that the GDP thus outputted will decline and individual affluence be harmed unless productivity per worker increases.

However, GDP growth is not determined solely by labor inputs – increases in capital inputs as a result of,

say, capital investment and improvements in total factor productivity (TFP)⁹⁾ due, for example, to advances in technology make a proportionately large contribution to growth in GDP. According to the *White Paper on International Economy and Trade 2005*, Japan’s economic growth to date has been determined not only by labor inputs, but rather by the large contribution made by capital accumulation and TFP,¹⁰⁾ and this point must be borne in mind when considering economic growth. The fact remains, however, that the size of the labor force is one factor exerting an impact on economic growth, and with Japan on the verge of a precipitous decline in the labor force population due to the falling birthrate and population aging, measures will certainly be needed to maintain and raise the labor force participation rate in conjunction with raising productivity per capita.

One other thing that must not be ignored when considering economic growth is the fact that people are simultaneously “consumers” as well as “producers.” Focusing on people as “consumers,” there are concerns that population decline could cause the domestic market (principally consumer demand) to shrink, thus impeding

9) Total factor productivity (TFP) is an important concept to any consideration of economic growth, and is defined as the residual contribution to the economic growth rate not accounted for by capital and labor.

10) The *White Paper on International Economy and Trade 2005* noted, “Even if the labor force declines, if the decline can be covered by raising productivity by at least as much through the use of accumulated capital and intellectual property, it will be possible to achieve continued economic growth.”

the economy.¹¹⁾ In other words, population decline has a major impact on the market on both the supply and demand sides.

2. Employment-related measures to maintain Japan's economic dynamism

In order to maintain Japan's economic dynamism (wealth per person), there are two effective approaches that can be taken: (1) by maintaining and raising the ratio of employed persons to the overall population, and (2) by limiting the decline in demand in the domestic market. To this end, simultaneous action must be taken on the following two fronts.

(1) Tapping into the latent labor force

If Japan's economic dynamism is to be maintained, it is first and foremost essential that the rate of employment to the population of working age be raised through simultaneous action by the Government to develop employment policies to create jobs, and by individual enterprises to raise the employability of diverse workers.

Specific methods of doing so include the use of young people newly entering the labor market, making use of women who have yet to enter the labor market, such as women who are presently full-time housewives, and using elderly people who still want to work but do not have the opportunity to do so.¹²⁾

Regarding the young, the continuing large numbers of "freeters" (job-hopping part-time workers) and "NEETs" (Not in Education, Employment or Training) are a problem. However, many of the young people in unstable employment actually want to get a steady job but do not have the opportunity to do so, and the large numbers of such people who want to be employed provide SMEs with an excellent opportunity to employ young workers.

Regarding women, combining work and parenting is difficult in Japan, and the labor participation rate is particularly low among women in their thirties. Many women find it difficult to continue working due to the heavy burden of parenting, and women's participation in the labor market has to be promoted by creating the conditions that enable them to continue working while caring for children.

Regarding the elderly, the baby-boomer generation is on the brink of mandatory retirement, and there are concerns over the impact this could have. Some older people want to continue working after mandatory retirement for various reasons, such as to contribute to society, for personal satisfaction, or to stay healthy, and they offer a potentially valuable source of manpower for SMEs that are struggling with labor shortages. Highly experienced older people can also play a part in the in-house training of employees and in their local communities.

Below, then, let us simulate the job creation effects of raising the employment rate using the results of MIC's *Employment Status Survey*.

Fig. 3-1-6 shows the estimate number of employed persons in the future in three scenarios¹³⁾: (i) in the event of no change in the employment rate from 2002,¹⁴⁾ (ii) in the event of a gradual recovery in the employment rate in all age groups to the level in 1992 (the highest level in recent years) by 2015,¹⁵⁾ and (iii) in the event of an annual 0.5% increase in the employment rate among 20-39 year old women and 60-64 year olds.¹⁶⁾ In scenario (i), the number of employed persons will decline by 6,210,000 in the 20 years from 2005 to 2025 in parallel with the decline in the population, but the decline will be limited to 3,020,000 in scenario (ii) and 4,220,000 in scenario (iii).

As Japan's SMEs have to date used a wide variety of sources of labor, including the young, women, and elderly, the role of SMEs will no doubt grow increasingly important in the future.

11) It must be remembered that the shrinkage of the domestic market does not necessarily impede economic growth. Demand could be maintained through growth in foreign demand (exports). Given strengthening economic relations in the East Asian region, growth (though not GDP growth) is also possible through increased foreign direct investment and funneling back to Japan of earnings from these investments, which will increase gross national product (GNP). Similarly to measures to raise productivity on the supply side, consideration should also be given to measures beyond simply maintaining the size of the population.

12) Another method of exploiting latent labor power is through the use of foreign workers. In the Ministry of Justice's Third Immigration Control Basic Plan (March 2005), it is stated that "With the drastic decline in the population of productive age, it is important that the intake of foreign workers in specialized and technical fields be pursued more positively." Regarding "fields that are not presently assessed as falling into the category of specialized and technical fields," on the other hand, the plan says, "Proper consideration needs to be given to both the positive and negative effects of taking in foreign workers on Japanese industry and people's lives." The pros and cons of expanding the fields in which foreign workers are accepted and how to do so will need to be examined further in the future.

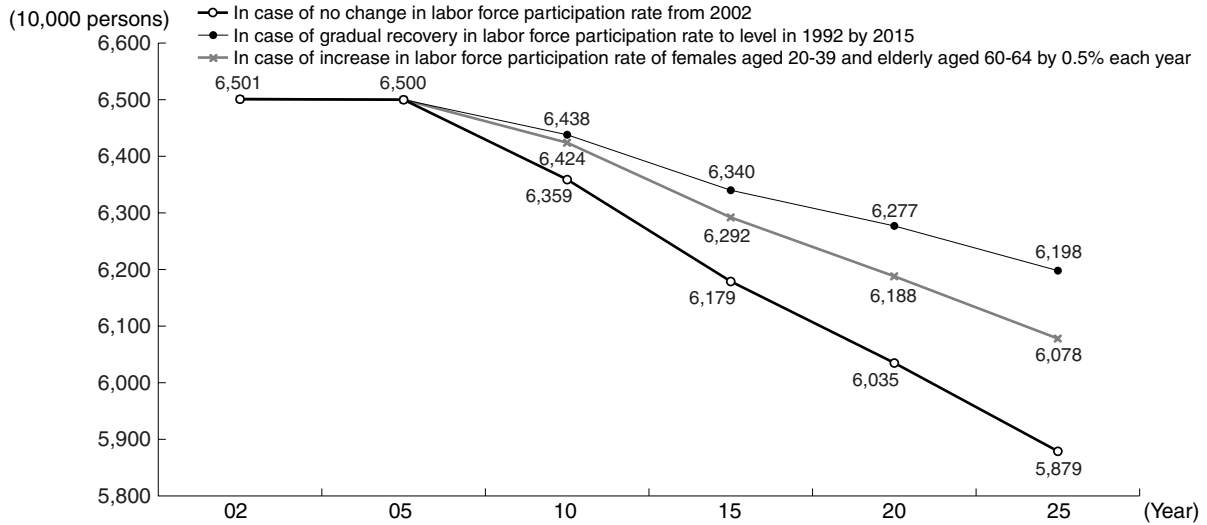
13) Regarding the employment rates in scenarios (ii) and (iii), see Appended Note 3-1-4.

14) According to MIC's *Employment Status Survey*, the employment rate in 2002 (combined total for men and women aged 15 and over) was 59.5%.

15) According to MIC's *Employment Status Survey*, the employment rate in 1992 (combined total for men and women aged 15 and over) was 63.9%. For this scenario, it was assumed that the employment rate would recover evenly to the level in 1992 in the 20 years from 2006 to 2025.

16) The employment rates in 2025 in this scenario are 78.0% for women in their twenties, 68.8% for women in their thirties, 75.8% for men aged 60-64, and 49.5% for women aged 60-64. For other age groups, the employment rates of both sexes in 2002 were used.

Fig. 3-1-6 Future number of employed persons in case of change in labor force participation rate
 The scale of the decline in the number of employed persons could be limited by a recovery in the labor force participation rate



Source: Compiled by the SME Agency based on National Institute of Population and Social Security Research, *Population Projections for Japan (2002)* and MIC, *Employment Status Survey (2002)*.

- Notes:
1. The base total population was calculated using the middle estimates of the National Institute of Population and Social Security Research's *Population Projections for Japan*.
 2. Labor force participation rates were calculated for men and for women (aged 15-19, 20-29, 30-39, 40-49, 50-59, 60-64, and 65 and over) by recompiling data from MIC's *Employment Status Survey*.

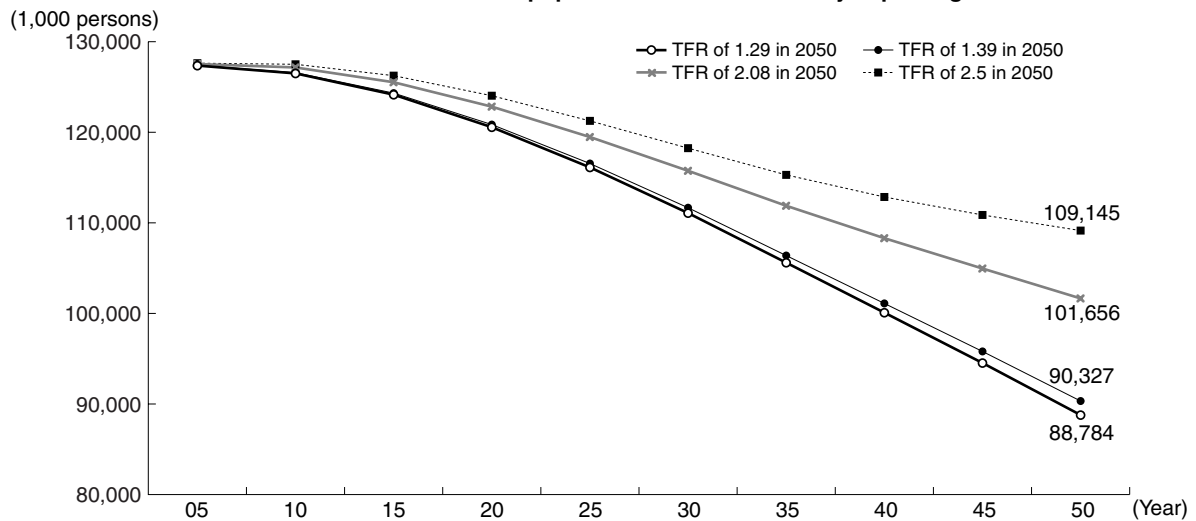
(2) Recovery of the birthrate

Secondly, limiting the decline in the size of the population and the decline in demand in the market by reversing the decline in the birthrate would have a considerable impact on maintaining Japan's economic dynamism over the long term.

Fig. 3-1-7 shows the projected total population

assuming total fertility rates (TFRs) up to 2050 to be, respectively, 1.29 (status quo), 1.39 (middle estimate), 2.08 (population replacement level), and 2.5. From this it can be seen that although the total population will decline to 88.78 million in 2050 assuming that the TFR remains at 1.29 as at present, the decline can be limited if the birthrate recovers.¹⁷⁾

Fig. 3-1-7 Total population in case of change in total fertility rate
 The scale of the decline in the total population can be reduced by improving the TFR



Source: National Institute of Population and Social Security Research, *Population Projection Database*.

17) For detailed figures, see Appended Note 3-1-5.

An increase in the birthrate would depend on a complex combination of factors, including the marriage rate, marriage age, birthrate and childbearing after marriage, and the proportion of children born outside marriage. What is clearly important, however, is that how individual citizens work has a major impact on creating a society that is more amenable to having and

raising children. Of particular note is that the smaller an enterprise is, the higher is the proportion of women caring for children who have passed infancy and early childhood and are employed as permanent employees,¹⁸⁾ indicating that SMEs have a major role to play in helping workers to balance the demands of work and parenting.

Section 3 Progressing population aging

1. The state of population aging

While in 1950 only 5% of the Japanese population was aged 65 or over, the proportion exceeded 7% in 1970 and 14% in 1994, and the population continues to age rapidly.¹⁹⁾

Once the baby-boomer generation enters the 65-and-over age group, population aging is expected to accelerate even further. According to estimates by the National Institute of Population and Social Security Research, the elderly population will continue to grow rapidly until 2020, and thereafter generally stabilize (Fig. 3-1-8). On the other hand, the proportion of elderly in the total population will continue to increase due to the total population going into decline in 2005, reaching 22.5% in 2010 and 27.8% in 2020. Japan is therefore projected to

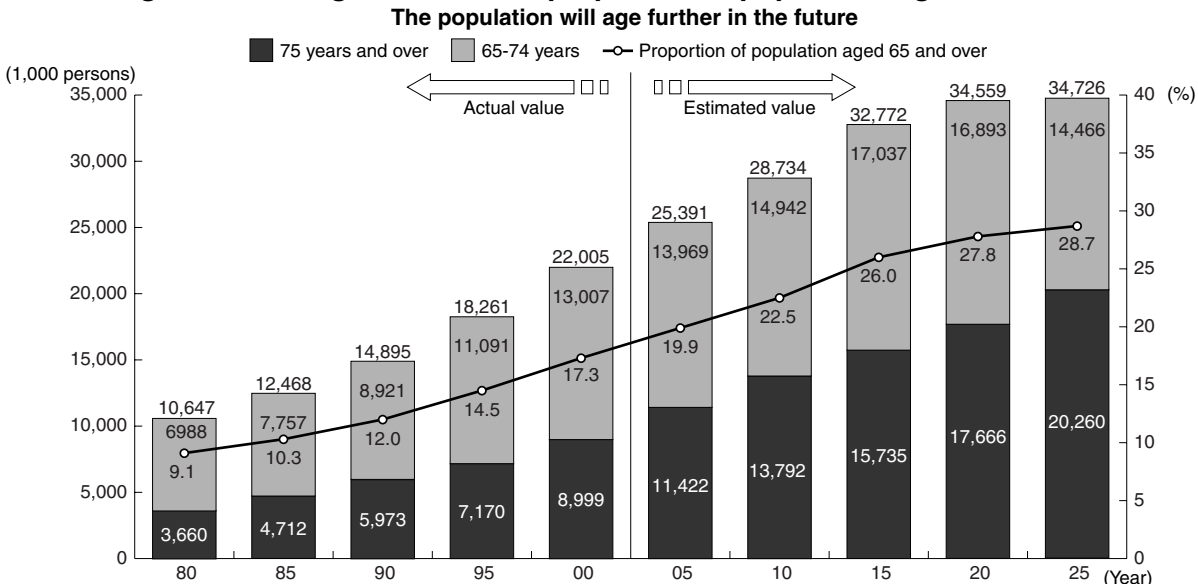
become an extremely aged society, with approximately one in four people being aged 65 or over.²⁰⁾

Among the elderly, the young-old population²¹⁾ will peak in 2016 before going into decline. The old-old population, on the other hand, will continue to grow, and is projected to exceed the young-old population in 2018. It therefore appears that the proportion of old-old among the elderly will increase further.

2. Aging of the labor force and transmission of skills

Next, we consider the aging of the labor force. In 2004, the total labor population (labor force population aged 15 or over) came to 66,420,000, of which 4,900,000, or 7.4% of the total, were aged 65 and over.

Fig. 3-1-8 Changes in size and proportion of population aged 65 and over



Source: Figures up to 2000 are from MIC, *Population Census*. Figures for 2005 onward are from National Institute of Population and Social Security Research, *Population Projections for Japan* (January 2002 estimates).

18) See Part III, Chapter 3.

19) A society in which the proportion of persons aged 65 or over exceeds 7% is called an “aging society,” and once the proportion exceeds 14% it is called an “aged society.” In general discourse, the two tend to be subsumed together under the term “aging society.”

20) According to these same estimates, the proportion of elderly will reach 35.7% in 2050, which means that around one in three people in Japan will be aged 65 or over.

21) In the *2005 Annual Report on the Aging Society*, the elderly are divided into “young-old” (aged 65-74) and “old-old” (aged 75 and over).

The proportion of the total labor force population aged 65 or over has continued to grow from 4.9% in 1980, and with the total labor force forecast to decline dramatically, it is likely to grow increasingly aged (Fig. 3-1-9).

Specifically, then, what sized enterprises are particularly affected by the decline and aging of the labor force? Let us consider this question in detail using data from MIC's *Labor Force Survey*.

Fig. 3-1-10 shows the number of employed persons over time at employers with (1) 100 or more employees, (2) 10-99 employees, and (3) 1-9 employees. From this it can be seen that over the past 10 years, whereas the number of employed persons at businesses with 10-99 employees has increased slightly and the number at businesses with 100 or more has remained largely constant, there has been a downward trend at businesses with 1-9 employees. Owing to the fact that the number of employed persons aged 55-64 and 65 or over at enterprises with 1-9 employees has hardly changed over time, there has also been a further increase in the proportion of elderly at these enterprises.²²⁾

Breaking down the situation by number of employees thus shows that even among SMEs, it is the smaller enterprises that are being particularly affected by the decline and aging of the labor force, and there are fears that the aging of the population could make it difficult to ensure the transmission of skills and knowledge within enterprises. Among small-sized enterprises especially, if

skills and knowledge are not smoothly transferred, this can have a direct impact on a business's very survival. The problem of ensuring that skills are passed on to the next generation of workers is thus a major challenge for SMEs in an aging society.

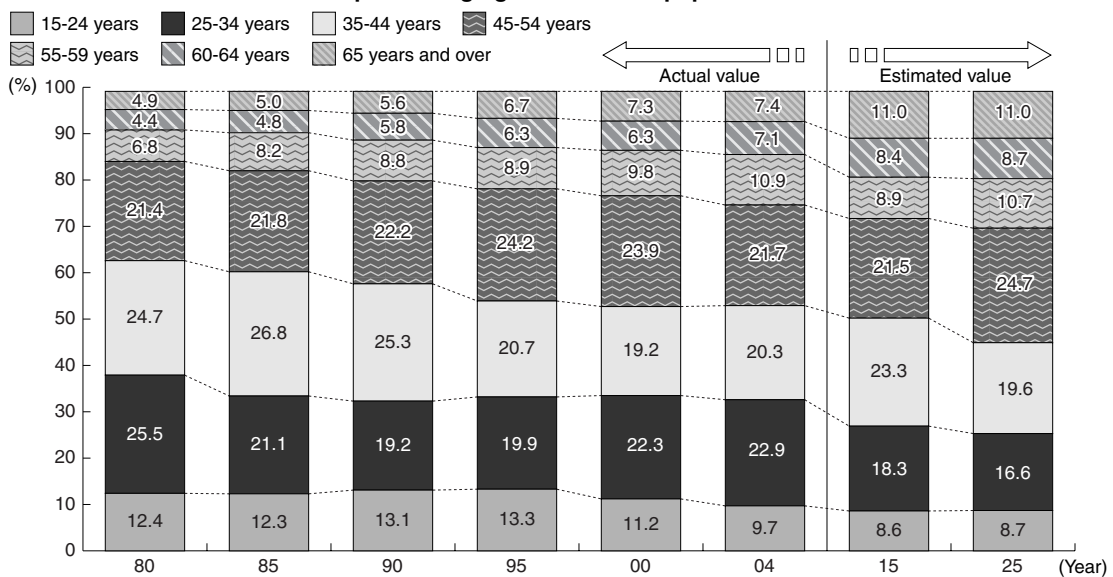
3. Aging of proprietors and business successions

Below, we look at the impact of the advent of an aging society with fewer children focusing on the ages of those involved in management.

Starting with the self-employed, MIC's *Employment Status Survey* indicates that whereas the average age of self-employed persons was 49.2 in 1979, this had risen to 56.2 in 2002, confirming that the self-employed are growing older. Looking also at the number of self-employed persons over time, it is apparent that there has been a dramatic fall in the number aged less than 60 since around 1987 (Fig. 3-1-11).

Regarding next the age of corporations' representative directors, the statistics show that the overall average rose from 53 years and 1 month in 1985 to 58 years and 6 months in 2004.²³⁾ Broken down by amount of capital, the average age of representative directors at enterprises with capital of at least ¥50 million has remained at approximately the same level, but the average age at enterprises with capital of less than ¥50 million has increased similarly to the average

Fig. 3-1-9 Changes in age profile of labor force population
Conspicuous aging of labor force population too



Source: MIC, *Labor Force Survey* up to 2004. MHLW estimates from 2015 onward.

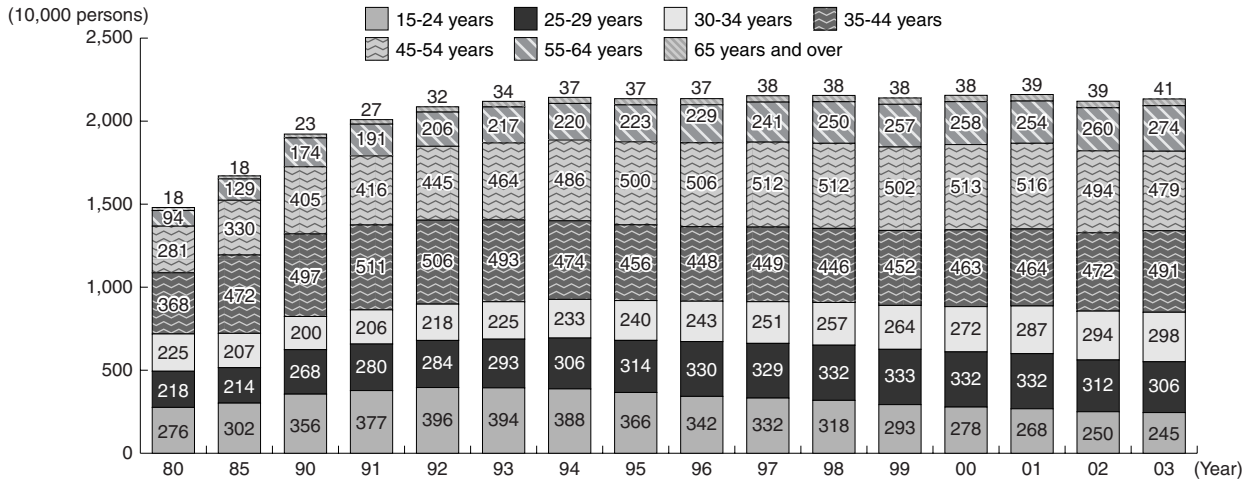
Note: The labor force population is the combined total of employed persons and unemployed persons aged 15 years and over.

22) The proportion of employed persons aged 55 or over working at enterprises with 1-9 employees was 24.3% in 1980. However, this increased to 32.6% in 1990 and 39.3% in 2000, and passed 40% for the first time in 2003 when it reached 40.9%.

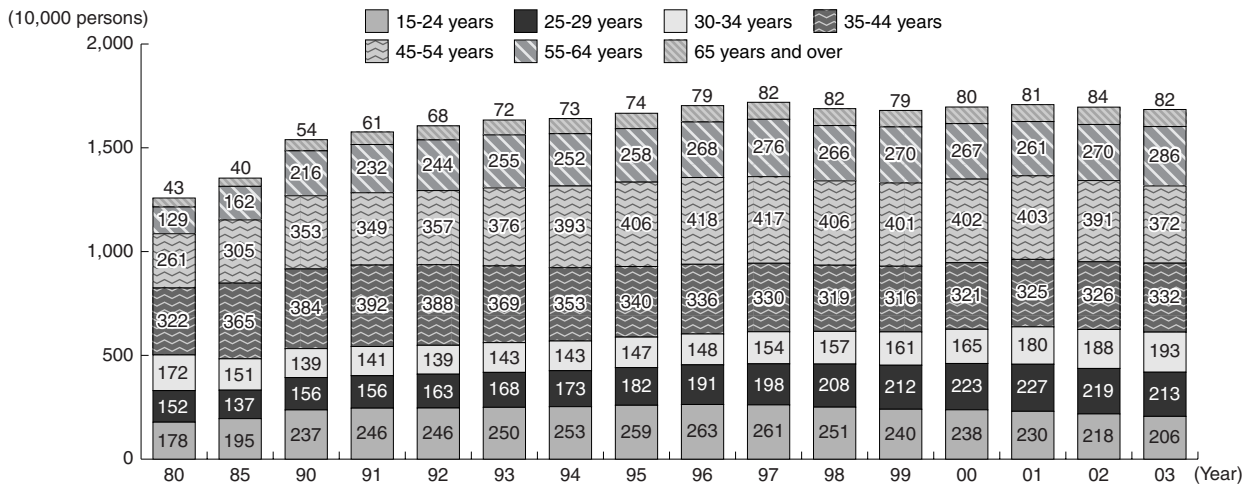
23) For detailed figures, see Appended Note 3-1-6.

Fig. 3-1-10 Trends in number of employed persons by age group
 People employed by enterprises with fewer employees are declining in number and growing older

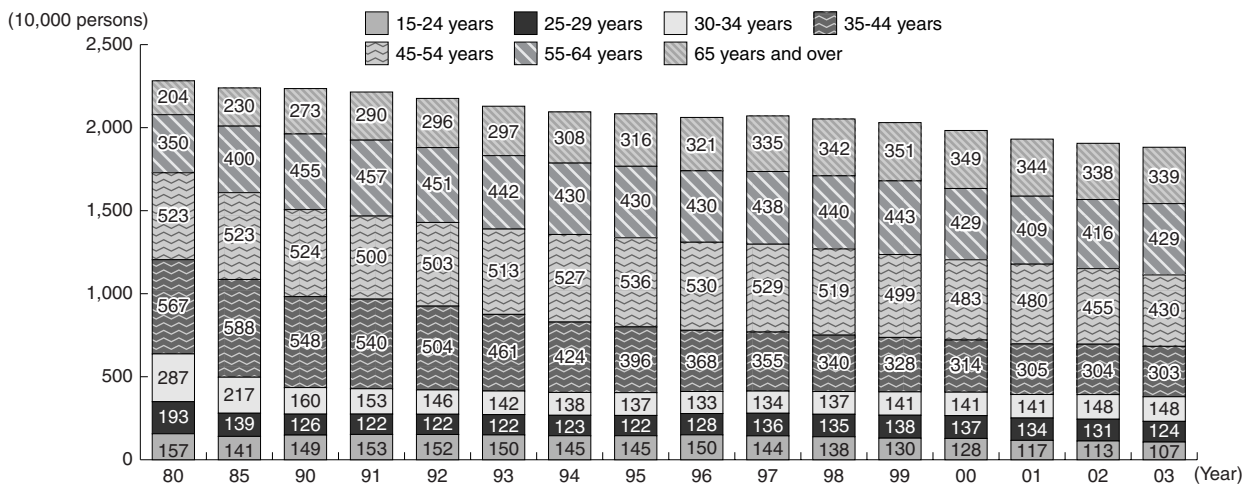
1) Size of employer: 100 or more employees



2) Size of employer: 10-99 employees



3) Size of employer: 1-9 employees



Source: Recompiled from MIC, Labor Force Survey.
 Note: Employed persons includes the self-employed and employment of family members.

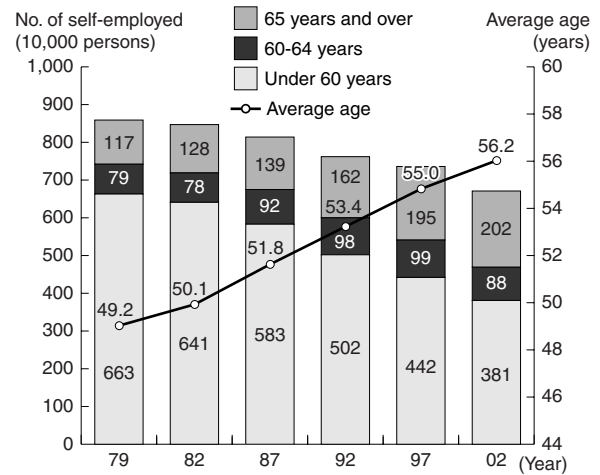
age of presidents overall. In other words, the rising age of SMEs' representative directors is pushing up the average of Japanese enterprises' representative directors as a whole (Fig. 3-1-12).

Because of the strong decision-making powers that proprietors gave at SMEs, the aging of these proprietors – i.e., SMEs' decision-makers—can often make positive business management along the lines described earlier impossible, reducing an enterprise's dynamism and leading ultimately to its cessation of business activity due to its exit from the marketplace. Some enterprises that end up exiting were unable to solve the problem of ensuring smooth handovers due, for example, their inability to find a successor from among the proprietor's relatives or within the enterprise itself. As proprietors grow older, it is likely that increasing numbers of enterprises will encounter this kind of challenge.

Looking ahead, facilitating the smooth handover of businesses themselves and business resources, including by means of inheritance or acquisition by parties other than relatives or employees, will be important to maintaining the dynamism of the Japanese economy.

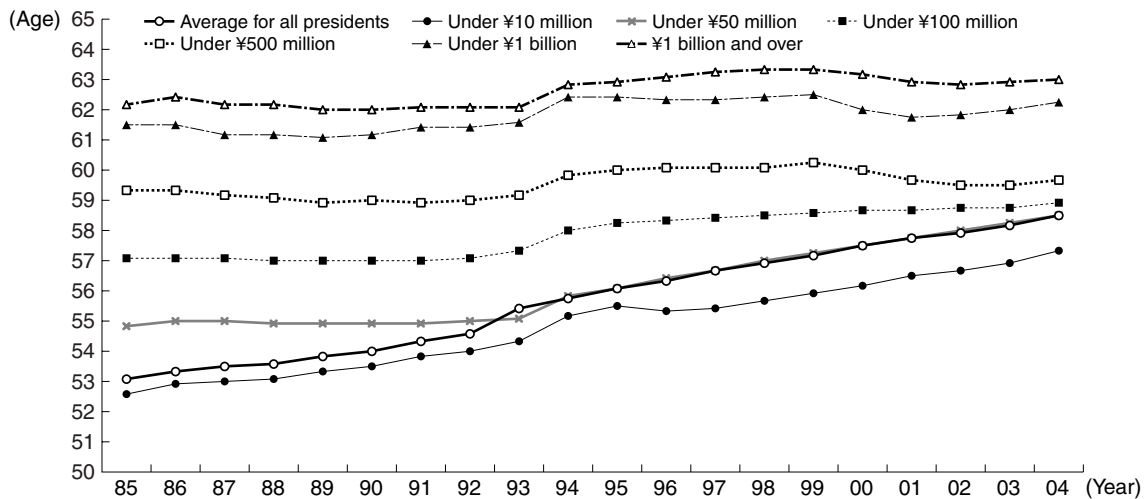
Fig. 3-1-11 Trends in number and average age of self-employed

Increase in self-employed persons aged 65 or over and rise in average age of self-employed as a whole



Source: Recompiled from MIC, *Employment Status Survey*.

Fig. 3-1-12 Trends in average age of representative director by amount of capital
Aging of representative directors of enterprises with less capital pushes up average age of representative



Source: Teikoku Databank, Ltd., *Survey of the Proportion of Presidents Changed*.

Section 4 Rural depopulation and maintaining and raising regional economic dynamism

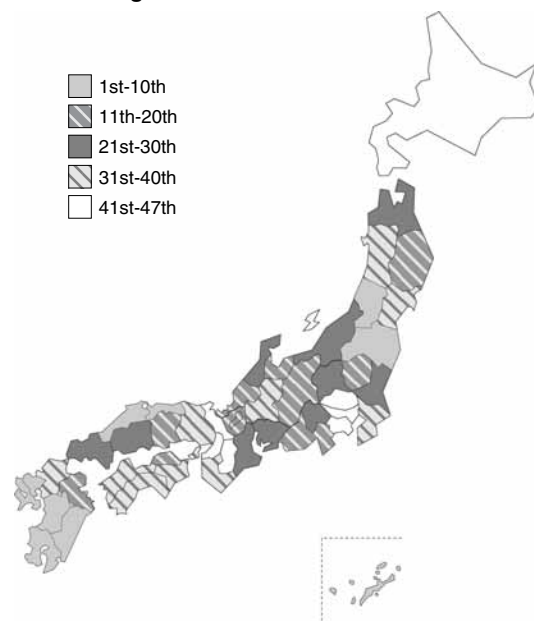
1. Population change by prefecture

Having observed how the population of Japan has already begun to decline, a breakdown of population change at the prefectural level shows that only in a very few regions is the population growing. Below, we analyze this situation from the point of view of total fertility rates (TFRs) and population movements after birth.

Beginning with TFRs, Fig. 3-1-13 is a map of Japan showing the TFR of each prefecture. From this it is apparent that rates are comparatively low in the highly urbanized Kanto and Kansai regions.²⁴⁾

Regarding next population movements after birth, the total population is growing mainly in the Kanto region, where the TFR is low. Statistics on social mobility, too, which depicts changes in population after birth, show that large increases are occurring only in prefectures with major cities, such as the prefectures of Tokyo, Kanagawa, and Aichi, and social mobility in prefectures with comparatively high TFRs is almost entirely negative²⁵⁾ (Fig. 3-1-14).

Fig. 3-1-13 Total fertility rates by prefecture
TFRs higher in rural areas than urban areas



Source: Compiled based on MHLW, *Vital Statistics*.
Note: Based on TFRs in 2004.

Fig. 3-1-14 Demographic change by prefecture

(Unit: persons)

Prefecture	Change	Natural increase	Social increase	Prefecture	Change	Natural increase	Social increase
Hokkaido	-18,440	-5,209	-13,231	Shiga	5,380	3,188	2,192
Aomori	-10,750	-3,409	-7,341	Kyoto	-254	269	-523
Iwate	-8,423	-2,994	-5,429	Osaka	-676	12,153	-12,829
Miyagi	-2,056	1,129	-3,185	Hyogo	4,582	3,969	613
Akita	-9,333	-4,951	-4,382	Nara	-4,492	57	-4,549
Yamagata	-7,115	-3,116	-3,999	Wakayama	-6,320	-2,799	-3,521
Fukushima	-8,410	-2,280	-6,130	Tottori	-2,459	-937	-1,522
Ibaraki	-3,075	939	-4,014	Shimane	-5,065	-2,412	-2,653
Tochigi	1,319	639	680	Okayama	-1,952	-257	-1,695
Gunma	-2,046	-80	-1,966	Hiroshima	-1,304	600	-1,904
Saitama	15,639	15,427	212	Yamaguchi	-7,416	-4,177	-3,239
Chiba	13,552	10,210	3,342	Tokushima	-4,306	-2,116	-2,190
Tokyo	86,104	8,083	78,021	Kagawa	-1,951	-788	-1,163
Kanagawa	43,922	22,432	21,490	Ehime	-6,098	-3,059	-3,039
Niigata	-10,189	-4,737	-5,452	Kochi	-4,833	-2,783	-2,050
Toyama	-2,274	-1,270	-1,004	Fukuoka	3,320	2,812	508
Ishikawa	-2,938	374	-3,312	Saga	-3,062	-527	-2,535
Fukui	-2,419	-300	-2,119	Nagasaki	-9,006	-1,894	-7,112
Yamanashi	-1,731	-496	-1,235	Kumamoto	-4,897	-1,103	-3,794
Nagano	-5,423	-1,584	-3,839	Oita	-2,215	-1,656	-559
Gifu	-2,678	412	-3,090	Miyazaki	-4,515	-698	-3,817
Shizuoka	686	2,934	-2,248	Kagoshima	-6,928	-3,329	-3,599
Aichi	35,263	19,020	16,243	Okinawa	10,260	7,727	2,533
Mie	253	-433	686	Total	45,231	52,980	-7,749

Source: MIC, *Population, Vital Statistics, and Number of Households Based on the Basic Resident Register*.

Note: Indicates population migration between March 31, 2004, and March 31, 2005.

24) For detailed figures, see Appended Note 3-1-7.

25) The positive natural growth in Fig. 3-1-14 despite the low TFRs of urban areas appears to be due principally to the number of women of reproductive age (15-49 years), which is used as the denominator to calculate the TFR is higher in urban areas.

Taking all these things together, it seems that while TFRs are higher in rural areas, many people migrate to urban areas after birth, causing populations to grow in urban areas and population decline to accelerate in rural areas. The end result, in other words, is rural depopulation.

2. SMEs as the lubricant of regional economies

Even as the population as a whole in Japan declines, those regions forecast to experience particularly rapid population decline in the future due to depopulation will also see the financial bases that support their public infrastructures shrink in size. In order for people in the provinces to continue to enjoy affluent lifestyles under such conditions, it will become more effective to pursue “compact town development” that concentrates urban functions as far as possible in “town centers,” makes use of existing infrastructure, and curbs spending on maintenance.

If “compact town development” is to be pursued, it is important also that instruments such as city planning be enhanced. At the same time, it is important to enhance the quality of life in town centers and make them more attractive. To this end, an important role can be played by what is known in Japan as the “lifestyle support service industry,”²⁶⁾ such as childcare services, domestic services, and nursing care services, which have traditionally been provided outside the market place by neighbors and relatives.

As these services are distinguished by (1) the lack of concern about profit-making, (2) the labor intensive, face-to-face nature of the work, and (3) their strong ties with the local community in comparison with traditional industries, they are likely to be provided mainly by SMEs and to create an important new role for SMEs.

Using *Industry Statistics by Size*,²⁷⁾ it is possible to

measure the economic ripple effect of production activity in the lifestyle support service industry on large enterprises and SMEs. According to *Industry Statistics by Size 2003*, domestic production in the areas of industry thought to cover the lifestyle support service industry amounted to ¥11,537.9 billion in 2003. If we add to this the economic effect on other industries of these services, the amount comes to ¥16,700.4 billion. With demand for childcare, domestic, nursing and other services projected to increase as the birthrate declines, the population ages, and increasing numbers of women enter the workforce, the lifestyle support service industry is expected to grow increasingly in the future.

As of 2003, the ripple effect of the lifestyle support services industry on other industries was valued at ¥5,162.5 billion,²⁸⁾ of which ¥1,732.4 billion is estimated to be in manufacturing. If we break this figure down according to size of enterprise, it is estimated that ¥627.0 billion relates to large enterprises and ¥1,105.4 billion relates to SMEs. The ripple effect on the service industry is valued at ¥1,025.2 billion (¥864.0 billion effect on business services and ¥161.2 billion on personal services), which is estimated to break down as ¥284.1 billion relating to large enterprises and ¥741.1 billion relating to SMEs. This means that in manufacturing and the service sector, SMEs are more closely involved in lifestyle support services than large enterprises.²⁹⁾

As we have seen, the historic changes in Japan’s demographic structure – i.e., the unprecedented decline in the birthrate, aging of society, and decline in the population—are likely to have long lasting and varied effects on SMEs. In the rest of Part III, therefore, we analyze business handovers and the transmission of skills at SMEs in Chapter 2, SMEs’ role in creating a society that is more amenable to having and raising children in Chapter 3, and the creation of bustling town centers and development of local communities in Chapter 4.

26) The number of workers employed in the “lifestyle support service industry” is calculated based on the number of persons employed in social welfare professions and domestic support services according to MIC’s *Labor Force Survey*. According to this survey, the number of workers employed in the lifestyle support service industry was 864,000 in 2002, 941,000 in 2003, and 1,079,000 in 2004. Although medical and educational services may also be regarded as providing forms of lifestyle support, these are excluded as childcare, domestic, nursing and similar services are considered to comprise lifestyle support services in the main text.

27) For example, when enterprise A, a manufacturer of sports equipment, engages in production activity, it purchases materials and services from enterprise B. Enterprise B in turn buys from enterprise C, and so on. This illustrates how the production activity of one enterprise has a knock-on effect on the activities of other enterprises and so induces production. The *Input-Output Tables* allow the final value (induced value of production) of this chain reaction to be measured, and the *Industry Statistics by Size* is designed to allow induced production value to be measured dividing enterprises into large enterprises and SMEs.

28) ¥16,700.4 billion - ¥11,537.9 billion = ¥5,162.5 billion (see earlier)

29) See Appended Note 3-1-8.

Chapter 2 The generational “double whammy” and business successions/skills transfers at SMEs

As observed in Chapter 1, the aging of Japan’s demographic structure is becoming pronounced, and the full-blown graying of society appears not far off.

Leaving the issue of access to new labor resources – i.e., the young and women—to Chapter 3 onward, we examine in this chapter the problems faced by SMEs as a

result of population aging.

In Sections 1 to 3 below, we analyze the question of business successions by proprietors, and then in Sections 4 and 5 we consider the question of the transfer of skills from one generation of workers to the next.

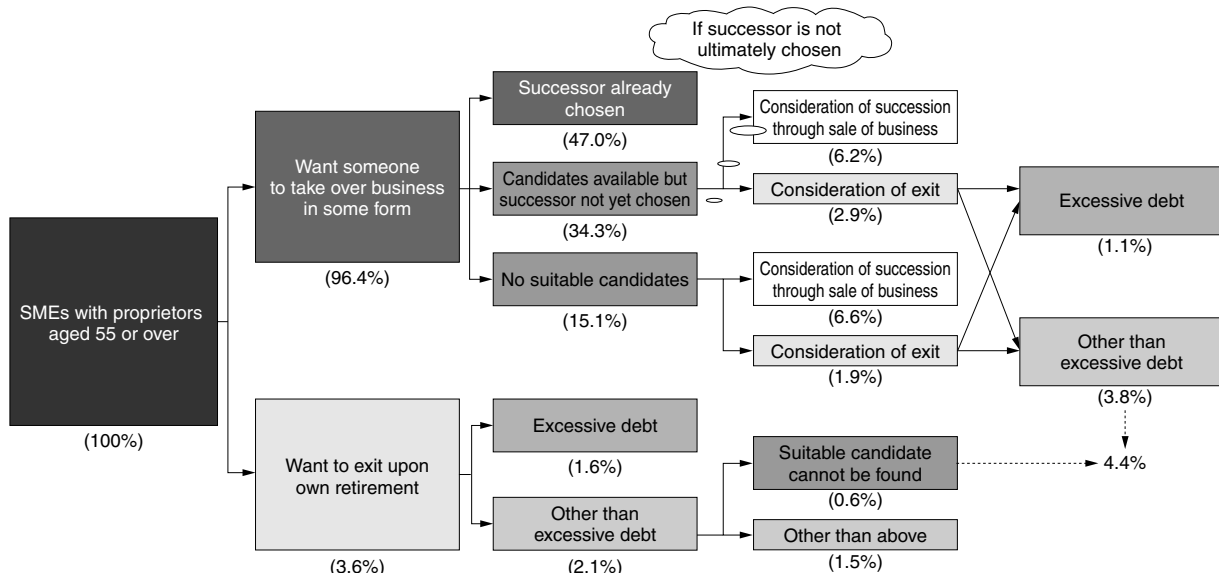
Section 1 Economic impact of absence of successors at SMEs

As Fig. 3-1-12 in Chapter 1 showed, the average age of the representative directors of SMEs is rising by the year. According to the *Questionnaire Survey of Business Successions and Transfer of Vocational Skills*¹⁾ (referred to below as the *Succession Questionnaire*) conducted by Mitsubishi UFJ Research and Consulting Co., Ltd., the average age at which proprietors want to retire is 64.5. There is little difference between proprietors aged 55 and over (65.1) and proprietors aged under 55 (61.9), confirming that retirement in one’s sixties is generally considered desirable among SME entrepreneurs. As we

saw in Chapter 1, however, the average age of representative directors of corporations in 2004 was approximately 58 years and 6 months, which is several years lower than the average age (64.5) at which proprietors want to retire. It would appear from this that the generation of proprietors who founded so many enterprises in their twenties and thirties during the high-growth period are now all reaching retirement age together.

However, the decision to retire from business is by no means an easy one to make, and it is not uncommon for

Fig. 3-2-1 Options considered by proprietors aged 55 and over regarding business succession



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

- Notes:
1. “Excessive debt” is the sum of “loss making” enterprises (enterprises whose debts have exceeded their assets for three terms in a row) and “descending into excess debt” enterprises.
 2. “Want to exit upon own retirement” and “other than excessive debt” include non-responses.
 3. “Other than above” is the sum of “due to company’s difficult business situation,” “due to uncertainty over future of market” and “other.”

1) A questionnaire survey conducted in December 2005 of 15,000 unlisted enterprises consisting primarily of corporations with at least 10 employees that have been in business for 10 years or more. The response rate was 13.2%.

an enterprise to have to exit the market if the handover from one proprietor to the next does not go smoothly.

According to the *Succession Questionnaire*, approximately 0.6% of all respondents among SMEs whose proprietors were aged 55 or over that responded that they wanted to “exit upon own retirement” due to having “no suitable successor” were financially capable of staying in business (i.e., they did not have more debts than assets) (Fig. 3-2-1).²⁾ In addition, among enterprises that had not yet decided on a successor, approximately 3.8% of those that responded that they would “exit” (without selling off their business, etc.) were financially in a position to remain in business (i.e., they did not have more debts than assets).

In other words, 0.6-4.4%³⁾ of SMEs with proprietors currently aged 55 or over may exit due to ultimately lacking a successor despite being able to remain in business financially.

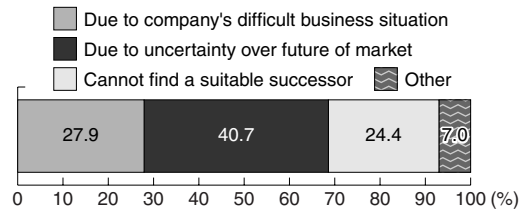
As described in Part I, Chapter 2, the annual average number of SME startups according to MIC’s *Establishment and Enterprise Census of Japan* (2004) is 167,681, while the annual average number of exits is 289,731. This means that the number of enterprises is declining by 122,050 per year (an annual rate of approximately 2.8%).⁴⁾

Next, let us estimate what proportion of the 290,000 or so enterprises that exit each year do so due to lacking a successor.

According to the *Succession Questionnaire*, 24.4% of the enterprises that responded that that they presently “want to exit upon own retirement” gave as their primary

Fig. 3-2-2 Reasons for considering exiting upon own retirement

24.4% of enterprises considering exiting upon the current president’s retirement give the absence of a successor as the primary reason



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

Note: Only enterprises that responded “want to exit upon own retirement” are included.

reason “cannot find suitable successor” (Fig. 3-2-2).⁵⁾ Based on these figures, it is estimated that approximately 70,000⁶⁾ of the roughly 290,000 exits each year are due to not having a successor. Assuming that the jobs at such enterprises are completely lost, this translates into annual job losses of approximately 200,000-350,000.⁷⁾

Below, we examine in detail SME entrepreneurs’ views on business successions in the context of their own aging. In particular, we analyze in greater depth methods of business succession from the point of view of ensuring the transfer of business resources to the next generation through, for example, M&As, as well as handovers to relatives such as sons and daughters.

Section 2 Business succession problems faced by SME entrepreneurs

The upward trend in the average age of SME entrepreneurs and problems ensuring smooth changes of management were noted in Chapter 1, and this trend is particularly pronounced among enterprises with capital of less than ¥100 million. Although handovers thus do not appear to be going smoothly in many cases, a large proportion of proprietors say that they want someone to inherit their business in some form. That this is so is apparent also from the fact that 95.1% of the business proprietors who responded to the *Succession Questionnaire* said that they wanted to hand their business on to someone in some form rather than close it

down upon retirement (Fig. 3-2-3).⁸⁾

On the other hand, 4.9% of proprietors want to exit without handing their business on to the next generation. Unsurprisingly, a high proportion of enterprises that have fallen into excess debt give “severe business position of company” as their reason for wanting to exit. However, although enterprises that are in financially better shape are more likely to give as their reason for exiting “cannot find suitable successor,” even among enterprises that do not have more debts than assets there are many that give as their reason “uncertainty over future of market.” It thus seems that the proportion of

2) In this chapter, non-respondents are included in Fig. 3-2-1 in order to provide a better overall picture, but are excluded from all other figures.
 3) The difference between the “pessimistic” scenario, in which all enterprises that have not yet chosen a successor and do not have more debts than assets are unable to ultimately find a successor, and the “optimistic” scenario, in which all enterprises find a successor.
 4) Annual decline in number of enterprises (122,050) / number of SMEs (4,326,342) (MIC, *Establishment and Enterprise Census of Japan* (2004)). See Supplementary Statistical Data Table 1 for further details.
 5) See Appended Note 3-2-1 for graphs that break the situation down by number of employees.
 6) Annual average number of exits (289,731) x proportion of enterprises considering exiting due to lack of successor (24.4%) = 70,694 enterprises
 7) Regarding the calculation process, see Appended Note 3-2-1.
 8) If we consider only proprietors aged 55 or over, the proportion that answered that they want someone to take over their business in some form rises to 96.4% (see Fig. 3-2-1).

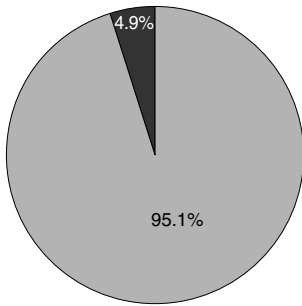
enterprises giving “cannot find suitable successor” and the proportion giving “uncertainty over future of market” is approximately constant regardless of financial situation (Fig. 3-2-4).

What then is the situation of enterprises that want someone to inherit their business? As can be seen from Fig. 3-2-3, the proportion of all proprietors that want someone to take over their business in some form is 95.1%. Of these, (1) 44.0% have already chosen a

Fig. 3-2-3 Future prospects of business at present

Most SME proprietors say that they want someone to take over their businesses after them

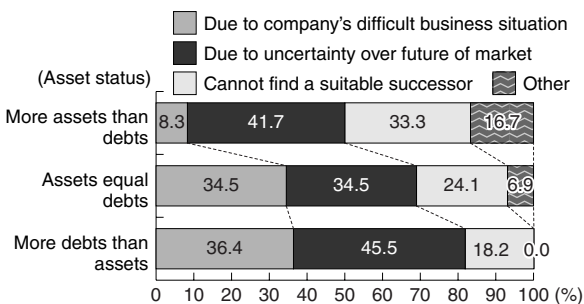
- Want someone to take over the business in some form
- Want to exit upon own retirement



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

Fig. 3-2-4 Reasons for considering exiting upon own retirement (by asset status)

Around 20-30% of enterprises give “cannot find a suitable successor” as their reason for considering exiting, regardless of asset status



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

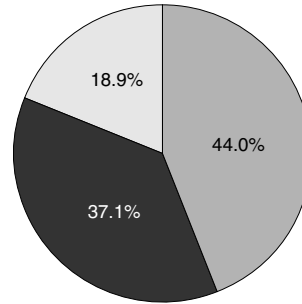
- Notes:
1. Only enterprises that responded “want to exit upon own retirement” are included.
 2. Enterprises with “more debts than assets for three terms in succession” or “descending into excessive debt” are classified as having “more debts than assets,” and enterprises with “more assets than debts for three terms in succession” or “recovering from excessive debt” are classified as having “more assets than debts.”

successor,⁹⁾ (2) 37.1% have not chosen a successor but have a candidate in mind, and (3) 18.9% of enterprises have no suitable succession candidate either (Fig. 3-2-5).

Regarding respondents’ financial status, 57.0% of those wanting someone to inherit their business had more assets than debts, and 28.5% had equal debts and assets (Fig. 3-2-6). 14.5% of enterprises had more debts than assets, indicating that some enterprises want someone to inherit their business, or are unable to close down their business, despite their severe business situation. As demonstrated in Column 3-2-1, which describes the typical characteristics of SME entrepreneurs, the proprietors of many SMEs are

Fig. 3-2-5 State of determination of successor
44.0% of enterprises that want someone to take over their businesses have already decided on a candidate

- Already decided
- Not yet decided but candidate identified
- Cannot find a suitable candidate

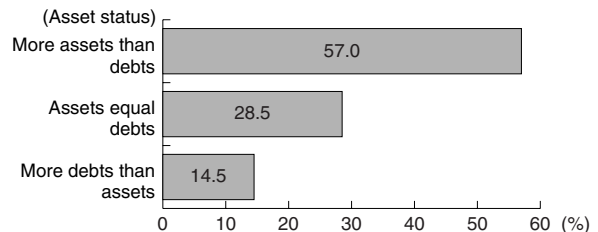


Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

Note: Only enterprises that wanted someone to take their business in some form are included.

Fig. 3-2-6 Asset status of enterprises that want someone to take over their business

Even among enterprises with excessive debt, a certain proportion want someone to take over their business



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

- Notes:
1. Only enterprises that wanted someone to take their business in some form are included.
 2. Enterprises with “more debts than assets for three terms in succession” or “descending into excessive debt” are classified as having “more debts than assets,” and enterprises with “more assets than debts for three terms in succession” or “recovering from excessive debt” are classified as having “more assets than debts.”

9) “Successor already decided” here means that the proprietor is prepared to hand over his/her business to a particular person, and does not indicate that this decision has been expressed publicly.

distinguished from those of large enterprises by being both the representative director and the main shareholder, resulting in an insufficient separation of management and ownership. The frequency with which loans from financial institutions are secured by personal guarantees can also hinder the handover of a business to a third party. Case 3-2-1 describes one example of an enterprise that encountered difficulties in arranging a business succession due principally to the problem of personal guarantees. Even if an enterprise decides to exit, this can incur a variety of costs. These factors may be the main reasons why proprietors remain in business despite wanting to quit or falling into excess debt. When such poorly performing enterprises are inherited by another proprietor, however, the results are often

unsuccessful.

While founders might generally be expected to have a soft spot for their own businesses, an examination of whether the proprietors interested in business succession were founders or non-founders reveals no particular difference. Rather than whether or not the proprietor is the founder, the main attributes affecting business succession seem to be share ownership and size of enterprise.

What arrangements do proprietors approaching the age for handing the reins of management to a new generation make in order to prepare for the changeover? The proportion of proprietors that “consult someone” regarding business succession is 44.2%, which is less even than one in two (Fig. 3-2-7). Regarding the reason

Column 3-2-1 Nature of SME managers: The manager is also the owner

How do SMEs differ from larger companies when it comes to succession and continuity?

As was discussed in this Part, there exist many examples of “hereditary” SMEs. When discussing the matter, however, SME managers tend consistently to claim to put more emphasis on “excellent managerial ability” than relationships of blood or marriage when selecting a successor. (See page 176.)

But if that is so, why don't they select a capable one from among the executives, fairly, without regard to the blood relationship? It turns out there is a reason.

Often among SMEs, company ownership and management overlap, with the majority of ownership concentrated in the hands of the manager – not just in private, sole-proprietor-type companies, but also incorporated entities. In cases like that, merely turning over the seat of “president and CEO” to a capable executive may not constitute an actual succession. Rather, only the relationship changes. The previous manager remains the owner with voting control, while the new manager has a status of a hiree.

Insofar as the previous manager is alive, there may be little adverse effect from this. But when the previous manager dies and the ownership passes to others, trouble can arise. If shares in the company are inherited by more than one member of the previous manager's family, there is no guarantee that they will see eye to eye. Some may have no interest in the company at all.

If an SME manager wishes to avoid this kind of confusion at the inheritance of a company's voting rights (shares), he or she should transfer them at the same time the managerial seat is transferred.

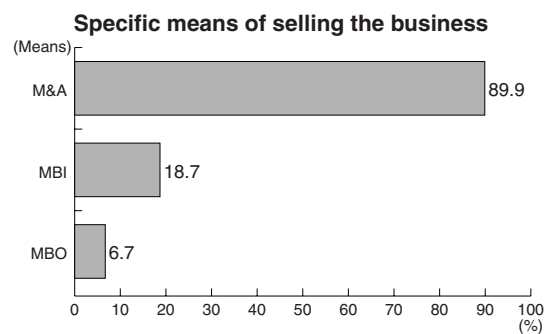
There are two ways to do this: (1) have a third party buy them; or (2) transfer them to a son, daughter or other relative.

In the first case, the buyer might be either a company executive or an outsider. When an executive personally buys the company/business unit where he or she works and obtains the right to manage it, this is called a management buy-out (MBO). Individual executives, however, usually have neither the funds to purchase the company, nor the ability to borrow on that scale from a financial institution.

As a result, it is quite difficult for an executive of a company, unrelated to the owner, to be the successor.

In the *Succession Questionnaire*, when those who answered that they “would consider selling the business” were asked about the specific means they had considered, only 6.7% said “MBO.”

If an owner has neither offspring nor a relative to succeed to the business, and if there is no executive in the company in a position to work a management buy-out, two further options are available as a means of business succession: allowing another company to buy the company and merger with it (merger and acquisition: M&A), or allowing an outside third party to purchase the company and manage it (management buy-in: MBI).



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

- Notes:
- Aggregate of only those companies for which a successor has not been decided, and which answered that they “would consider selling the business” as a means of providing for succession.
 - Totals exceed 100 due to multiple responses.

Case 3-2-1

Company ultimately files for bankruptcy under the Civil Rehabilitation Law due to trouble in finding a successor for the business largely attributable to the problem of providing a personal guarantee

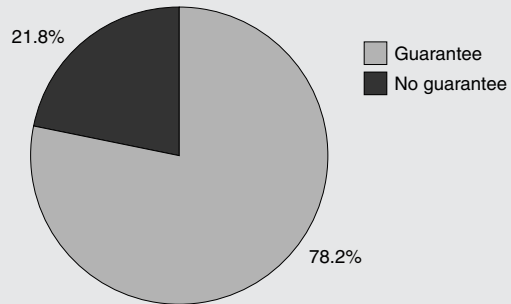
Company A, located in Tokyo and with a workforce of 50, is a security equipment installer that was established more than 50 years ago. The company's founder passed away soon after, and because his son did not succeed to the business, a leading customer dispatched a representative to take care of the company. Because Company A's business grew stronger, a succession of representatives was dispatched to the company in subsequent years. As a result, no effort was made to find another successor from within the company itself.

However, the company's performance began to slump as the economy deteriorated, coinciding with the sudden passing away of the incumbent representative. It was from this point that things started to go wrong.

Although the financial institution Company A dealt with had requested a personal guarantee* from each successive representative, the leading customer stopped dispatching a representative partly because of the risks involved in this. There was no choice but to appoint as representative a longstanding company employee who had not been groomed to take over the reins of the business.

Although the financial institution sought a personal guarantee from this new representative, he continued to refuse to become guarantor and resigned after a year. Another longstanding company employee was then appointed representative. As had been the case in the past, the financial institution made a request for personal security, and because no other employee was able to become guarantor the

Percentage of SME representatives providing personal guarantees to financial institutions against company borrowing



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

Note: The percentage of company representatives providing personal guarantees to financial institutions shown above represents the combined total of those that “guarantee most of the company's borrowing,” “guarantee the company's borrowing up to a certain extent,” and “provide a basic guarantee.”

representative acceded. However, aware of what had happened over the years, no other employees sought to become the next representative, and unable to recover from poor business attributable in part by the absence of leadership, the company ultimately filed for bankruptcy under the Civil Rehabilitation Law.

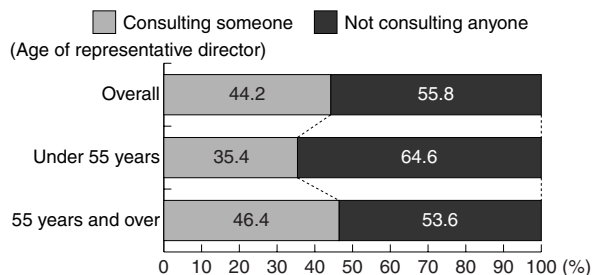
* As seen from the graph, approximately 80% of SME representatives in Japan provide a personal guarantee against company borrowing.

for not consulting anyone, 33.4% of proprietors say “no need to consult as sufficient action is being taken,” while 40.3% say that they are “not seriously considering business succession.” It is therefore worth noting that awareness of business succession per se appears to be low (Fig. 3-2-8). In particular, if we limit our focus to just proprietors aged 55 or over, 33.1% of enterprises responded that they are “not seriously considering business succession” regardless of the fact that they want someone to take over their business in some form (Fig. 3-2-9). With proprietors approaching retirement, there are concerns that sufficient preparations are not being made, and there is a real possibility that business successions could become a serious problem within the next few years.

Below, we examine the particular challenges faced by three types of enterprise that want to see their businesses to be inherited by a successor: (1) enterprises that have already chosen a successor, (2) enterprises that have not yet chosen a successor but have a candidate in mind, and (3) enterprises that do not at present have a suitable succession candidate.

Fig. 3-2-7 Proportion of proprietors consulting someone about business succession (by age of proprietor)

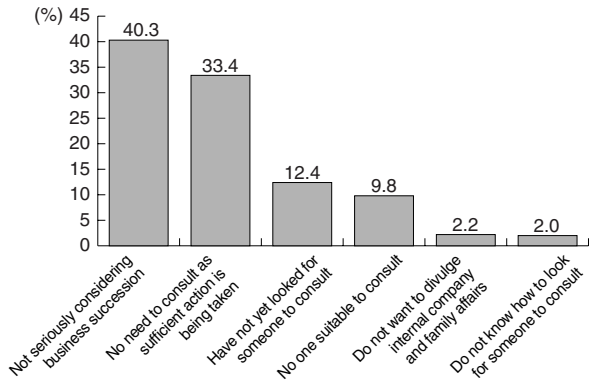
Proprietors aged 55 or over are more likely to consult someone about business succession, but the majority do not



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

Fig. 3-2-8 Reasons for not consulting anyone about business succession

While 33.4% gave “no need” as their reason for not consulting anyone about business succession, 40.3% say they are not seriously considering business succession

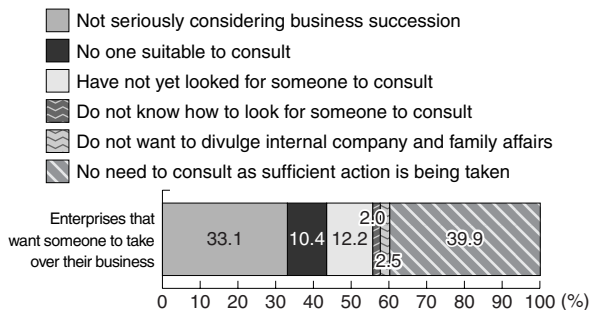


Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

Note: Only enterprises that responded “not consulting anyone” regarding business succession are included.

Fig. 3-2-9 Reasons for not consulting anyone about business succession (proprietors aged 55 and over)

Even among proprietors aged 55 or over who are approaching retirement and want someone to take over their business, 33.1% are not seriously considering business succession



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

Note: Only enterprises whose proprietors are aged 55 or over are included.

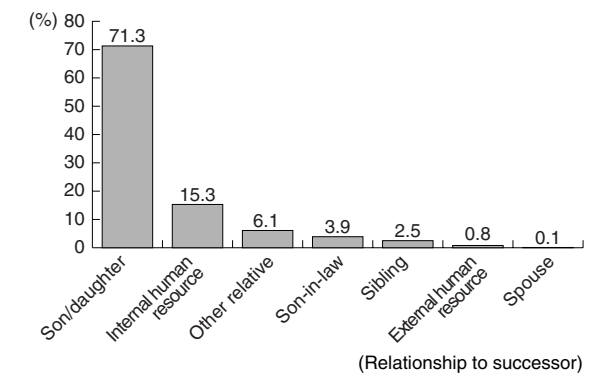
1. Problems faced by enterprises that have decided on a successor

As shown earlier in Fig. 3-2-5, 44.0% of enterprises interested in business succession have “already decided” on a successor.

Broken down by age group, 48.9% of proprietors aged 55 or over have decided on a successor, compared with 24.2% of proprietors aged less than 55. Unsurprisingly, then, the proportion of enterprises that have decided on a successor increases with age. It is important to note, however, that even among enterprises whose proprietors are aged 55 or over, over 50% have not decided on a successor. As certain problems will inevitably be

Fig. 3-2-10 Relationship to successor

Although most successors at enterprises that have already chosen one are sons or daughters, a certain proportion choose someone from within the enterprise



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

Note: Only enterprises that responded that they had “already chosen” a successor are included.

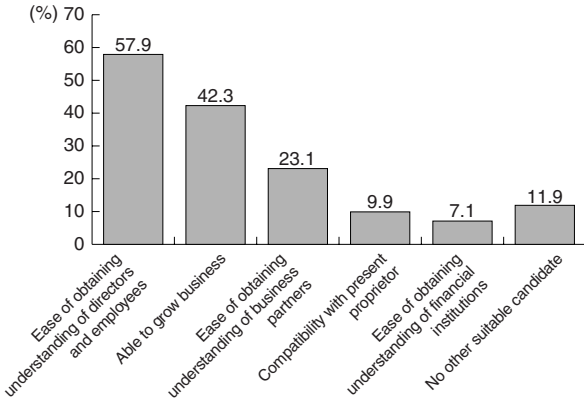
encountered no matter what kind of person is chosen as successor, enterprises should confirm what challenges they will encounter when they actually choose a successor (such as the need to consult experts and put in place the necessary arrangements within the enterprise) in order to give themselves time to address them properly.

Regarding exactly what kind of people are chosen as successors, 71.3% are sons or daughters of proprietors, and the proportion of relatives rises to 83.9% when others such as sons-in-law, siblings, and spouses are included (Fig. 3-2-10). While it is thus apparent that the successors chosen at enterprises that have already decided on a successor are typically relatives of the representative director, it is likely that, as was seen in Column 3-2-1, this is due primarily to the fact that proprietors at most SMEs not only have to have management ability, but must also inherit ownership of the enterprise itself (i.e., the proprietor’s shareholding). In recent years, however, there has been an increase in the number of business successions by third parties other than blood relatives at SMEs, too. This subject we will return to in greater detail in a later section.

At the same time, it appears that successors tend not to be chosen simply due to their being a relative. According to Fig. 3-2-11, the commonest reason given for having already decided on a successor, cited by 57.9% of enterprises, is “ease of obtaining understanding of directors and employee,” followed by “able to grow business” (42.3%). This is far more than the 11.9% that give as their reason “no other suitable candidate.” Putting these reasons together with the fact that 71.3% of successors are sons or daughters, it may be concluded that successors are chosen not simply because they are the proprietor’s own child, but also on other grounds, such as (1) the greater acceptance within the firm of relatives at SMEs, and (2) the expectation that the opportunity of

Fig. 3-2-11 Reasons for having already chosen a successor

Reasons for deciding on a successor include obtaining the understanding of directors, employees and business partners, and the successor's ability to grow the business



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).
 Notes: 1. Only enterprises that responded that they had “already chosen” a successor are included.
 2. Totals exceed 100 due to multiple responses.

having been able to watch their parent at the helm of a business makes proprietors’ children managerially better equipped to be proprietors themselves.

If we focus on the financial status of enterprises that have decided on a successor, shown in Fig. 3-2-12, it can be seen that there is little correlation between having already decided on a successor and financial status. This would suggest that whether or not an enterprise is preparing for business succession does not depend on financial status. Because of the large number of enterprises that have not found a succession candidate that have more debts than assets, however, the question of whether an enterprise can actually continue in business (i.e., whether or not anyone actually wants to succeed to the business regardless of what the proprietor thinks) does seem to be related to financial status.

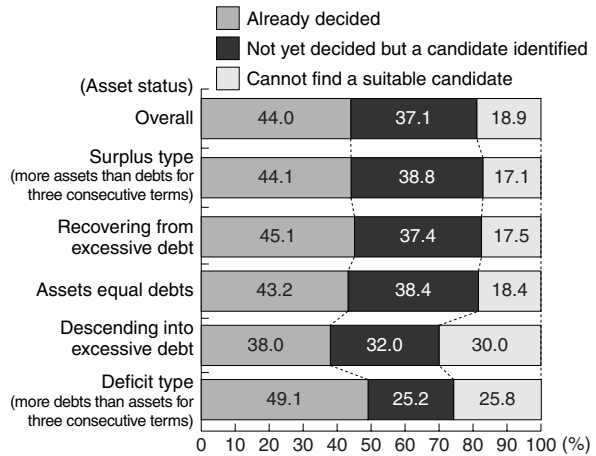
To summarize the above, successors at enterprises that have decided on a successor tend to be mainly sons and daughters of proprietors, though they are not chosen simply because they are relatives as other factors are also at work, such as the importance of gaining the understanding of stakeholders and their ability to grow their enterprises.

Next, let us consider what specific steps proprietors are taking in readiness for an actual change in management. From Fig. 3-2-13, it can be seen that over 60% of enterprises with proprietors aged 55 or over that have decided on a successor had decided on a successor at least three years before the survey date. One of the reasons for deciding on a successor ahead of a succession would seem to be to allow a certain amount of time for proprietors to prepare for succession in order, for example, to train their successors.

What then is the situation regarding actual

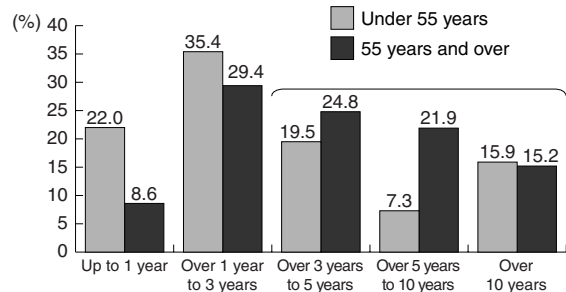
Fig. 3-2-12 State of determination of successor (by asset status)

The proportion of enterprises that have already chosen a successor appears to be unrelated to asset status, but the proportion of enterprises without a suitable candidate is higher among enterprises with excessive debt



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).
 Note: Only enterprises that wanted someone to take their business in some form are included.

Fig. 3-2-13 Timing of choice of successor
 Over 60% of enterprises whose proprietor is at least 55 and have chosen a successor chose their successor at least three years ago, indicating that many spend considerable time making preparations



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).
 Notes: 1. Only enterprises that responded that they had “already chosen” a successor are included.
 2. The above periods indicate the time elapsed counting back from the end of October 2005.

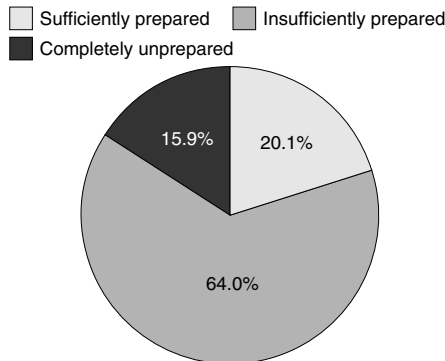
preparations? Among enterprises that responded that they had decided on a successor, only 20.1% said that they were “sufficiently prepared.” On the other hand, 64.0% said that they were “insufficiently prepared” and another 15.9% said that they were “completely unprepared.” Thus even though they have decided on a successor, almost 80% of enterprises say that they have not made sufficient preparations for business succession (Fig. 3-2-14).

One reason why enterprises have not necessarily prepared for business succession despite having decided on a successor from a comparatively early stage is that,

because business succession problems usually lack immediacy, they tend to be accorded low priority compared with other routine business. This lack of incentive for proprietors to set about preparing in good time is one of the things that distinguishes business succession problems.

Fig. 3-2-14 State of preparations for business succession

Roughly 80% of enterprises have not prepared sufficiently or at all for business succession despite having chosen a successor



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

Note: Only enterprises that responded that they had “already chosen” a successor are included.

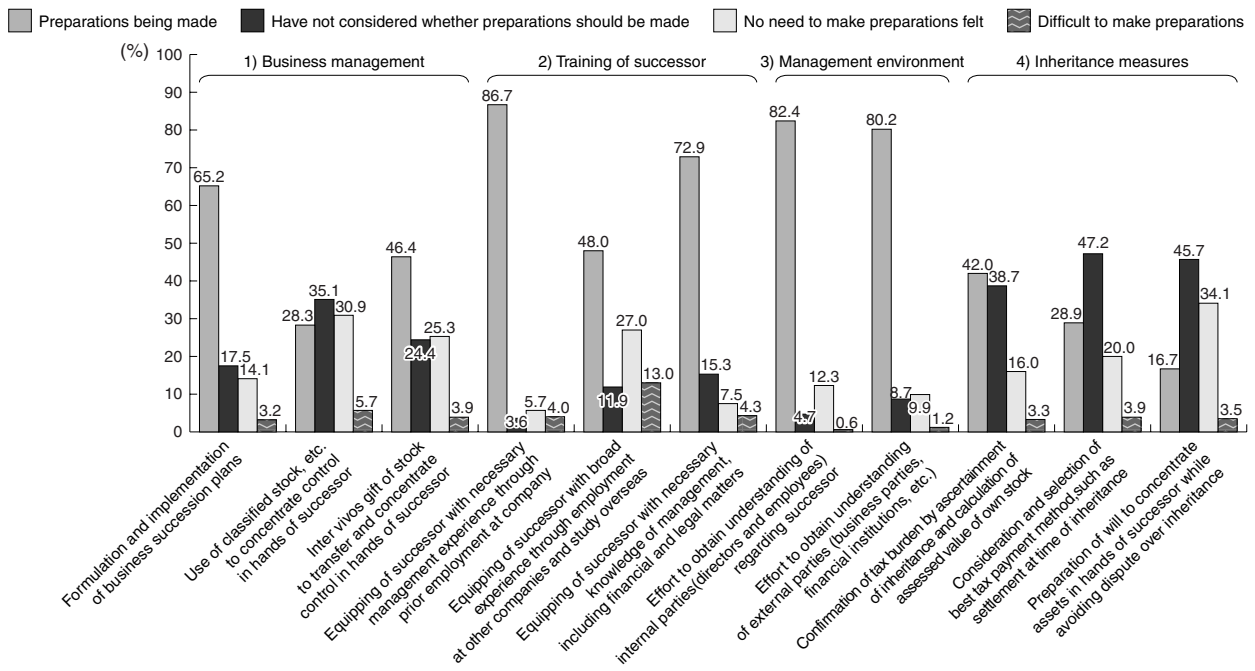
Next, we focus on the following four areas in which enterprises can start making concrete preparations for business succession: (1) business management, (2) training of successors, (3) business environment, and (4) inheritance measures (Fig. 3-2-15).

From this, it can be seen that large numbers of enterprises are expending a certain amount of effort on training their successors and gaining interested parties’ acceptance for them by such means as employing them at their enterprises before succession, equipping them with the knowledge that they need about management, and

1) Business management	(1)	Formulation and implementation of business succession plans
	(2)	Use of classified stock, etc. to concentrate control in hands of successor
	(3)	Inter vivos gift of stock to transfer and concentrate control in hands of successor
2) Training of successor	(4)	Equipping of successor with necessary management experience through prior employment at company
	(5)	Equipping of successor with broad experience through employment at other companies and study overseas
	(6)	Equipping of successor with necessary knowledge of management, including financial and legal matters
3) Management environment	(7)	Effort to obtain understanding of internal parties (directors and employees) regarding successor
	(8)	Effort to obtain understanding of external parties (business parties, financial institutions, etc.)
4) Inheritance measures	(9)	Confirmation of tax burden by ascertainment of inheritance and calculation of assessed value of own stock
	(10)	Consideration and selection of best tax payment method, such as settlement at time of inheritance
	(11)	Preparation of will to concentrate assets in hands of successor while avoiding dispute over inheritance

Fig. 3-2-15 Concrete preparations for business succession and state of implementation

While many proprietors have started training their successors and preparing the management environment, comparatively many enterprises have not started taking any action in areas regarding specialist knowledge, such as business management and inheritance measures



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

Note: Only enterprises that responded “sufficiently prepared” or “insufficiently prepared” regarding concrete preparations for business succession are included.

gaining the understanding of stakeholders. What is also apparent, however, is that not only are inheritance-related preparations comparatively neglected, but there are also many enterprises that answered that they “have not considered whether or not preparations should be made” or “no need to make preparations felt.” This is probably a reflection of the fact that advice on setting companies’ finances in order and the taxation side of business successions is difficult in practice for proprietors to obtain due to the everyday pressures of work, and that it is difficult for successors, too, to broach the subject of inheritance with siblings and other relatives while their parent is still in good health. Even at enterprises that are performing well, however, measures to concentrate management rights at the time of succession and tax-related measures require professional knowledge. They are also not the kind of thing that can be resolved quickly once embarked upon, and can in some cases lead to disputes. They therefore need to be tackled sooner rather than later. Case 3-2-2 describes the case of a company that sold off the proprietor’s shares and secured the funds needed to pay its tax obligations by taking inheritance tax measures. While there is thus an incentive to disperse shares in order to lighten the tax burden, it is also necessary to concentrate shares and voting rights in the hands of the successor to a certain extent in order to develop the successor’s management environment. The optimum capital policy therefore needs to be determined taking both these aspects into account.

There are also cases in which enterprises can be forced to exit despite having chosen a specific successor

due to failing to make the necessary preparations for succession, as in Case 3-2-3.

Business successions require a variety of knowledge on subjects such as the legal system and taxation, making it difficult for proprietors to overcome problems on their own. Appropriate professional advice therefore needs to be sought. Who then do SME entrepreneurs themselves identify as the best sources of advice? According to Fig. 3-2-16, the closest source of advice, cited by 31.6%, is licensed tax accountants. If this is combined with the 8.8% that cited certified public accountants, the two professions responsible for tax affairs and auditing account for around 40% of the total. This is probably a reflection of the fact that, as business successions at SMEs have traditionally been associated with inheritance tax issues, sources of advice who can be consulted about tax affairs are regarded as important partners by SMEs. If we look at Fig. 3-2-16 2), we can see that enterprises that regard licensed tax accountants and certified public accountants as their best sources of advice take measures that require specialist knowledge, such as inheritance-related measures, confirming that they set about tackling problems that could create a problem at the time of business succession from an early stage. “Directors and employees” and “spouses” are also cited by 18.1% and 13.1% of enterprises respectively, which is probably due to the fact that people who are normally near at hand are convenient sources of advice due to the ease of making preparations (such as training successors and developing the management environment) if a successor has already been chosen.

Case

3-2-2

Business succession amid fears of an inheritance tax crisis

Company B, located in Tokyo and with a workforce of 100, is a construction company founded more than 50 years ago. It had a sizeable market share due to its area of operations covering the whole of Japan from Hokkaido down to Kyushu. On the financial side, having no real debts it had operated quite safely.

It was agreed that when the former representative director reached the age of seventy, he would pass on the business to his eldest son, who had been groomed to succeed his father. The eldest son also had extremely good business skills and there was no disagreement whatsoever from the company’s directors, employees, customers, and financial institutions. The share valuation at the time of succession, however, was high because the company was so successful, and a substantial inheritance tax was anticipated.

Because the former representative director had not considered it appropriate to earn excessive remuneration himself, it was anticipated that cash and cash equivalents would be insufficient to cover the inheritance tax. Although personal assets provided a certain amount of funds on hand,

something had to be done because they were not enough to cover the entire amount of the inheritance tax. After taking advice from the company’s accountant, the decision was taken to disperse the shares. For more than ten years, shares owned by the former representative director were gifted to his successor repeatedly, and shares were also sold to trustworthy employees and customers, as well as to financial institutions. The ratio of shares held by the family dropped to 51%.

As a result, when the former representative director passed on and succession occurred, the inheritance tax could be paid from cash and cash equivalents. A tax return was filed and paid without a problem, and the business has continued to perform well since the appointment of the new representative director. However, because the ratio of shares held by the family has dropped to 51%, the agreement of other shareholders has to be sought when deciding on important company matters by means of special resolutions at a general meeting of shareholders, where resolutions must be agreed upon by at least two-thirds of those with voting rights.

Case 3-2-3

Company faced with closure due to error in grooming a successor

Company C in Chiba Prefecture has a workforce of 30. Established around 30 years ago, it is a foodstuff retailer. The current president has a very sound business philosophy and since its establishment the company had secured high profits, accumulated abundant internal reserves, and at its peak owned three stores. However, the emergence of a series of large suburban stores in the company's trading area produced a gradual decline in Company C's sales and the business progressively worsened.

The president himself undertook a variety of measures aimed at ensuring the continuation of the business, such as attending numerous seminars, reviewing the products they carried, and closing down unprofitable stores. Nonetheless, it was not possible to stem the decline in sales, and turnover dropped to around half of what it had been during the company's most prosperous period.

The president's eldest son, who was the candidate

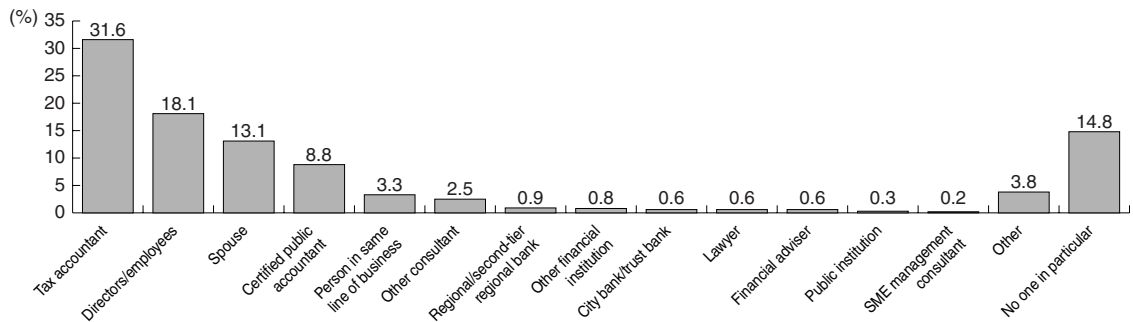
successor, worked at another company to gain experience after graduating from school and joined the company during its most prosperous period. As the candidate successor, the son's role in the company was to provide support for his father. However, rather than participating in the business from the perspective of being the next manager, the eldest son continued to work as a general supervisor just as ordinary employees did, and so was not able to grasp the changes that were occurring in the industry or the changing times. The president was not too concerned about this either.

However, as a result of not grooming the next president, the company became aware that there was a problem with continuation of business, and it appeared likely that the stores would be closed as the president aged. The company is planning to start over again by renting out the real estate belonging to the stores that make up the company's assets.

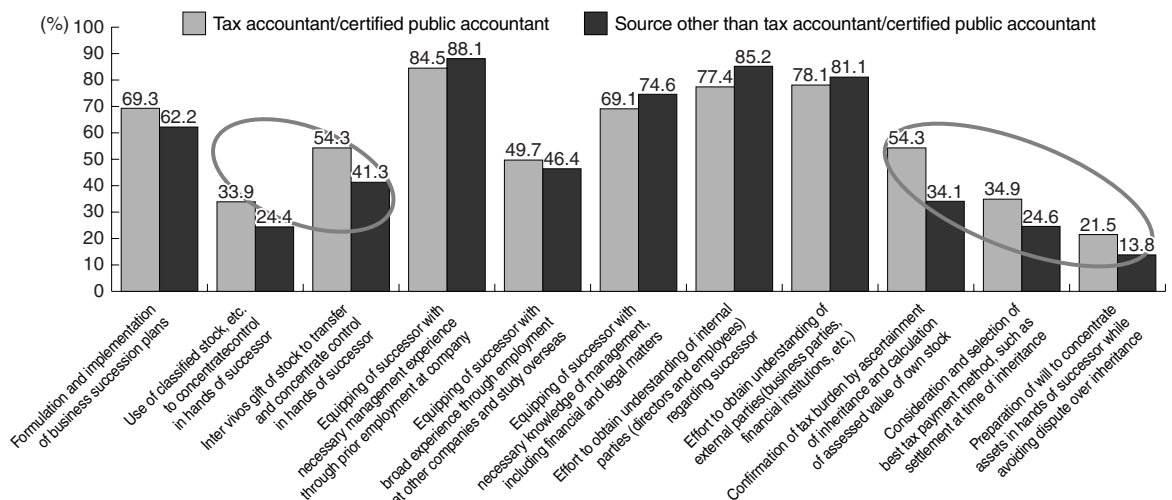
Fig. 3-2-16 Best source of advice consulted regarding business succession and details of preparations by type of adviser

The highest proportion of enterprises consult tax accountants regarding business succession, and a high proportion consult tax accountants and certified public accountants regarding preparations requiring more specialist knowledge, such as inheritance-related matters

1) Most consulted adviser

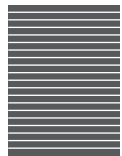


2) Details of preparations by source of advice



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

- Notes: 1. Only enterprises that responded that their successor had been "already chosen" are included.
- 2. Regarding the concrete preparations being made, only enterprises that responded "preparations being made" are included.

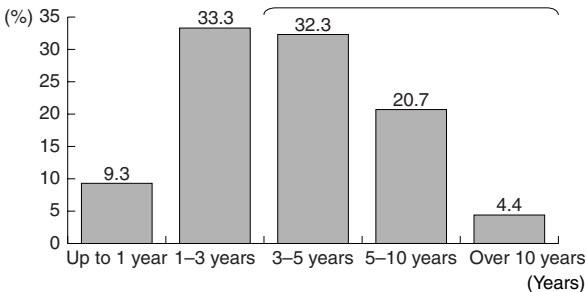


2. Characteristics and problems of enterprises that have not chosen a successor but have a candidate in mind

The proportion of enterprises interested in business succession that have not decided on a specific successor but do have a candidate in mind is 37.1% (Fig. 3-2-5). As the proprietors of around 60% of these enterprises say that they want to decide on a successor at least three years before their retirement, they appear to want to spend several years preparing for succession (Fig. 3-2-17).

What factors are emphasized by enterprises with candidates when choosing a successor? According to Fig. 3-2-18, 56.3% of respondents say “management

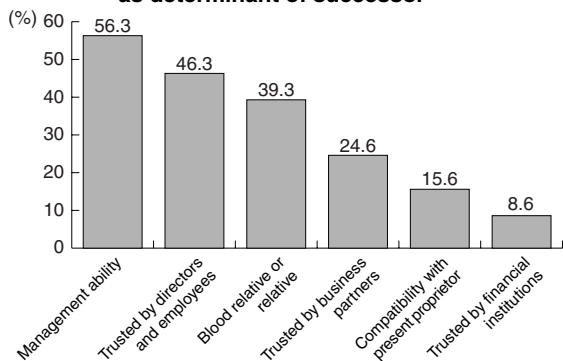
Fig. 3-2-17 Timing of choice of successor
Around 60% of proprietors want to choose their successor at least three years before retiring



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

- Notes:
1. Only enterprises that said that their successor had been “not yet decided but candidate identified” are included.
 2. Proprietors were asked how many years before their retirement age they wanted to choose a successor.

Fig. 3-2-18 Reasons for choice of successor
Many proprietors cite management ability as determinant of successor



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

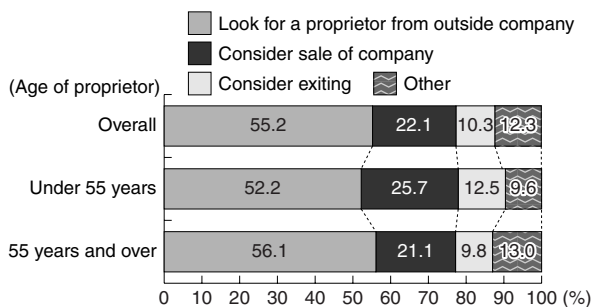
- Notes:
1. Only enterprises that said that their successor had been “not yet decided but candidate identified” are included.
 2. Totals exceed 100 due to multiple responses.

ability,” considerably outweighing the 39.3% that say “blood relative or relative.”

An analysis was also performed to determine whether the criteria by which a candidate was chosen as successor differed depending on whether the proprietor had any children and on the number of consanguineous heirs, but no marked difference in the tendency for “management ability” to exceed “blood relative or relative” was observed.¹⁰⁾ This seems to indicate that there is little difference in the criteria for determining a successor depending simply on whether or not the proprietor has a son. This demonstrates that although over 80% of the proprietors at enterprises that have decided on a successor selected a blood relative, the choice of successor is not always guided simply by their being related, but also by their potential as managers. Proprietors appear to emphasize management ability as well as just blood relationship,¹¹⁾ and this is probably the right approach to take to managing a company.

Next, let us consider what happens in the case that an enterprise is unable to choose a successor from among current candidates. Fig. 3-2-19 shows enterprises’ responses to the question of what policy they would adopt in the event that they could not choose a suitable successor from among the proprietor’s relatives or within the enterprise. 55.2% of enterprises said that they would “search for new president from outside the company,” 22.1% said that they would consider selling off the company, and 10.3% said that they would consider exiting. A high proportion thus say that they would rather invite in an outsider than sell or close down their business, which is a similar trend to that exhibited by enterprises of type (3), which do not presently have any

Fig. 3-2-19 Response in case that present candidate is not chosen as successor
If the present candidate were not chosen as successor, a high proportion of enterprises would look for a new proprietor from outside the company



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

- Note: Only enterprises that said that their successor had been “not yet decided but candidate identified” are included.

10) For specific figures, see Appended Note 3-2-2.

11) Wakebayashi (2002) identifies four areas of management ability: 1) ability to purchase shares at market value, 2) ability to pledge personal assets as security, 3) ability to provide personal guarantees, and 4) knowledge and leadership in financial and managerial fields.

suitable candidates. Next, therefore, we will analyze these two together.

3. Characteristics and problems of enterprises with no suitable candidates

Fig. 3-2-5 earlier confirmed that 18.9% of SMEs interested in business succession did not presently have a suitable succession candidate. Even considering only proprietors aged 55 or over, 15.5% of enterprises did not have suitable candidates. Given that successors need to be determined several years before succession (including time for preparations), this indicates that these enterprises could fall into serious difficulties in which they cannot choose a successor within the next few years, making succession impossible.

As previously noted, the proportion of enterprises that have yet to choose suitable candidates is comparatively high among enterprises with excess debts, indicating that the two are somewhat related (Fig. 3-2-12). However, it is not only the financial status of an enterprise that causes a succession candidate not to be found, and many enterprises face no obstacles to continuing in business from a financial point of view.

What measures do enterprises that do not presently have a succession candidate intend to take in the future in order to choose a successor? 56.0% of enterprises responded “training and development of director or employee as candidate,” 37.8% responded “search for new president from outside company,” and 21.2% responded “consideration of succession through sale of company” (Fig. 3-2-20).

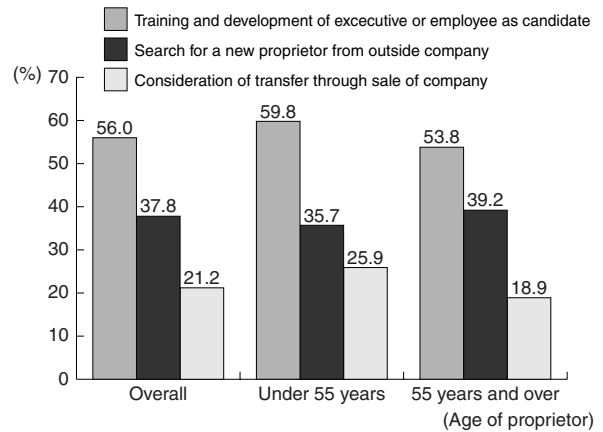
If a director or employee is to be nurtured as a future successor, a variety of problems unrelated to management ability can occur, such as the problem of securing funds for the acquisition of shares by the director or employee, as described in earlier in Column 3-2-1, and the need for proprietors to provide personal guarantees. But does inviting someone in from outside the enterprise to be proprietor provide an effective solution to these difficulties? Let us examine the attitudes specifically envisaged by proprietors.

Fig. 3-2-21 shows which parties are specifically

considered when looking for a new president from outside the company, and from this it can be seen that high proportions of both enterprises that presently have a succession candidate and those that do not responded that they would like to invite in someone who was not a stakeholder, such as someone from a business partner, business in the same industry, or financial institution. While interested parties might appear to be familiar with an SME’s business dealings and be easy to approach for concrete advice, 50% or more of enterprises want to invite in an outsider, rather than a stakeholder, as their new president. Although this may be a reflection of the lack of a stakeholder with suitable management abilities from within their own circle, it may conversely be an indication of the fetters and psychological resistance associated with use of parties, such as business partners and businesses in the same industry, with which conflicts

Fig. 3-2-20 Action taken in order to decide on a successor

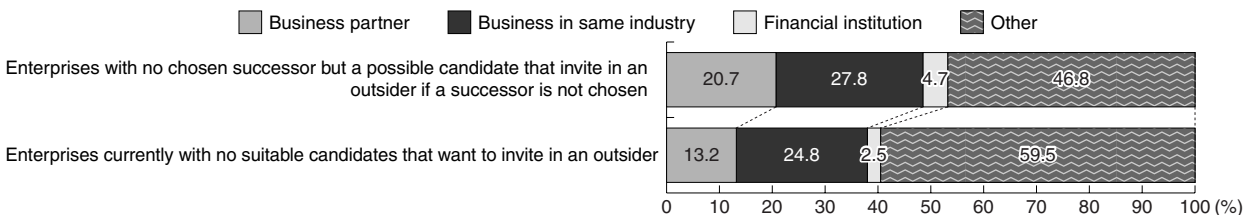
Many enterprises that have not chosen a candidate successor want to educate and train a successor from within the company



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

- Notes:
1. Only enterprises that wanted someone to take over their business in some form and that responded “no suitable candidate” are included.
 2. Totals exceed 100 due to multiple responses.

Fig. 3-2-21 Parties contacted when looking for a new proprietor from outside company
When considering an outsider as the next proprietor, enterprises tend to prefer someone who is not a stakeholder in the company



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

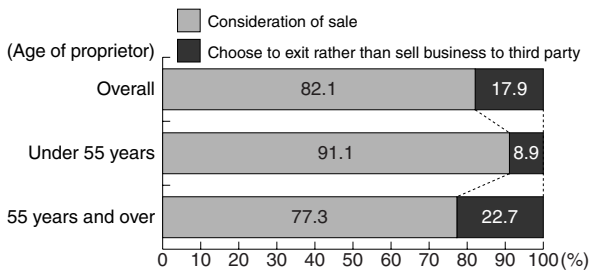
Note: Only enterprises that wanted someone to take over their business in some form and responded that a successor was “not yet chosen but candidate identified” or “no suitable candidate” are included.

of interest and competitive relations can easily arise precisely because they are familiar with the enterprise’s own business.

That being said, there is a strong possibility that if an enterprise decides to look for a new proprietor to whom it can entrust its business from beyond its circle of stakeholders (especially if looking within the next few years), it will ultimately be unable in practice to find a suitable successor. It is quite possible that an enterprise may run into a brick wall due to not finding successor, despite wanting someone to inherit its business.

Fig. 3-2-22 Choice of sale of company or exit when a successor cannot be found

Older proprietors aged 55 or over are more likely to choose to exit rather than sell off their business

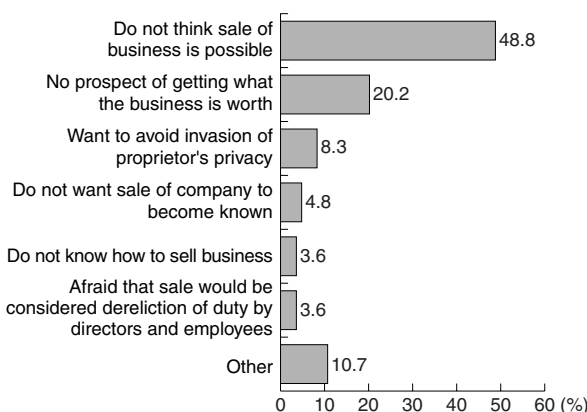


Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

Note: Enterprises that wanted someone to take over their business in some form and responded that they had “no suitable candidate” lined up were asked what they would do if they were unsuccessful in finding a successor through “education and training of directed from within the company” or “looking for a proprietor from outside the company.”

Fig. 3-2-23 Reasons for choosing to exit rather than sell business

Many enterprises do not consider the sale of their business to be an option



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

Note: Only enterprises that wanted to someone to take over their business in some form, have no suitable candidate, and said that they would “choose to exit rather than sell business to a third party” if the search for a successor were to be unsuccessful are included.

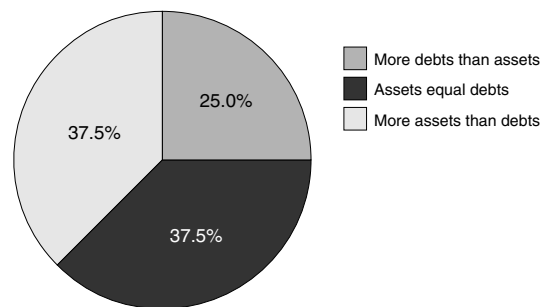
Whatever choices are made regarding successions, enterprises need to start with concrete preparations such as consultation of experts. And if a successor cannot ultimately be found despite trying various methods of deciding on a successor, an enterprise may be forced to choose to exit or sell off its business.

Leaving a detailed examination of successions through sell-offs to Section 3, below we analyze enterprises that responded that they would consider exiting rather than selling their business.

Among enterprises that do not presently have a suitable succession candidate, 17.9% said that they would choose “exit” rather than “sale of business” if they could not find a successor and had to choose one or the other. Broken down by age group, the proportions were 22.7% among those aged 55 and over, and 8.9% among those aged less than 55. This tendency is thus particularly pronounced among proprietors aged 55 and over (Fig. 3-2-22). It appears from this that the proportion of proprietors sensing opposition to business sell-offs and M&As rises with age. Let us then look at the main reasons for choosing to exit rather than sell off a business. 48.8% of enterprises “do not think sale of business is possible,” and the next commonest reason is “no prospect of getting what the business is worth,” cited by 20.2% (Fig. 3-2-23). Among the enterprises that responded “do not think sale of business is possible,” however, 75.0% have more assets than debts (Fig. 3-2-24), and the possibility cannot be ruled out that they give

Fig. 3-2-24 Asset status of enterprises that do not consider the sale of their business to be an option

Only 25.0% of enterprises that do not consider the sale of their business to be an option have excessive debt



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

Notes: 1. Only enterprises that wanted someone to take over their business in some form but had no suitable successor that said that they would “choose to exit” if the search for a candidate were unsuccessful and answered that they did not consider the sale of their business to be an option are included.
2. Enterprises with “more debts than assets for three terms in succession” or “descending into excessive debt” are classified as having “more debts than assets,” and enterprises with “more assets than debts for three terms in succession” or “recovering from excessive debt” are classified as having “more assets than debts.”

up the idea of a sell-off from the outset and consider exiting due to lack of concrete information about selling a business. As we shall see in the following section, selling a business is a feasible option even for enterprises with few employees, provided that they are in financially good shape, and collecting information on selling a

business may provide one means of avoiding exiting. In the next section, therefore, we look at the subject of successions through the sale of a business as one means by which even enterprises without a successor can avoid exiting and remain in business.

Section 3 Main issues concerning SME business successions by sale of business

1. Resistance among proprietors to sell-offs

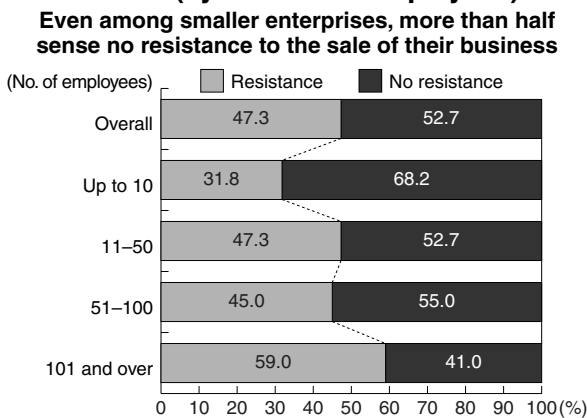
If a proprietor cannot find a successor but still wants someone to take over his or her business, one effective means of succession is through the sale of the business itself. Below, we analyze what challenges remain in such a case. We start by ascertaining what image enterprises that consider business sell-offs to be an option have of such sales. 47.3% of enterprises said that they sensed “resistance” to sale of business, and 52.7% said that they felt “no resistance” (Fig. 3-2-25). It can thus be seen that even among enterprises that would consider selling their business if the alternative was exiting, almost one in two feel some resistance to the idea of selling off their business.

However, while M&As generally tend to be thought of as having nothing to do with small enterprises, a breakdown by number of employees interestingly reveals

that resistance to the idea of business sell-offs is in fact lower at enterprises with comparatively few employees.

The reasons for sensing resistance to sell-offs despite being prepared to consider the idea are similar to those among enterprises considering exiting, with 27.8% of enterprises responding “do not think sale of business is possible.” This would indicate that a considerable number of enterprises are put off by the image of business sell-offs before they get down to concrete examination of the idea, rather than collecting new information on the sale of a business. On the other hand, enterprises that responded “afraid that sale would be considered dereliction of duty by directors and employees” accounted also for 27.8% of the total. This contrasts with the small proportion (3.6%) among enterprises that are considering exiting, as shown in Fig. 3-2-23 (Fig. 3-2-26). When a proprietor considers selling his or her business in practice, it seems that it is sentimental concerns that give rise to resistance, due, for example, to the feeling that the proprietor is somehow betraying his or her employees, who have become like family and worked together with the proprietor to grow the company, by selling the business and pocketing the returns by himself or herself.¹²⁾ This explains why while a high proportion of enterprises “considering exiting rather than selling business” registered resistance to the idea simply on “logistical” grounds, i.e., lack of knowledge how to even go about selling a business, personal feelings also pose a major obstacle when it comes down to actually considering the sale of a business.

Fig. 3-2-25 Resistance to sale of business (by number of employees)



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

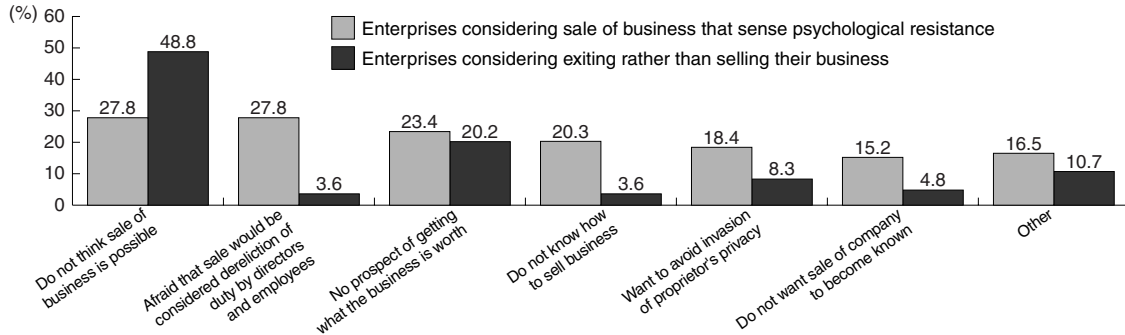
Note: Only enterprises that wanted someone to take over their business in some form, had not chosen a successor, and responded that they would “consider succession through sale of business” are included.

2. Use of M&As possible even for SMEs

The merger and acquisition of enterprises tends to be associated mainly with large enterprises. However, the number of deals is rising by the year, including among SMEs (Fig. 3-2-27). One feature of this trend is the number of acquisitions occurring between listed and unlisted enterprises. However, M&As between unlisted enterprises are also trending upward year by year. As described in Column 3-2-2 (“Advantages and

12) Furuse (2005) identifies the following three psychological factors preventing proprietors from deciding to sell their business: “loneliness,” “unease,” and “sense of guilt.”

Fig. 3-2-26 Reasons for sensing psychological resistance to sale of business
Enterprises actually considering sale of business are more likely than enterprises considering exiting to sense psychological resistance

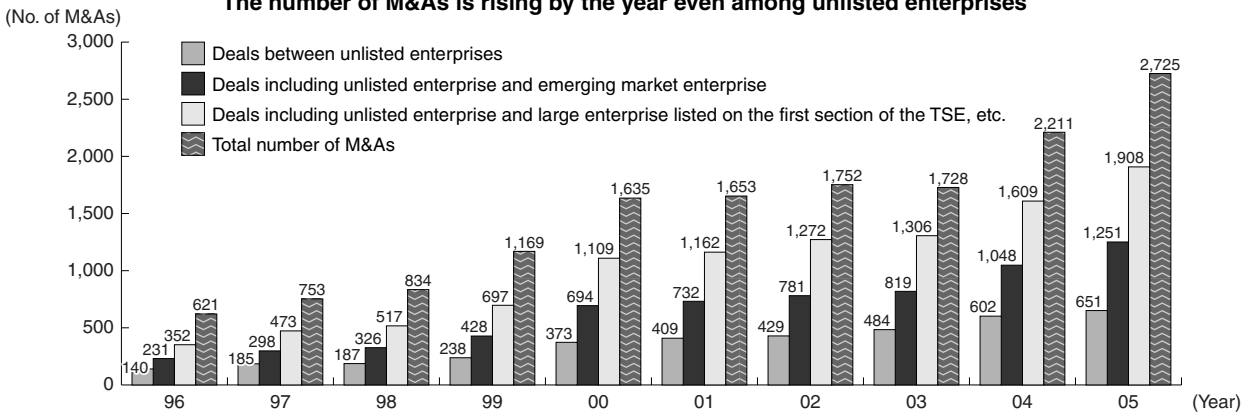


Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

- Notes:
1. Only enterprises considering selling their business that responded that they "sensed resistance" are included.
 2. As multiple responses were allowed in the case of "enterprises considering sale of business that sense psychological resistance," totals exceed 100.
- On the other hand, only one response was allowed in the case of "enterprises considering exiting rather than selling their business."

Fig. 3-2-27 Trends in number of M&As

The number of M&As is rising by the year even among unlisted enterprises



Source: Recof Corporation.

disadvantages of M&A”), business sell-offs are possible irrespective of enterprise size provided that an enterprise has clear core competences and at least a certain amount of earnings and assets that can be acquired. As Cases 3-2-4 and 3-2-5 demonstrate, there are even actual instances of successful business successions through merger or acquisition of small enterprises with just 11 employees.

Below, we examine how specifically small enterprises view M&As.

Let us imagine, for example, the typical pattern where the buyer is a middle-tier enterprise and the acquired enterprise is a small enterprise. If acquisition talks go well and a new proprietor is sent in from the buyer (i.e., the middle-tier enterprise), the seller (previous president) will go around introducing the new president to interested parties, explaining that a successor has at last been found and asking for their continued cooperation

and custom. Making the handover seem outwardly like an ordinary change of president at an SME is one of the keys to ensuring a smooth transition, both in relations with employees and with business contacts and financial institutions. In order to ensure a smooth transition, it is also common for the previous president of the acquired company to remain at the company for two or three years as a director without representation rights, or as an adviser or counselor. Once the acquired enterprise has fitted in as a subsidiary or division of the buyer, the previous president then stops providing advice and can safely enter retirement.

Column 3-2-2 Advantages and disadvantages of M&A

M&A is short for "Mergers and Acquisitions."* Merger means that two or more companies combine into one; acquisition means that one company buys all or part of another. M&A has been known as a business practice in the U.S. since about 1895. In Japan, the pursuit of them accelerated during the time of the bubble economy, the late 1980s, and they are now commonly seen in this country, too. According to Kitachi and Kitazume (2005), the aim of an acquisition is to purchase the assets and/or management of another company and make them part of one's own company, or to acquire the stock of another company and thus make it one's subsidiary; while the aim of a merger is to combine one's own and the other company effectively into one, both in name and in substance, in one incorporated entity. In fact, M&A can mean more than that. Any kind of business tie-up, for example, that gives one company the strong right to influence the other through the tie-up, can be included in the broad sense of M&A.

Advantages, as well as disadvantages, flow from combining two or more organizations that have grown in different cultures, and some of each are listed further below. For an SME facing a "succession problem," however, here are the main ones:

Advantages:

- (1) The manager of the selling company may retire, confident in the succession, and
- (2) the company's employees may continue working.
- (3) The acquiring company does not have to start from scratch, and
- (4) gets an established, mature business.
- (5) This can allow it to diversify its business in a very short time (i.e., right away), with opportunities to increase both sales and profits.

Disadvantages:

- (1) The buying company may have limited information at the time the M&A is agreed to, and issues may come out after the closing.
- (2) Employees of the selling company may face a different working environment, partly due to differences in corporate culture and managerial philosophies.

Advantages of M&A

- Unifying two or more companies contributes to realizing a growth economy through the productive use of previously unused resources.
- Economies of scope can be realized by creating complementary relationships among companies, and through other combined effects.
- Risks can be dispersed among multiple businesses.
- With its core competence, the acquired company can smoothly continue its business, while the acquiring company buys time in having not had to start up a new business unit from scratch.
- The buyer can acquire a valuable package of intangible fixed assets, including technology and selling power.
- By acquiring an existing company, with known levels of sales and profits, business plans, etc., can be made relatively precisely following conclusion of an M&A agreement.

Disadvantages of M&A

- Only limited information may be available during the process of negotiating an M&A, and in reality, for example, bad loans held by the acquired company are found from time to time after an M&A agreement.
- Despite the advantage of buying time for the acquiring company through an M&A, it may be difficult to combine two companies in a short period, in part due to differences in corporate cultures.
- Determination of a transfer price – putting a value on the acquired company – may be difficult.

Source: Compiled from Hiroyuki Itami and Tadao Kagono, *Seminar: Introduction to Business Administration* (1996); etc.

* Kitachi & Kitazume (2005) noted that, in the traditional Japanese M&A market, the purpose of many was to solve the problem of "dogs," to use the Product Portfolio Management (PPM) terminology of the Boston Consulting Group Inc. (Appended Note 3-2-3). Recently, however, M&As tend to be more positive efforts to improve corporate value by selling/buying "stars" and "cash cows." For more on major M&A methods, see p.268 of the White Paper on Small and Medium Enterprises in Japan (2001).

**Case
3-2-4**

Small company with workforce of eleven and no successor successful in continuation of business through M&A

Company D in Chiba Prefecture has a workforce of eleven and was established in 1975. The problem of the absence of a successor to the business was resolved by selling the business.

Enterprise overview

Company D is an SME engaged in the installation and maintenance of fire prevention equipment and disaster prevention communication systems. Despite being a small company, it continued to post consistent sales and profit margins, thus growing steadily. However, the company's owner-proprietor aged and because he was now over sixty, the question of succession became an urgent problem.

Circumstances surrounding sale of business

Although the owner had a son, he was not a candidate successor because he was a pharmacist and had no plans to become involved in the company's business. Although succession by a director or employee was considered, because the value of the company's assets was calculated from the book value of the amount of net assets to be around ¥150 million, and the price of the company's shares was expected to be quite high as well, the amount was higher than an individual could afford. Accordingly, succession by a director or employee was not practical, and the question of succession became a major concern for the owner.

It was under these circumstances that the owner, who had previously learned of a method of using M&A for business succession, consulted Nihon M&A

Center Inc. and looked into options for selling the business. He proceeded to select candidate companies, keeping in mind his criteria for a purchaser, such as being able to ensure the employment of his workers, and his remaining at the company as a director with no representation rights for a period until the company takeover had been sufficiently completed. He, therefore, considered a real estate management company as the purchaser. This was because he thought that synergies could be expected for both parties by adding the installation and maintenance of fire prevention equipment to real estate management, and that they could take advantage of their mutual strengths.

Effects of sale of business

Because the business was sold, the business has been able to continue as it had in the past. Also, although when the sale was explained to all the company's directors and employees a slight amount of anxiety and surprise was evident, this anxiety has disappeared due to a number of factors. These include a clear explanation of the synergies that the sale would bring, all employees continuing in their jobs and the purchaser treating them with the utmost care, and no change in their remuneration. The sale has been relatively well received by customers and financial institutions because the former owner-operator remained at the company, a clear explanation of what was happening was provided, and synergies emerged after the sale took place.

**Case
3-2-5**

Succession of business through M&A in collaboration with the Chamber of Commerce and Industry due to the absence of a successor

Company E is located in Chiba Prefecture, has a workforce of 40, and was established in 1963. At a time when the absence of a successor was a cause for concern, the enterprise was continued by means of a sale to another company in the same industry while ensuring continued employment of its work force.

Enterprise overview

Company E is a transportation company dealing in general freight. It delivers freight primarily to Tokyo, Osaka and Ibaraki and is contracted to transport industrial-use raw materials and airport cargo. The founder president has no son, and his two daughters work in other industries. As he became older (63 years) he began to consider the succession of his business, and although at one stage he considered succession to a nephew, he felt there were limits to how long the company could be managed by someone from the same family. Also, when he began to consider the question of succession around 2001, the Truck Transportation Business Law was being revised and he felt that if the company were to survive in the industry it needed someone who had specialist knowledge.

Circumstances surrounding sale of business

At the time that the company president was considering the succession of his business, he heard that the Tokyo Chamber of Commerce and Industry had started a "M&A Support Market," so he visited its office for some advice and decided to consider the option of succession by selling the business. Despite negotiating with a number of companies, he failed to reach agreement with any of them due to the harsh conditions facing the industry. Therefore, the representative director began considering the option of closing down the business by downsizing if M&A did not take place. Then in 2003, two years after he had begun considering this option, the decision was taken to sell the business to a North Kanto company engaged in the same industry, resulting in a successful M&A in which the employees retained their jobs.

Effects of sale of business

The sale of the business has enabled all employees to continue in their jobs, as well as producing synergies for the purchaser through the creation of a new and expanded trading area. Since the sale, the performance of the enterprise has continued unchanged.

3. Sources of advice on business sell-offs

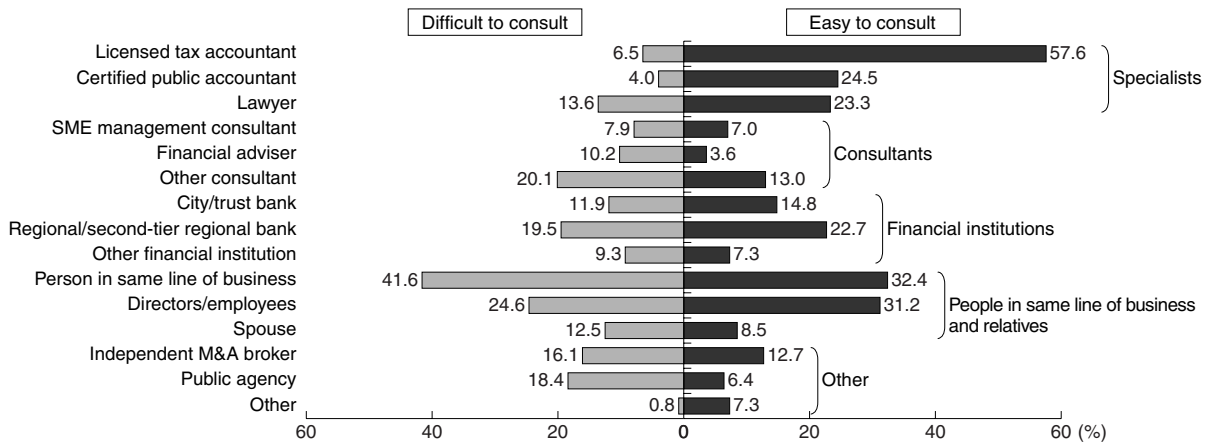
Next, let us examine the sources of advice on sell-offs that are available to SMEs.

Even SMEs that have considered selling their business generally do not have any specialist knowledge, and a decision cannot easily be made by the proprietor alone. If we check then what sources of advice proprietors find most approachable when considering whether to sell their business, we find that more than one in two (57.6%) answer “licensed tax accountant,” following by 32.4% that say “person in same line of business” (Fig. 3-2-28). The main reason for the approachability of licensed tax accountants is

“familiarity with internal affairs of company,” cited by 73.2% of respondents, while the main reason in the case of people in the same reason, cited by 44.9%, is “abundant expert knowledge and highly capable.” Evident from this is the ease of consulting licensed tax accountants, who routinely prepare financial documents and provide advice on tax matters, and the ease of consulting people in the same line of business, which requires a wealth of specialist knowledge on an enterprise’s core business (Fig. 3-2-29).

Conversely, what sources of advice are difficult to approach regarding business sell-offs? As seen earlier in Fig. 3-2-28, people in the same line of business were most commonly identified as being hard to approach, and this option was chosen by 41.6% of respondents.

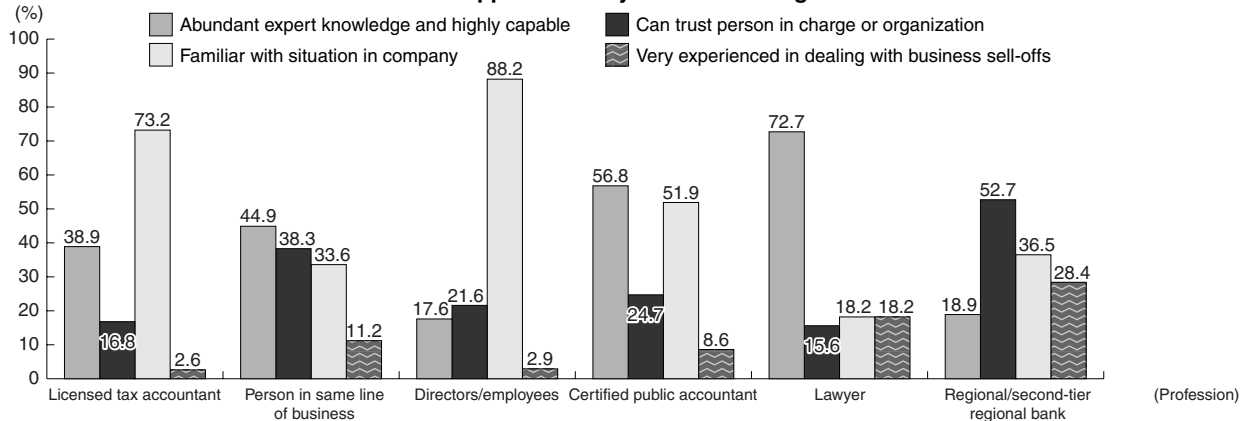
Fig. 3-2-28 Sources of advice that are easy and difficult to consult regarding sale of business
Businesses in the same industry, directors, and employees are both easy and difficult to consult



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

- Notes: 1. Only enterprises that responded “also considering succession through sale of business” are included.
- 2. Totals exceed 100 due to multiple responses.

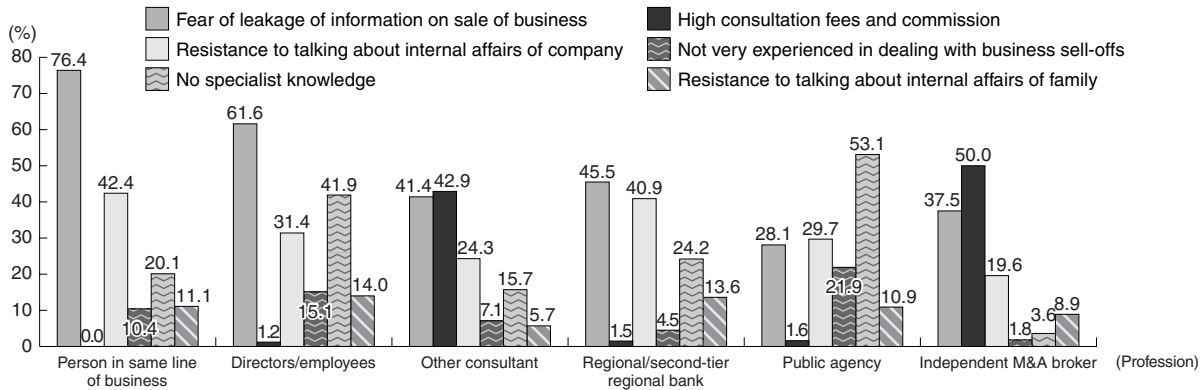
Fig. 3-2-29 Reasons for ease of consultation regarding sale of business (by source of advice)
Reasons for approachability differ according to source



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

- Notes: 1. Reasons for ease of consultation of six sources of advice considered easiest to approach regarding sale of business.
- 2. Totals exceed 100 due to multiple responses.

Fig. 3-2-30 Reasons for difficulty consulting regarding sale of business (by source of advice)
The main reason for difficulty approaching sources of advice regarding a business sell-off is in all categories the fear of information being leaked



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

Notes: 1. Reasons for difficulty approaching the six sources of advice considered most difficult to approach regarding sale of business.
 2. Totals exceed 100 due to multiple responses.

The main reason for this is “fear of leakage of information on sale of business,” cited by 76.4% of enterprises. This indicates that while many proprietors find people in the same line of business to be easy to approach for advice about selling their business due to their expert knowledge and know-how on the industry concerned, there are also many proprietors that are more negative about seeking advice from them due to concern about generating rumors about the sale of their business (Fig. 3-2-30).

Recent years have seen an increase in activity at the local level to provide advice and intermediary services in order to assist business sell-offs, as exemplified by the M&A brokering services provided by the Tokyo and Osaka Chambers of Commerce and Industry. In addition to such publicly-backed sources of support, it is also becoming more common for leading city banks and other financial institutions to enter the brokering market and provide M&A intermediary services¹³⁾ specifically targeted at SMEs.¹⁴⁾ Underlying this appears to be demand for expert knowledge in a wide range of fields due to the need to complete all kinds of procedures, ranging from tax matters to the discovery of a seller or buyer and setting of prices.

4. Features of SME M&A market: “Wet market” putting employees’ jobs ahead of price

A major reason why SME entrepreneurs consider selling their business is not only of course to ensure the

survival of their enterprise, but also to ensure the continued employment of existing employees.

Asking SME proprietors who were considering selling their businesses whether they would give priority to the returns that they would pocket from the sell-off or to ensuring their employees’ job security produced an extremely clear-cut finding. This was that whereas only 21.5% of enterprises sought a “company that would rate corporate value highly but not guarantee employees’ jobs,” as much as 69.6% sought a “company that guarantees employees’ jobs but assessed corporate value lower” (Fig. 3-2-31).¹⁵⁾ From this it may be concluded that when considering whether to sell off their business, SME entrepreneurs generally put their employees’ job security before their own personal gain.

One of the reasons for this is that SMEs are typically closed companies and, unless they become listed on the stock market, are rarely vulnerable to a “hostile takeover,” making any form of M&A other than friendly acquisition by agreement between buyer and seller unthinkable.

In this respect, the SME M&A market differs from what people normally imagine when they think of M&As. It could in fact be described as a “wet market”¹⁶⁾ in which social obligations and human feelings in a sense play more of a part than market principles, as a result of which proprietors will put the future interests of employees who have been through thick and thin with him or her ahead of simply price concerns.

Conversely from the buyer’s point of view, the assessment of employees’ own skills and contacts as

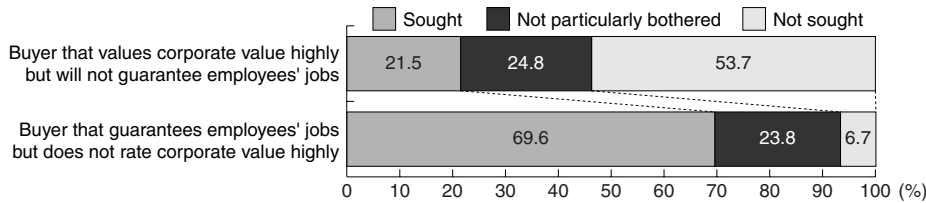
13) Such as the Nihon M&A Center Inc.

14) According to Furuse (2005), the number of entries in the intermediary business, such as services run by regional financial institutions and chambers of commerce and industry, has been increasing since 2000.

15) For other detailed data on the desired acquirers of businesses, see Appended Note 3-2-4.

16) Furuse (2005).

Fig. 3-2-31 Desired acquirers of business
Proprietors seek buyers that will protect their employees' jobs



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

Notes: 1. Only enterprises that responded “also considering sale of business” regarding business succession are included.
 2. “Sought” is the combined total of “sought” and “somewhat sought,” and “not sought” is the combined total of “not sought much” and “not sought.”

corporate value becomes an increasingly important determinant of acquisition as the size of the target enterprise decreases. As immediately laying off the employees who are an SME’s business resource would eliminate one of the attractions of acquiring the enterprise in the first place, therefore, this is generally unlikely to occur.

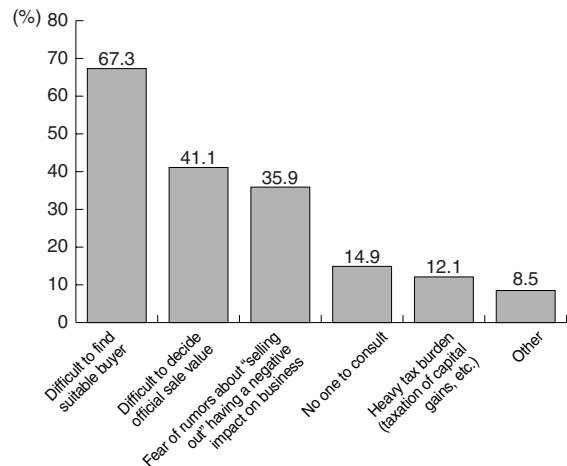
5. Obstacles when considering business sell-off and solutions

Thus far, we have focused primarily on the advantages of business sell-offs as a means of business succession at SMEs. However, obstacles naturally arise when enterprises start looking into the idea in detail. One of the main obstacles is determining a company’s corporate value and price. There are various ways of valuing the unlisted shares that are the primary capital environment of Japanese SMEs.¹⁷⁾ However, enterprises thinking about selling their businesses also have to be aware of the need to consider what each method’s merits and demerits are, and which applies to them. When they actually begin to consider in detail the sale of their business, they tend to overprice their companies, causing price negotiations with potential buyers to run into difficulties.

However, whereas only 41.1% of enterprises consider price factors to be a problem when selling their business, 67.3% of enterprises say that they find it “difficult to find suitable buyer” (Fig. 3-2-32), suggesting that considerable numbers of enterprises do not know how to go about finding a buyer. Finding and matching buyers and sellers can thus be a problem. In recent years, however, the emergence of intermediary services provided by enterprises with close local ties to assist the

Fig. 3-2-32 Obstacles encountered when selling a business

When business sell-off is considered, companies find it difficult to decide suitable buyer and sale value



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

Notes: 1. Only enterprises that responded “also considering sale of business” regarding business succession are included.
 2. Totals exceed 100 due to multiple responses.

sale of SMEs, achieved, for example, through collaboration between regional financial institutions and brokers, has expanded the range of options available to SMEs. Owing also to the annual decline in the proportion of sons and daughters succeeding their parents as proprietors,¹⁸⁾ use of M&As and other kinds of sale are likely to enjoy increasing use as means of business succession in the years ahead.

17) The fair value of unlisted shares can be assessed by the following methods: 1) net asset valuation (which focuses on the net value of an enterprise’s assets); 2) capitalization approach; 3) discounted cash flow (DCF) method; 4) dividend discount method; 5) authentication by comparison with similar industry method; and 6) authentication by comparison with similar company (a method of valuation based on estimating value from the share price of listed enterprises). Which method should be used will depend on factors such as an enterprise’s size, number of employees, and amount of capital.

18) 2004 White Paper on Small and Medium Enterprises in Japan, p. 181. For detailed data, see Appended Note 3-2-5.

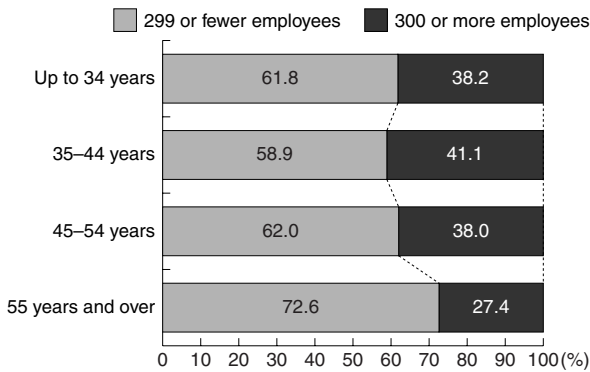
Section 4 Impact of aging of employees on SMEs

So far, we have considered the question of business successions in the context of the aging of SME entrepreneurs. However, employees as well as proprietors are growing older, and there are concerns about an imbalance occurring between the backbone younger workers and older workers. Below, we examine what impact the aging of workforce has on SMEs, and consider what measures SMEs are taking in response.

The results of MIC’s *Employment Status Survey* (2002) show that the proportion of older workers¹⁹⁾ is

higher at enterprises with fewer employees. Whereas up to age 54 the proportion of all employees in each age group employed at enterprises with fewer than 300 employees is generally around 60%, the proportion aged 55 and over working at enterprises with fewer than 300 employees is 72.6% (Fig. 3-2-33).²⁰⁾ A breakdown of employment by SMEs with fewer than 300 employees of persons aged 55 or over by age group and industry also reveals that 55-59 year olds constitute a large proportion of the workforce in manufacturing.²¹⁾ This is likely due primarily to the decline in the entry rate in manufacturing in recent years, and the large number of comparatively older enterprises. In the retail and wholesale trades, on the other hand, the still small gap between the entry and exit rates in recent years, indicating a healthy turnover of enterprises, has resulted in a comparatively high proportion of employment of younger workers (Fig. 3-2-34).

Fig. 3-2-33 Proportion of full-time regular employees by number of employees
The proportion employed at smaller enterprises increases with age



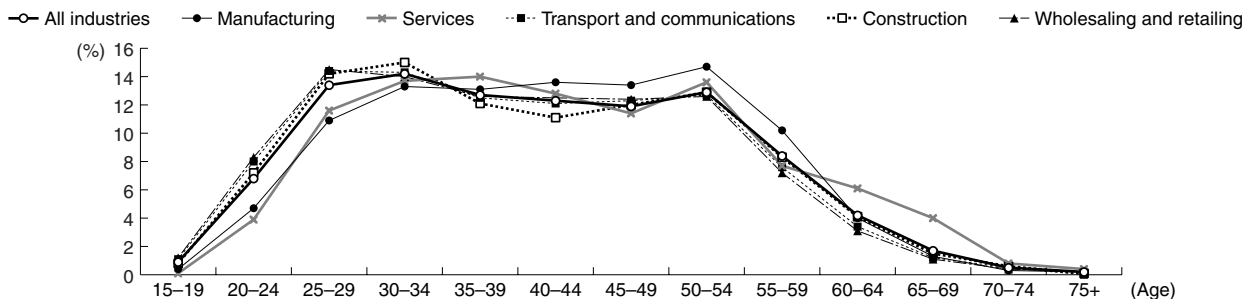
Source: Recompiled from MIC, *Employment Status Survey* (2002).
Note: Employed persons considered to be “regularly employed” are defined as full-time regular employees.

Fig. 3-2-35 shows the mandatory retirement age distribution for SMEs, from which it can be seen that a considerable number of enterprises set a mandatory retirement age of around 60. On this basis, it is forecast that the mass retirement of the baby boomers in around 2007 (dubbed the “2007 problem”) will have a variety of impacts on enterprises.

Generally speaking, it is thought that the 2007 problem will have a negative effect, in the form of a need to ensure the transmission of skills to new workers and rising burden of retirement benefits will squeeze corporate finances, and a positive effect, in the form of reduced labor costs and an opportunity to blood a new

Fig. 3-2-34 Proportion of full-time regular employees by industry and age (enterprises with 299 or fewer employees)

At enterprises with 299 or fewer employees, the proportion of employees aged 55 or over in manufacturing is high



Source: Recompiled from MIC, *Employment Status Survey* (2002).

Notes: 1. Only enterprises with 299 or fewer employed persons are included.
2. Employed persons considered to be “regularly employed” are defined as “full-time regular employees.”

19) In this survey, “older workers” are defined as workers aged 55 or over, and this definition is used below.
20) “Employees” here refers to employed persons who are “regularly employed” (full-time regular employees).
21) In the service industry, however, the proportion of employees aged 60 and over is comparatively high.

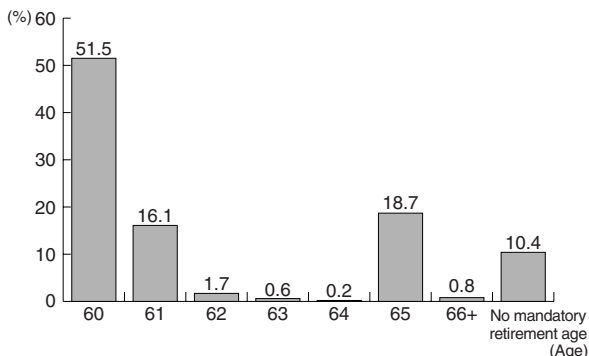
generation of workers. Of the two, a greater focus tends to be placed on the downside. However, what do SMEs themselves actually think?

According to the *Succession Questionnaire*, 54.8% of enterprises said that they would be “affected” or “affected a little” by the retirement of older workers, compared with 35.8% that responded “not affected much” or “unaffected.” It is thus not necessarily the case that the majority of SMEs expect to be affected (Fig. 3-2-36). It can also be seen from Fig. 3-2-37 that a large majority of enterprises in all industries responded that they “cannot say” whether the retirement of the baby-boomer generation would affect them, and the proportion of enterprises expecting the effect to be positive is approximately the same as that expecting the effect to be negative. Overall, then, it does not appear that the “2007 problem” will have a particularly positive or negative effect on the management of SMEs.

Let us examine what specifically are the expected positive effects based on the results of the *Succession*

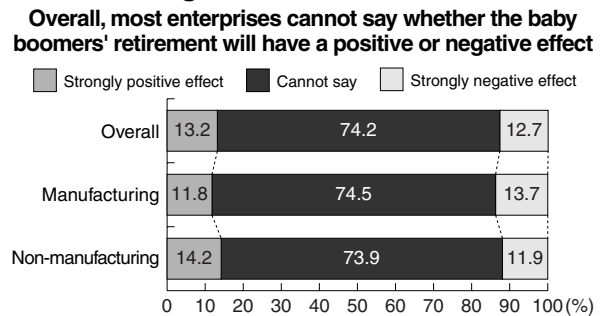
Questionnaire. The greatest benefits of the retirement of older workers anticipated by SMEs are the “reduction of high cost of employment of older employees,” cited by 40.9%, and the “potential to effect generational change by employing younger workers,” cited by 30.5%. 8.1% responded “opportunity to use IT, etc. to replace experience of older workers,” and 19.4% did not expect their retirement to have any positive effect. While there is a tendency to focus on the downside to the retirement of older workers in the form of the loss of older workers’ skills, the opening of vacancies in employment positions can shake things up internally and lead to expanded employment of younger workers at SMEs that generally find it difficult to increase their intake of new personnel. Thus the potential for the retirement of older workers to generate business innovation, such as through expanded positions for younger workers and opportunities for the introduction of IT, as a result of the generational changing of the guard cannot be overlooked (Fig. 3-2-38).

Fig. 3-2-35 Age of mandatory age at SMEs
Mandatory age is around 60 at two thirds of enterprises



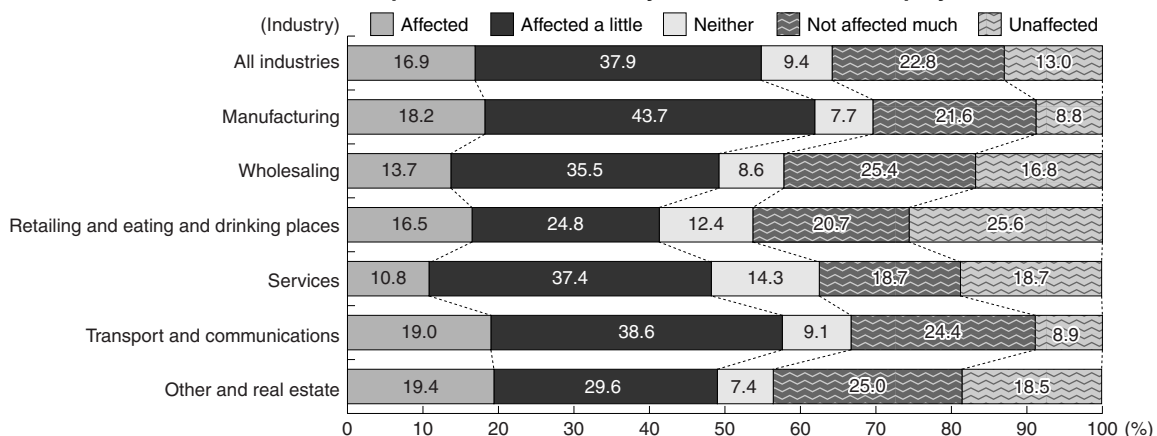
Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

Fig. 3-2-37 Positive and negative effects of retirement of baby-boomer generation
Overall, most enterprises cannot say whether the baby boomers’ retirement will have a positive or negative effect



Source: The Shoko Chukin Bank, *Survey of Employment Trends at Small and Medium Enterprises Focusing on the Baby-Boomer Generation* (August 2005).

Fig. 3-2-36 Impact of older employees reaching retirement (by industry)
Over half of all enterprises will be affected by retirement of older employees



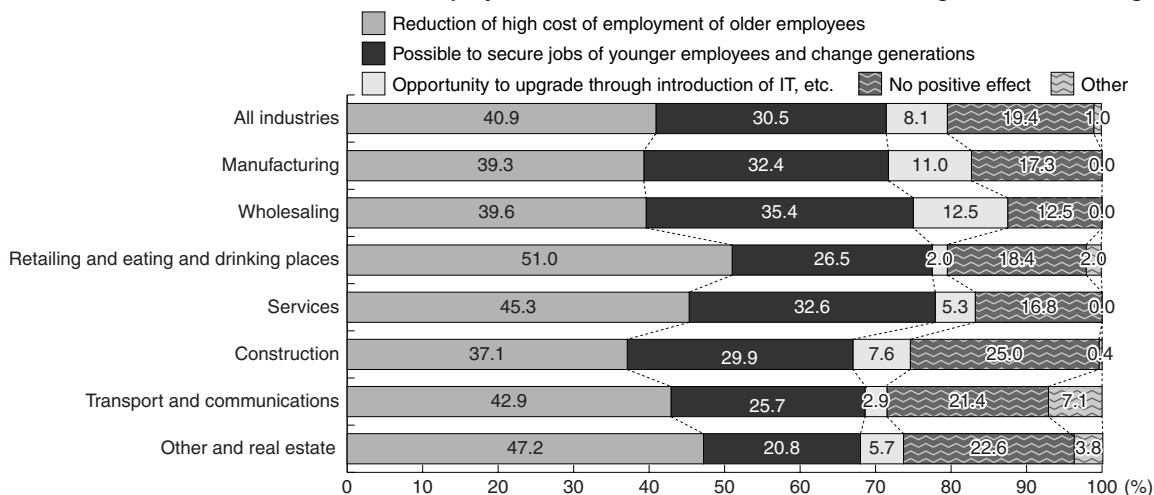
Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

Regarding the negative effects of the retirement of older workers, on the other hand, the commonest response, cited by 60.6% of enterprises, was “skills of retirees cannot be passed on.” This is considerably more than the 17.7% that responded “increase in lump-sum payments putting pressure on company finances” and the 3.4% that said “fear of loss of advanced skills of retirees to other companies.” 15.3% also said that they expected “no negative effect.”

Although overall the retirement of older workers will not have an overwhelmingly positive or negative effect on business, on the downside “transmission of skills”²²⁾ is cited by the vast majority of respondents in all industries. The problem of transition of skills appears to be one that in general potentially faces proprietors in all industries (Fig. 3-2-39).

Further evidence of this is provided by the responses regarding the “fear of problems ensuring transmission of skills” by occupation. These show that a high proportion of respondents feel it difficult to ensure that skills are passed on in what are generally considered to be advanced occupations, such as “researchers and engineers” and “organizational management positions,” and that in occupations in which personal experience, getting the “knack,” and know-how are valuable skills, a certain proportion of enterprises sense that transmission of skills is not going well in “sales and marketing positions,” including commerce and services, as well as “manual positions,” including the manufacturing front line. Overall, it appears that fears concerning the transmission of skills are not limited to any particular industry or workplace²³⁾ (Fig. 3-2-40).

Fig. 3-2-38 Positive effects of retirement of older employees (by industry)
Positive effects of retirement of older employees include reduction of labor costs and generational change



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

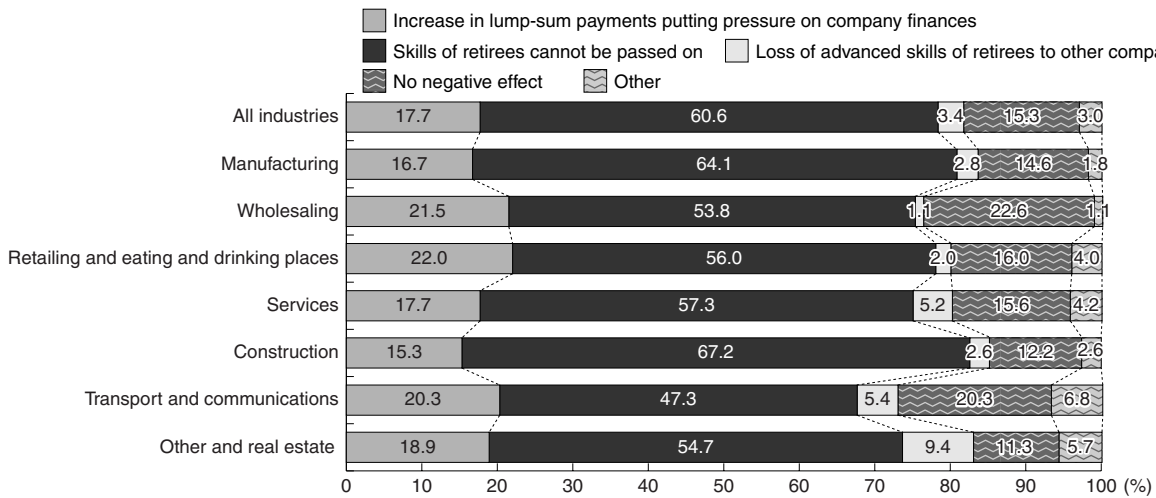
Note: Only enterprises that responded that the retirement of older employees would have an “effect” or “some effect” in the next five years are included.

22) “Skills” in Japanese generally refers to abilities associated with the manufacturing shop floor. As this survey was not limited to a specific industry, however, the term “vocational abilities” is used instead.

23) A similar survey on apprehensions concerning the transmission of skills in individual occupations is *A Survey of Personnel Strategies and Job Consciousness at a Time of Population Decline* (December 2004) conducted by the Japan Institute for Labour Policy and Training. This survey uncovered widespread concern about the transmission of skills in “skilled worker and production process” positions. However, a breakdown of respondents by industry shows that those who expressed concern about the transmission of skills in the “skilled worker and production process” category were concentrated in manufacturing, and that most of the responses in manufacturing were concentrated on one answer that tended to elicit this response. Other options, on the other hand, did not tend to elicit a response from any specific industry, and the responses chosen in each industry were more dispersed (Appended Note 3-2-6).

Fig. 3-2-39 Negative effects of retirement of older employees

Although the effects do not differ conspicuously according to industries, the main concern in all industries is ensuring the transmission of skills

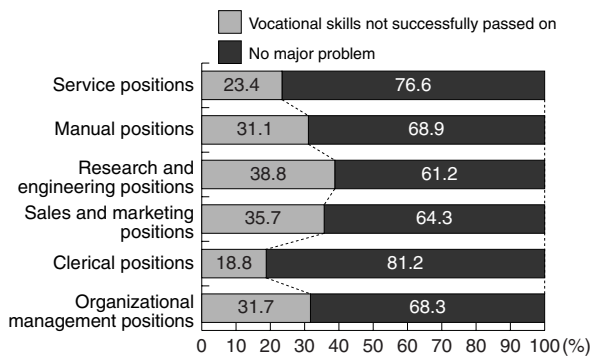


Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

Note: Only enterprises that responded that the retirement of older employees would have an “effect” or “some effect” in the next five years are included.

Fig. 3-2-40 Prevalence of fear of problem ensuring transmission of skills (by occupation)

Does not appear to be problem specific to certain workplaces



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

Section 5 Skills of older workers

1. Nature of skills

The problem of how to ensure that skills are passed on is, as we have seen, generally a challenge that concerns all industries and occupations. Why then does the transmission of skills on the manufacturing shop floor attract so much more attention?

What does “skills” as a term typically refer to? Past studies have broadly speaking treated skills as vocational

abilities, and have explained them by dividing into two conceptually different groups: “techniques”, which are replaceable by IT and the development of manuals, i.e., abilities and knowledge that can be automated with investment, and abilities and knowledge that are expressed verbally or numerically; and “skills,” which are abilities and knowledge that cannot easily be turned into manuals due to being inherent in each individual.²⁴⁾

While techniques can be converted to explicit

24) Narrowing his scope to just manufacturing, Yamamoto (2004) further categorizes skills into “basic skills,” “practical skills,” and “expert skills.” Koike, Chuma, and Ota argue that there have been no instances in economics to date of skill levels being successfully expressed quantitatively.

knowledge²⁵⁾ through use of IT or manuals on account of their being abilities that are shared within the organization, skills differ from techniques in that they consist of tacit knowledge, and are acquired by the individually, rather than organizationally, through experience and intuition. Invisible skills dependent on experience consequently tend to be difficult to pass on smoothly to successive generations of workers, and require a combination of measures, such as many years of on-the-job (OJT) training and education, to be transmitted. In other words, “skills” are themselves a business resource and consist of the ability to respond flexibly when new problems occur, and the ability to make improvements to existing work and perform work highly accurately and efficiently in combination with TPO (Fig. 3-2-41).

Of course, it must be borne in mind that advances in IT, such as CAD/CAM technology and accounting software, are broadening the scope of what is regarded as a “technique” that can be digitized or replaced with information technology to include “skills” that have

traditionally been difficult to convert to explicit knowledge.

Figure 3-2-42 depicts what expert skills are required in manufacturing. From the large proportion of enterprises that responded “technologically impossible to mechanize” or “potential for development of new value added based on experience and knowledge,” it can be seen that “skills” tend to be interpreted in terms of those elements that cannot be replaced with IT or manuals. On the other hand, it can also be seen that there exist some fields that, though physically possible to mechanize or digitize, are more effectively left to the “skills of the experienced worker” in cost terms.

Although transmission of skills is an issue that potentially concerns all kinds of industries and occupations, factors such as the following have made the problem particularly acute in manufacturing:

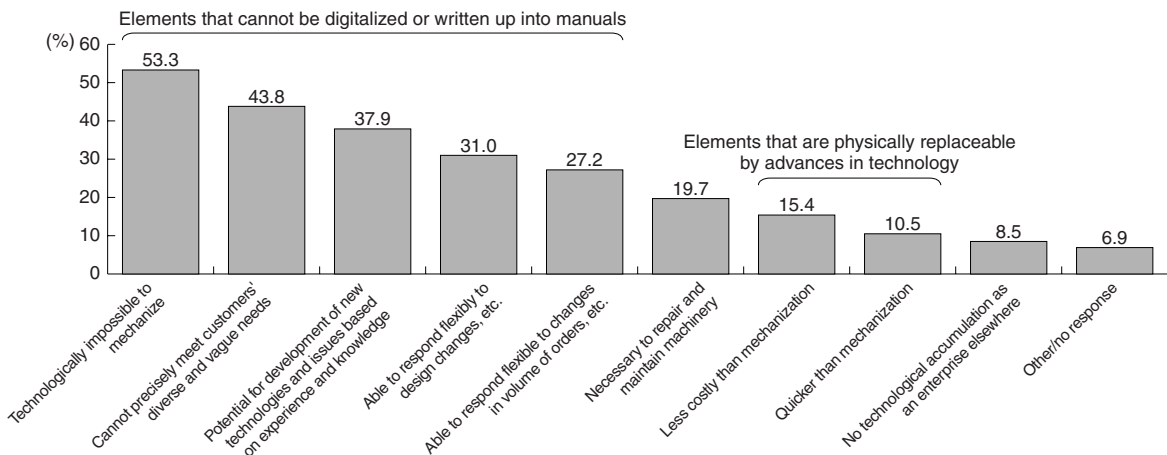
- 1) The increasing sophistication of technologies year after year
- 2) The rapid cycle of technologies, as a result of which the technologies to be passed on themselves

Fig. 3-2-41 Features of tacit and explicit knowledge

Tacit knowledge	Explicit knowledge
<ul style="list-style-type: none"> - Knowledge that is impossible or difficult to verbalize - Direct knowledge obtained through experience and five senses - Knowledge of the present - Skills acquired through physical sense or knack - Subjective and personal - Emotional and passionate - "Analog" and frontline knowledge - Often limited to specific people, places, and subjects - Possible to share, develop, and propagate through collaborative work involving physical experience 	<ul style="list-style-type: none"> - Verbalized explicit knowledge - Systematic knowledge segmented from tacit knowledge - Knowledge of the past - Dictionary-like structure in order to understand information on explicit methods, procedures, and things - Objective and social (organizational) - Rational and logical - "Digital" knowledge, i.e., "okayed" knowledge - Possible to relocate, transfer and reuse through use in tandem with information systems, etc. - Sharable and editable through linguistic media

Source: Nonaka and Konno (1999).

Fig. 3-2-42 Reasons for need of skilled workers in manufacturing
Many SMEs consider skills to consist of experience and knowledge that cannot be technologized



Source: SME Agency (ed.), *New Manufacturing Among SMEs* (2000).
 Note: Totals exceed 100 due to multiple responses.

25) Nonaka and Konno (1999) note that tacit knowledge and explicit knowledge interact in knowledge creation theory, and that knowledge spirals upward dynamically from the ontologically low personal level to higher levels (known as the SECI process) (Appended Note 3-2-7).

become outdated and are replaced by new technologies

- 3) Inability to inject sufficient human resources into internal training of the next generation of workers due to historical factors, i.e., demands for restructuring through cost reductions and quicker delivery times

Regarding 1) (increasing sophistication of technologies), the heavier dependence on employees' skills of smaller enterprises as a necessary business resource in manufacturing, as described in Part II, Chapter 3, means that the problem of skills transfer is potentially more serious at smaller enterprises.

Regarding 2) (shortening technology cycles), it appears that the situation is such that new technologies need to be absorbed without time to pass on older technologies to the next generation due to the year by year evolution of technology.²⁶⁾

Regarding 3) (shortage of resources to assist the transfer of skills), it can be seen from Fig. 3-2-43 that there is a strong awareness of "no time to provide training" and "shortage of staff to provide instruction" as obstacles to human resource training in manufacturing, more so even than in other industries. This is possibly an indication that manufacturers are generally more exposed to global competitive pressures than enterprises in the commercial and service sectors and, in the current vortex of unprecedented structural change wrought by economic integration in East Asia, manufacturers in particular are finding that they no longer have the resources to spare in order to train the next generation of employees.

Against this background, the particular focus on the problem of skills transfer on the manufacturing shop floor is somewhat understandable.

2. Action to assist skills transfer

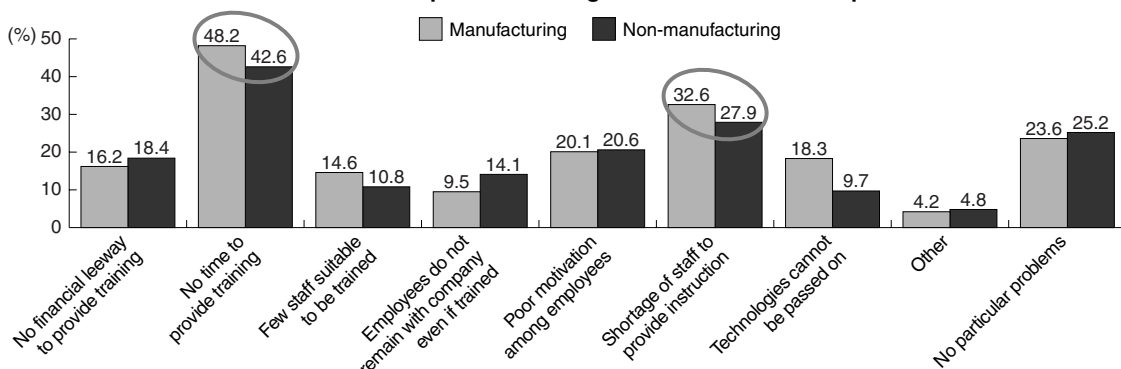
Enterprises need to consider how to conserve skills that cannot be passed on visually, and what measures should be taken in order to achieve this. According to Fig. 3-2-44, there are three methods by which skills can be continued and maintained organizationally: 1) by maintaining present skills through the reemployment of older workers; 2) by allocating human resources with OJT and other forms of training in the enterprise in mind; and 3) by taking steps to convert as far as possible tacit knowledge to explicit knowledge by means of use of IT and manuals.²⁷⁾

1) Retention of present level of skills through reemployment of older workers

Regarding the continued employment of retiring older workers, it can be seen from Fig. 3-2-45 that 70.5% of enterprises would like these workers to continue working and regard this as feasible, showing that many enterprises anticipate being able to continue to use existing older workers.

Regarding the concrete measures being taken to retain skills, "reemployment schemes for older workers" have been established at 51.2% of enterprises, followed by 29.9% that have established "short-term contract employment schemes" and 21.6% that "extend the mandatory retirement age." On the other hand, as many as 18.3% of enterprises answered that they had not introduced any post-retirement schemes for older workers (Fig. 3-2-46). Considering that according to Fig. 3-2-45, seen earlier, 24.3% of enterprises say that they would like older workers scheduled for retirement to continue working but consider this unfeasible or do not expect workers to continue working, it would seem that

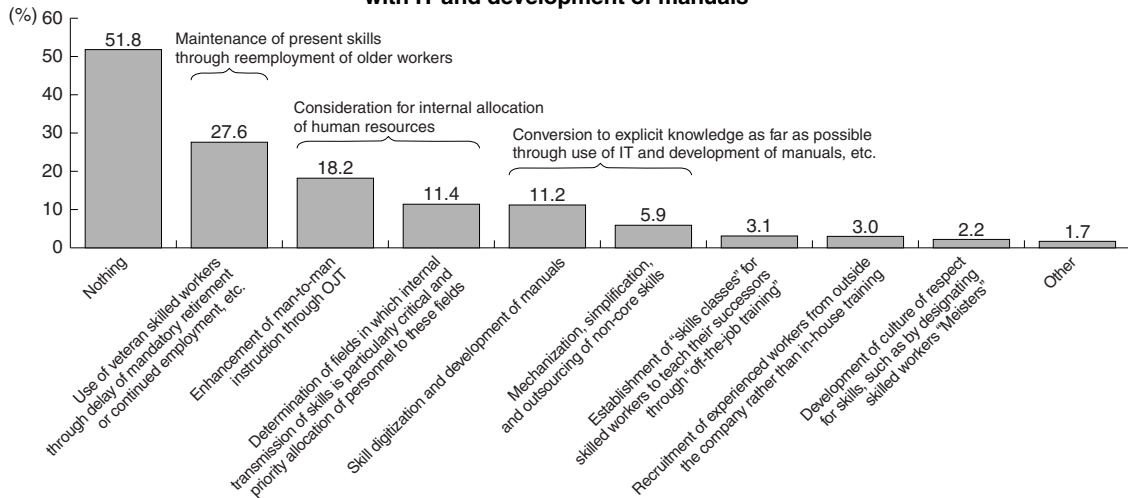
Fig. 3-2-43 Problems regarding training of human resources (by industry)
Manufacturers have less time to provide training and also fewer staff to provide instruction



Source: SME Agency, *Survey of Use of Human Resources* (December 2004).
 Note: Totals exceed 100 due to multiple responses.

26) In the 2005 White Paper on Small and Medium Enterprises in Japan, it was noted that the lifecycles of hit products have shortened over time (p. 37, Fig. 2-1-13), and shortening technology cycles are probably one factor behind this.
 27) 51.8% of enterprises in this survey responded that they were doing "nothing" to assist skills transfer. However, this makes sense if one also considers that around 40% of enterprises consider that the retirement of older workers will have "no particular effect" in the first place (see Fig. 3-2-36).

Fig. 3-2-44 Measures by enterprises to assist handover of skills from baby-boomer generation
Main three responses are reemployment of older workers, internal reallocation of human resources, and replacement with IT and development of manuals

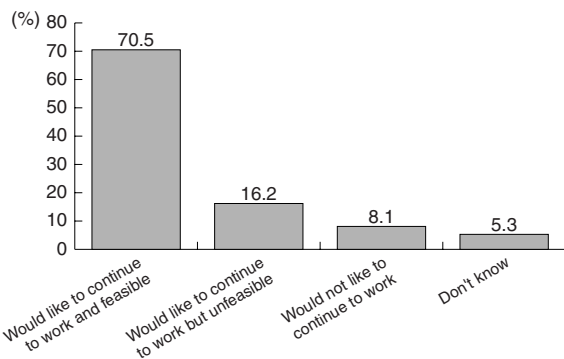


Source: Japan Institute for Labour Policy and Training, *A Survey of Personnel Strategies and Job Consciousness at a Time of Population Decline* (December 2004).

Notes: 1. Totals exceed 100 due to multiple responses.
 2. Non-responses are excluded from the above results.

Fig. 3-2-45 Potential and expectation of continued employment of retiring employees

Continued employment possible around 70% of enterprises with older workers near retirement



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

Note: Only enterprises that have introduced schemes for older employees such as “extension of mandatory retirement age,” “reemployment,” “short-term contract employment,” “part-time employment,” and “early retirement” are included.

action of one kind or another is in general being taken at enterprises that need to reemploy older workers.

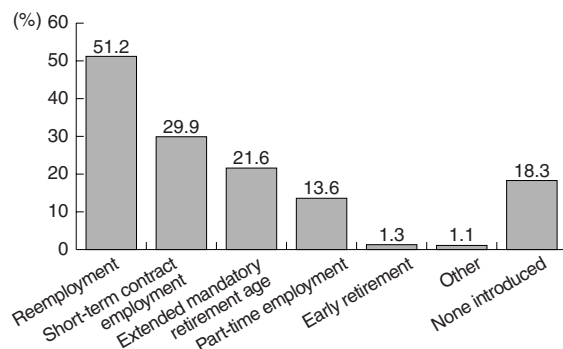
However, as older workers are at any rate approaching a time at which employment will become physically difficult, enterprises will still face the challenge of having to replace human resources and rejuvenate their workforces at some point in time.

2) Allocation of human resources in company

Fig. 3-2-44 shows that some enterprises consciously

Fig. 3-2-46 Schemes introduced for older employees

Over 80% of enterprises have introduced schemes of one kind or another for older employees



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

Note: Totals exceed 100 due to multiple responses.

allocate human resources to areas in the company in which skills transfer is required, with 18.2% saying that they employ “man-to-man instruction through OJT” and 11.4% saying that they “allocate human resources to fields in which internal transmission of skills is particularly critical”.

As touched upon above in relation to the reemployment of older workers, older employees will inevitably have to retire at some point, making it crucial that enterprises systematically allocate human resources to operations and fields in which skills need to be passed on in order to pave the way for the inevitable retirement of older workers (Case 3-2-6).

Case 3-2-6

Enterprise uses special OJT system for training young employees

Established in 1968, Ogaki Seiko Co., Ltd. is located in Gifu Prefecture and has a workforce of 160 employees. It manufactures dies used in precision machining.

The company adopts a medium- to long-term perspective about the products it manufactures and puts an effort into the recruitment and training of young employees who are said to take ten years to become qualified. Because there are very few opportunities to learn about "dies" in school, education for new employees starts from the basics as soon as they join the company. The company takes them through general information about dies and raises their awareness by showing them dies on the factory floor. For about three to five years, employees gain experience on the factory floor learning from one-on-one instruction about everyday skills and techniques.

Those in charge of this on-the-job training are veteran employees aged between forty and fifty who are required to have at least ten years' experience. But since some of these employees are not better suited than others to give instruction to young people, the management team considers having the right kind of personality to be important, and distinguishes between those who can give on-the-job training and those who cannot. One-to-one instruction takes between three to five years, during which new employees are assessed and assigned to a department.

One feature of the company's personnel training philosophy is allocating the right person to the right job, which is made possible because of the one-on-one instruction that allows experienced staff to get to know the finer attributes of each new employee.

3) Conversion of skills to explicit knowledge through use of IT and manuals

Technological progress has made it possible for some skills that used to be tacit knowledge to become explicit knowledge, and assisting this process is one way of ensuring that skills are passed on to new workers. According to 3-2-44, 11.2% of enterprises have already started "skill digitization and development of manuals," and 5.9% are engaging in the "mechanizing, etc. of non-core skills." Regarding skills that can be digitized or turned into manuals and skills that do not play a particularly core role at enterprises, then, the evidence indicates that enterprises are turning to automation rather than maintenance through the input of human resources.

3. Employment of younger workers

As has been described thus far, SMEs are taking all kinds of steps to ensure the survival of "tacit knowledge" skills. In actual fact, however, the biggest problem lurking behind the question of how to ensure the survival of skills is the difficulty faced by enterprises in recruiting the younger workers to whom these skills can be passed on in the first place.

If the loss of present skills is to be avoided, it is important that enterprises continue to employ the older workers that possess these skills. However, enterprises cannot rely on the skills of older workers forever. In order for enterprises to undergo constant renewal, younger workers have to be employed as needed to assist the handover of skills. According to Fig. 3-2-47, the primary reason for employment of younger workers by SMEs is to ensure the "transmission of skills and technologies." At the same time, however, an obstacle to the smooth transfer of skills in all industries is "inability to recruit younger workers in recent years" (Fig. 3-2-48).

We may conclude from this that while SMEs are perfectly aware of the need to recruit younger workers to whom skills can be passed on, actually recruiting such workers is easier said than done.

So why do they have problems recruiting younger workers? Fig. 3-2-49 shows the existence of difficulties on both the qualitative and quantitative sides; namely, the qualitative problem of "lack of desired human resources or few applicants with necessary abilities," and the quantitative problem of "few applicants even if position is advertised." Among these problems, however, the "quality" of applicants appears to be a particular concern.

When acquiring new workers, a key point is how to go about recruiting them.

According to METI's *Survey of Human Resource Needs* (2004), the number of methods used by enterprises to procure human resources (recruitment routes) is extremely low, averaging only 1.7, and in the case of mid-career recruitment in particular, many enterprises rely solely on methods revolving around the "Hello Work" public job-placement program for the unemployed. If enterprises want to employ more younger workers, they will probably need to diversify the number of recruitment channels that they use.

A further obstacle identified by respondents is that "workers recruited do not stay with the company for long," indicating that getting younger workers to stay is a problem. As long as skills depend on experience, getting human resources to stay is essential to the transmission of skills.

If enterprises are thus unable to secure the younger workers needed to ensure that skills are passed on, and in particular younger workers with the requisite abilities, on account of recruitment difficulties and younger workers leaving the workplace soon after hiring, it will become impossible to pass skills on to the next generation.

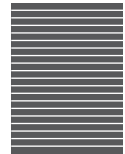
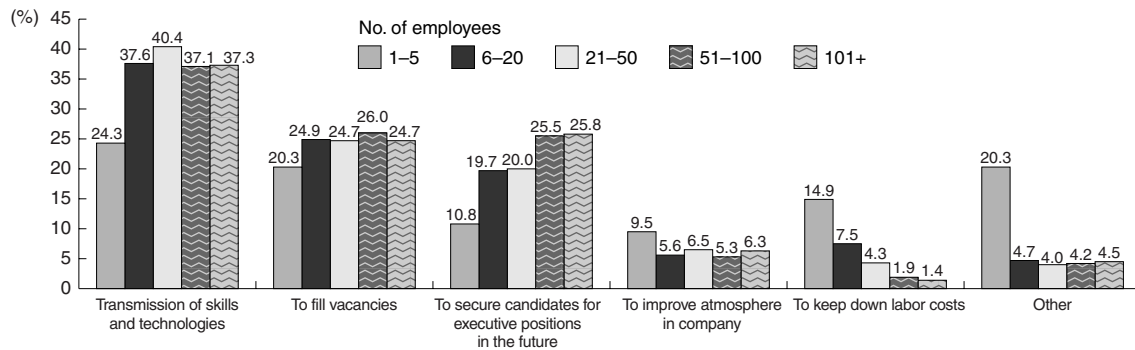
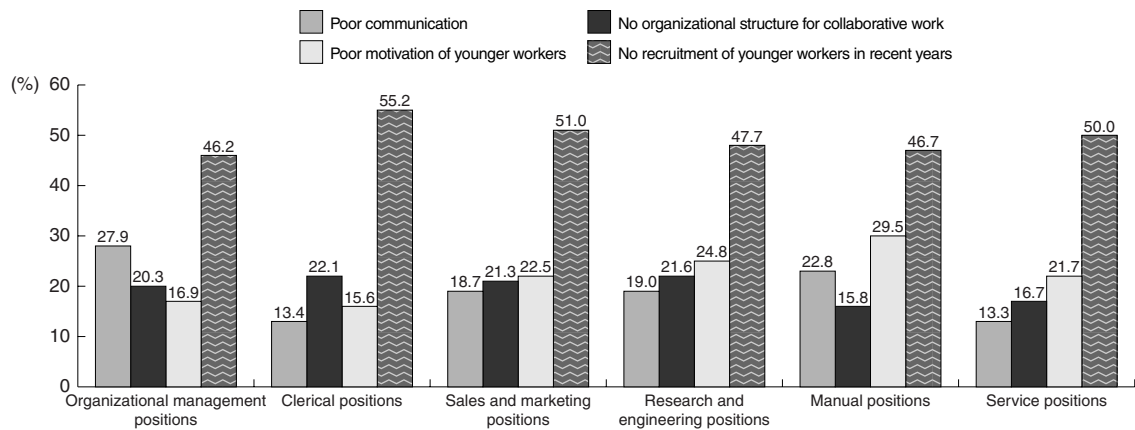


Fig. 3-2-47 Primary reasons for recruiting younger workers (by number of employees)
A high proportion of enterprises of all sizes employ younger workers with a view to transmission of skills and technologies



Source: Nomura Research Institute, Ltd., *A Survey of Employment of Young Workers* (November 2005).

Fig. 3-2-48 Obstacles encountered regarding transmission of skills (by occupation)
Failure to recruit younger workers impedes transmission of skills in all occupations

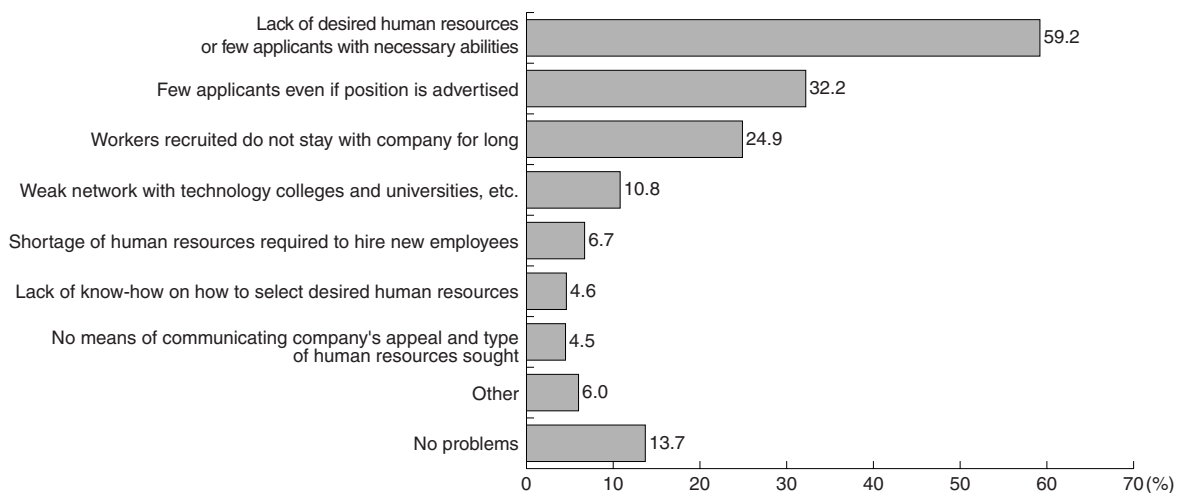


Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Business Successions and Transfer of Vocational Skills* (December 2005).

Note: Totals exceed 100 due to multiple responses.

Fig. 3-2-49 Obstacles to recruiting younger workers

Main obstacles to recruitment of younger workers are lack of desired human resources and few applicants with necessary abilities



Source: Nomura Research Institute, Ltd., *A Survey of Employment of Young Workers* (November 2005).

Note: Totals exceed 100 due to multiple responses.

Securing younger workers is crucial to ensuring the

smooth transmission of skills at SMEs.²⁸⁾

Section 6 Summary of Chapter 2

The preceding sections have discussed the “business succession” and “skills transfer” problems that, with the advent of an aging society, now confront SMEs. Below we summarize the main points regarding each.

1. Main points regarding the business succession issue

- Around 95% of SME entrepreneurs want someone to take on their business after their own retirement.
- One of the difficulties of business successions at SMEs is that it is not sufficient simply to transfer management rights (i.e., the post of president), as management will not go smoothly unless ownership of the company (assets such as shares) are also transferred.
- Less than half (approximately 49%) of all enterprises with a proprietor aged 55 or over that are interested in business succession have already decided on a successor, and around 15% cannot even find a candidate for succession.
- At enterprises that have already decided on a successor, over 70% (approximately 71%) are either the son or daughter of the proprietor. Only a minority of enterprises have made sufficient preparations for business succession, the main preparations consisting of the development of the management environment by training successors and gaining the understanding of stakeholders, and the proportion of enterprises that have taken action regarding tax or legal matters, such as inheritance measures, is low.
- Enterprises that have succession candidates in mind emphasize “management ability” as a factor in choosing one as a successor, and this tendency does not differ markedly regardless of whether or not the candidate is the proprietor’s son.
- A large proportion of enterprises that have not yet decided on a successor (including both those with and without candidates) say that they would invite in an outsider to be their proprietor if they were ultimately unable to decide on a successor. In practice, however, they fear this to be unfeasible. If a successor cannot be found from outside the company, another effective option is to sell the business.

- Successions through business sell-offs such as M&As offer the advantage of securing employees’ jobs. However, corporate culture and the psychological resistance of proprietors can also be problems.
- SME M&As are a means of business succession available even to small enterprises with around 10 employees provided that they have clear core competences and can offer a certain amount in the way of earnings and assets.
- The SME M&A market generally consists mainly of friendly M&As, and may be described as a “wet market” in which human feelings play a large part and greater priority is given to the jobs of employees in the division sold than to the sale price.

2. Main points regarding skill transfers

- Although the tendency is to focus on the negative side to the impending retirement of large numbers of older workers (dubbed the “2007 problem”), the positive and negative effects on SMEs are approximately equal. One of the downsides identified by many enterprises, however, is the problem of ensuring that skills are passed on.
- Skills transfer is a problem that generally concerns all industries and occupations. Due to the impact of constant advances in technology and global competitive pressure, however, it can be a particular challenge on the manufacturing frontline.
- The three main areas in which enterprises can take action by conventional means are through “maintenance of present skills by reemployment of older workers,” “deliberate allocation of human resources to assist OJT and other forms of training in the company,” and “conversion of skills to explicit knowledge through the use of IT and manuals.”
- However, the biggest obstacle to skills transfer identified by the vast majority of enterprises is their inability in recent years to recruit the younger workers that they would like. When recruiting new workers, enterprises use on average only 1.7 recruitment routes. Diversifying recruitment channels is thus one possible solution to the problem.

28) The issue of employment of younger workers at SMEs is described in further detail in Chapter 3. In order for enterprises to secure effective “next generation” business resources (skills acquired by people) and in order for young people to earn a stable income enabling them to marry and have children, recruiting and retaining younger workers is an important issue.

Chapter 3 The role of SMEs in creating a society that makes it easier to have and raise children

Section 1 Employment and working conditions from the perspective of birthrate decline

Japan’s total fertility rate (TFR) is presently at an extremely low level, causing Japan to go into population decline ahead of other industrialized countries, as noted in Part III, Chapter 1. In order to halt the downward slide in the birthrate, action needs to be taken to create a society that is more amenable to having and raising children.

The hurdles that young people specifically encounter on the way toward having children are twofold.

Firstly, they need a stable job and income. In Japan, few children are born out of marriage, and there is little likelihood of the birthrate being increased unless young people get married. Without stable employment,

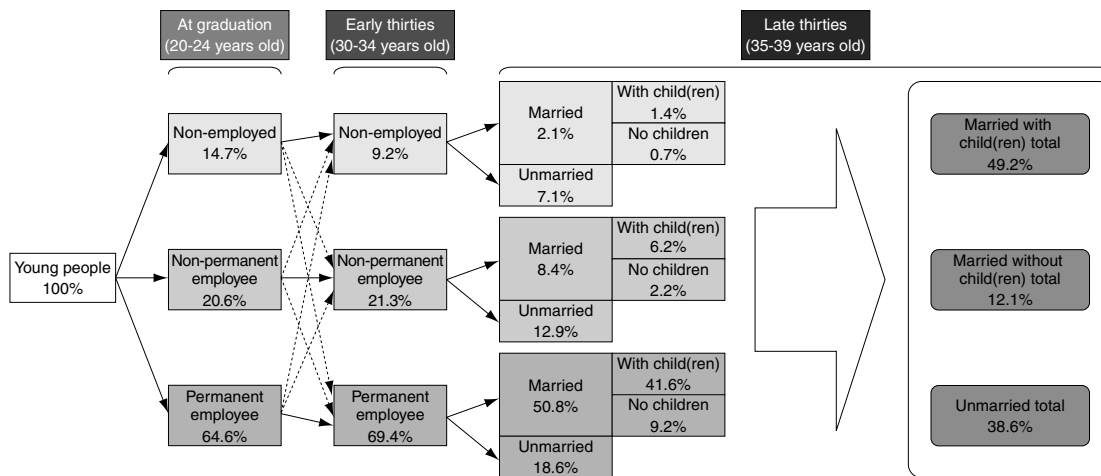
however, the chances of marriage are reduced. And even if one marries, one is less likely to have and raise a child on a low and unstable income.

And secondly, they need to be able to balance the demands of work and parenting. The entrenched view among Japanese enterprises until now has been that helping employees to balance the two is a burden on business, and support has as a consequence not advanced as much as it might have done.

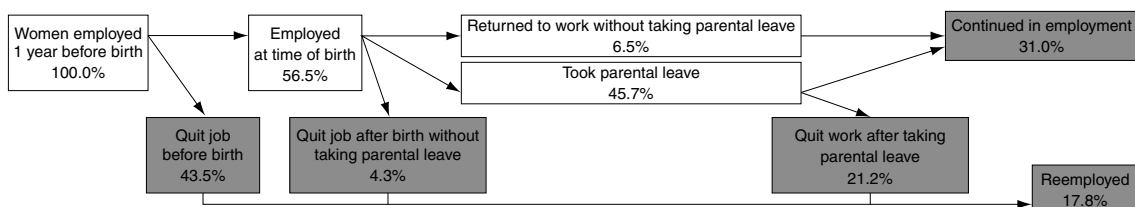
In this chapter, then, we focus on two key points in considering the role of SMEs in creating a society that makes it easier to have and raise children. These are 1) the stabilization of younger people’s employment and

Fig. 3-3-1 Forms of employment of younger people and women, and marital and child status from the perspective of birthrate decline

1) Flowchart for young people



2) Flowchart for women



Source: Compiled by the SME Agency from MIC, *Employment Status Survey (2002)*; Cabinet Office, *Survey of Opinion among Young People (2003)*; MHLW, *Statistics on Employment Changes Before and After Having a Child (2004)*; MHLW, *First and Third Longitudinal Surveys of Children Born in the 21st Century*.

- Notes:
1. “Non-employed” here refers to males who are “not working” excluding persons who are engaged in “housework” and persons “commuting to school or college”.
 2. “Non-permanent employees” here refers to males who are “mainly working” and who are “employed persons” other than “permanent staff and employees.”
 3. “Permanent employees” here refers to males who are “mainly working” and who are “employed persons” that are “permanent staff and employees.”

incomes, and 2) the establishment of conditions that enable people to balance work and parenting.

Let us begin by examining the forms of employment, marriage, and birth statuses of younger people and women using a variety of statistics and questionnaire findings. Looking firstly at the marital and child status of younger people¹⁾ by employment status, we find that, assuming that other social and economic conditions remain entirely unchanged, the proportion of younger persons presently aged 20-24 who will have a spouse and child(ren) when aged 35-39 is projected to be 41.6% among permanent employees,²⁾ 6.2% among non-permanent employees, and 1.4% among the non-employed³⁾ (Fig. 3-3-1 1)). Combining these three categories yields a figure of 49.2%. Thus the proportion of persons who will have a spouse and child(ren) is expected to be less than one in two. Even within the younger population, those who work in unsteady forms of employment and those without work find it financially difficult to marry and have and raise children. And if their numbers increase, the decline in the birthrate may accelerate further.

Next, let us look at pregnancies and births among women in employment. If the total of women employed one year before birth is 100%, then the proportion of women who withdraw from employment before or after birth⁴⁾ is 47.8%, the proportion who withdraw after taking parental leave⁵⁾ is 21.2%, and the proportion who remain in employment after taking parental leave is just 31.0%.⁶⁾ Furthermore, only 17.8% of women who withdraw from employment due to having a child (69.0% of the total) return to employment (Fig. 3-3-1 2)). In Japan, parenting remains largely the responsibility of women, and balancing work with having and raising a

child presents a major challenge for working women. Moreover, while an employer may have established arrangements to assist employees with children, such by providing for parental leave, the extent to which these arrangements can be utilized in practice is quite another matter, and depends on a variety of factors, including the understanding of the proprietor and fellow employees, access to childcare facilities in and around the enterprise, and the cooperation of husbands and relatives. If women's participation in the workforce continues to rise, there are fears that this could drive more people to delay marriage or not get married at all, accelerating the decline of the birthrate, unless employment conditions for women are improved.

The above suggests that the securing of stable jobs and incomes by younger people and continuation in employment while caring for children can effectively counter birthrate decline, and this is probably the kind of society that individual citizens want too. For example, while 5.4% of Japanese males “do not intend ever to marry,”⁷⁾ the lifetime non-marriage rate⁸⁾ is in fact 12.6%. Furthermore, while people want on average 2.56 children, the actual number is just 2.13.⁹⁾ Creating a society that makes it easier to have and raise children is thus important to creating a society that offers a high quality of life and greater opportunity for the self-fulfillment of its individual members.

In this chapter, we analyze the role of SMEs in creating a society that is more amenable to having and raising children by examining the employment of younger people at SMEs in Sections 2 to 4, and shedding light on the present situation and issues surrounding the balancing of work and parenting at SMEs in Sections 5 to 8.

- 1) “Permanent employees” and “non-permanent employees” here include only males who are “mainly working.” “Non-employed” consists of males who are not working, excluding persons who are engaged in “housework” and persons “commuting to school or college.”
- 2) In MIC's *Employment Status Survey*, employees other than corporate executives are divided into six categories according to the title used at their place of work: “permanent staff and employees,” “part-time workers,” “*arubaito* (side-job) workers,” “dispatched workers provided by temporary employment agencies,” “contract and *shokutaku* (short-term contract) workers,” and “other.” In this chapter, basically, regular employees (persons employed for more than one year or under contracts for no fixed term of employment excluding directors) who are called “permanent staff or employees” at their place of work are defined as permanent employees.
- 3) See Appended Notes 3-3-1 to 3-3-3 for details of how these flowcharts were produced.
- 4) Including women who withdraw from employment before birth and those who withdraw immediately after birth (after maternity leave, etc.).
- 5) Including women who withdraw from employment after taking parental leave without returning to the workplace, and women who return to the workplace but withdraw from employment immediately afterward.
- 6) See Appended Note 3-3-4 for details of how this flowchart was produced.
- 7) National Institute of Population and Social Security Research, *12th National Fertility Survey* (2002).
- 8) The “lifetime non-marriage rate” is the average of the non-marriage rates of persons aged 45-49 and 50-54, and expresses the non-marriage rate at the age of 50. The figure in the text was calculated by the National Institute of Population and Social Security Research based on MIC, *Population Census* (2000).
- 9) National Institute of Population and Social Security Research, *12th National Fertility Survey* (2002).

Section 2 Overview of the increasing instability of employment among younger people

Traditionally, young people have been hired mainly by large enterprises fresh out of college, and their career path after joining a company has been based on the Japanese employment practices of lifetime employment and promotion by seniority. In recent years, however, a rise in the number of people who do not find employment immediately after graduating or who leave their jobs soon after being employed has resulted in a deepening employment problem among the young in the form of rising youth unemployment rates and growth in the numbers of “freeters” (which is what job-hopping part-time workers have been dubbed in Japan) and “NEETs,” and a serious look needs to be taken at the use of younger people, including freeters. In this section, we provide a detailed overview of the increasing instability of employment among younger people.

1. State of unemployment and employment among younger people

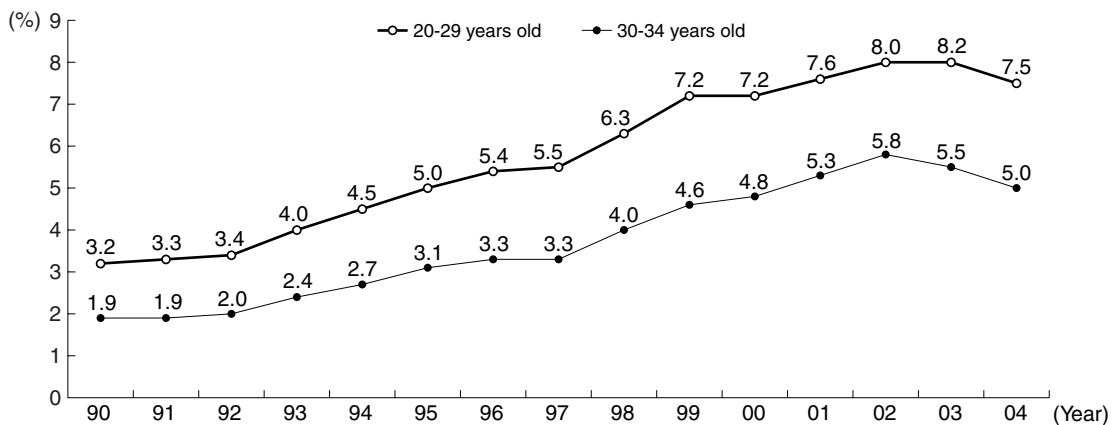
We begin by looking at unemployment among younger people. According to MIC’s *Labor Force Survey*, the official rate of unemployment¹⁰⁾ among both 20-29 year olds and 30-34 year olds has gradually risen

since the 1990s, and had reached 7.5% among the former and 5.0% among the latter in 2004 (Fig. 3-3-2). Although the trend has improved slightly in recent years, the employment situation faced by younger people remains severe.

Next, we examine trends in the number of freeters.¹¹⁾ Between 1996 and 2004, the number more than doubled from approximately 1,000,000 to 2,140,000. Broken down by age, there has been an annual increase in 30-34 year old freeters as well as freeters in their twenties, and the number in the 30-34 year old age group passed the 300,000 mark for the first time in 2003 (Fig. 3-3-4). According to MHLW’s *Survey on Employment Management* (2004), approximately one in two enterprises said that their upper age limit for employing freeters as permanent employees was 29 or less. From the point of view of ensuring stability of employment, therefore, the rising age as well as number of freeters must be regarded as a serious problem.

There has also recently been an increase in younger persons not in employment who have been dubbed “NEETs,” which is an acronym coined in the U.K. from the initials of “Not in Education, Employment or Training.” Although definitions differ somewhat, NEETs

Fig. 3-3-2 Trends in unemployment rates for younger people
Unemployment among younger people remains high



Source: MIC, *Labor Force Survey*.

- Notes:
1. Unemployment rate = unemployed persons / total labor force population, where the total labor force population = employed persons + unemployed persons.
 2. “Persons doing housework,” “persons commuting to school or college,” and “other persons” were excluded from the population parameter on the grounds that they are not members of the labor force.

10) Defined as the proportion of unemployed persons among the labor force population.

11) The term “freeters” has a variety of definitions. The one used here, however, is based on the population of “persons limited to graduates aged 15-34 years old,” in which 1) persons presently in employment are persons called “part-time workers” or “*arubaito* workers” by their employers, 2) persons presently seeking employment (unemployed persons) are persons seeking work as “*arubaito* or part-time workers,” and 3) persons who are not seeking employment, engaged in housework, or commuting to school or college are treated as desiring employment and aspiring to do “part-time or *arubaito*” work. Regarding women, the population was further limited to “unmarried persons” in addition to applying the above conditions 1) to 3) (see Fig. 3-3-3).

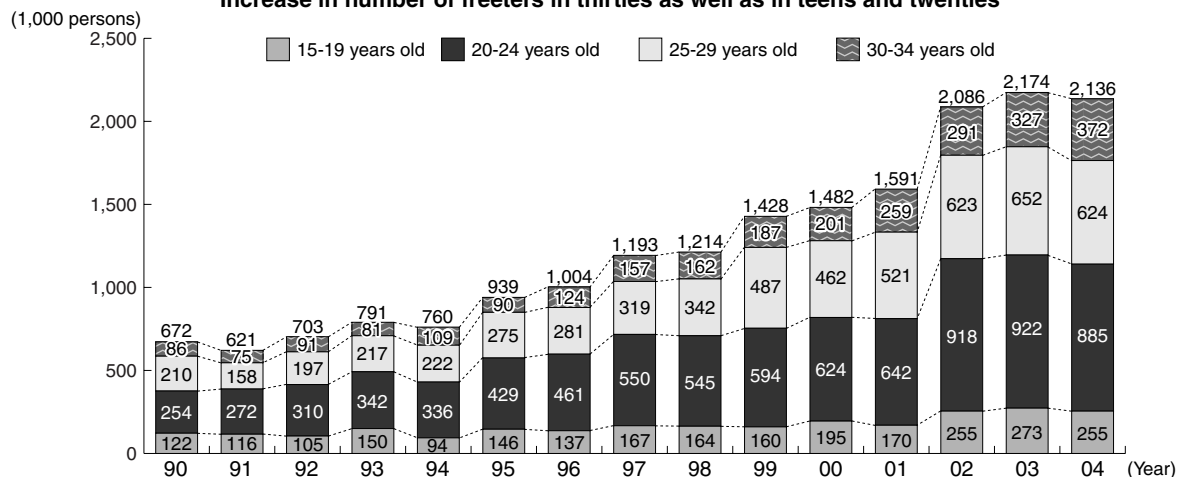
Fig. 3-3-3 Schematic of employment status of younger people

(15-34 years old)		Males		Females		
		(Unmarried/married)		(Unmarried)	(Married)	
Permanent employees		Permanent employees (13,247 thousand)				
Part-time and <i>arubaito</i> workers		Freeters (2,130 thousand)				Housewives (2,774 thousand)
Unemployed and non-workers	Want to be part-time or <i>arubaito</i> workers	Job seekers (913 thousand)				
	Want to be permanent employees	NEETs (640 thousand)				
Non-employed (not seeking employment)		Self-employed and others (2,410 thousand)				
Self-employed and others		Students (7,801 thousand)				
Students						

Source: Compiled by the SME Agency.

- Notes:
- Figures in parentheses indicate the number of persons in each category calculated by recompiling the results of MIC's *Labor Force Survey* (2004). The numbers of "freeters" and "NEETs" are according to the values given in MHLW, *White Paper on the Labour Economy 2004*.
 - "Housewives" consists of married women who are "engaged mainly in housework."
 - "Others" includes workers dispatched by temporary employment agencies, contract workers, and *shokutaku* workers.
 - "Job seekers" and "self-employed and others" exclude married women.
 - As "NEETs" includes people who want to work as part-time or *arubaito* workers despite not taking any concrete steps to find work, this category overlaps in part with freeters.
 - In addition to the categories shown in the above table, there are approximately 370,000 "unmarried women engaged in housework." There are also likely to be unemployed people who want to be self-employed and male "homemakers." Due to the small sample sizes, however, which make statistical accuracy problematic, they were excluded from the above.
 - Because of the above, it must be borne in mind that the above figures differ from the figures given in publicly released data and reports.

Fig. 3-3-4 Trend in number of freeters by age group
Increase in number of freeters in thirties as well as in teens and twenties



Source: Data up to 2001 recomplied from *Special Survey of the Labor Force Survey*. Data from 2002 onward recomplied from *Labor Force Survey (Detailed Tabulation)*.

- Notes:
- The parent population was limited to graduates aged 15-34 years old, and (1) persons designated "part-timers" or "arubaito" at their place of work were treated as persons currently in employment, (2) persons wanting to be arubaito or part-time workers were treated as persons currently seeking employment (unemployed persons), and (3) persons who were not seeking employment, not engaged in housework, and not commuting to school or college were treated as wanting employment and aspiring to do "arubaito or part-time" work. Regarding women, the above three conditions were applied and the parent population was in addition limited to "unmarried persons." Persons in the category (3) are not included in 1990-1995, due to limitations in questions asked.
 - The *Labor Force Survey* (Detailed Tabulation) was used to calculate averages from data for January-December for 2002 onward.
 - Figures for February of each year according to *Special Survey of the Labor Force Survey* were used up to 2001.
 - Due to 1. to 3. above, the definitions and methods of tabulation of freeters differ according to the year. The figures are not therefore contiguous.

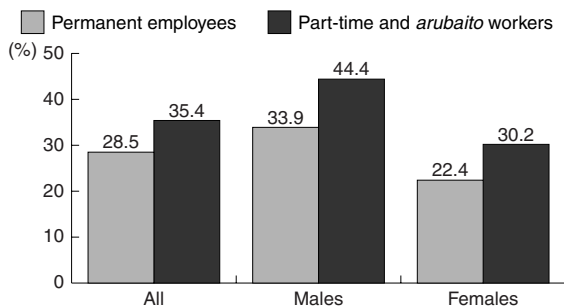
are generally considered to be young people who are not seeking employment and not receiving vocational training, and according to the definition used by MHLW, there were approximately 640,000 NEETs in Japan in 2004.¹²⁾

2. Impact of destabilization of younger people's employment on social structure

(1) Further decline of birthrate

Among younger people with unsteady jobs and income, many are dependent on their parents both financially and for somewhere to live. The marriage rate among these

Fig. 3-3-5 Proportion of persons who do not marry for financial reasons
Higher proportion of part-time and *arubaito* workers do not marry for financial reasons



Source: Cabinet Office, *White Paper on the National Lifestyle 2003*.
Note: Proportion of “permanent employees” and “part-time and *arubaito* workers” who responded “no money to spare (not enough money to get married)” to the question “if you are unmarried, why are you not married?” (multiple responses allowed).

younger people is low, and they also have less money to spare to raise children. According to a survey by the Cabinet Office,¹³⁾ the proportion of younger people who gave “no money to spare” as the reason for not marrying was higher among part-time and *arubaito* (side-job) workers than among permanent employees (Fig. 3-3-5).

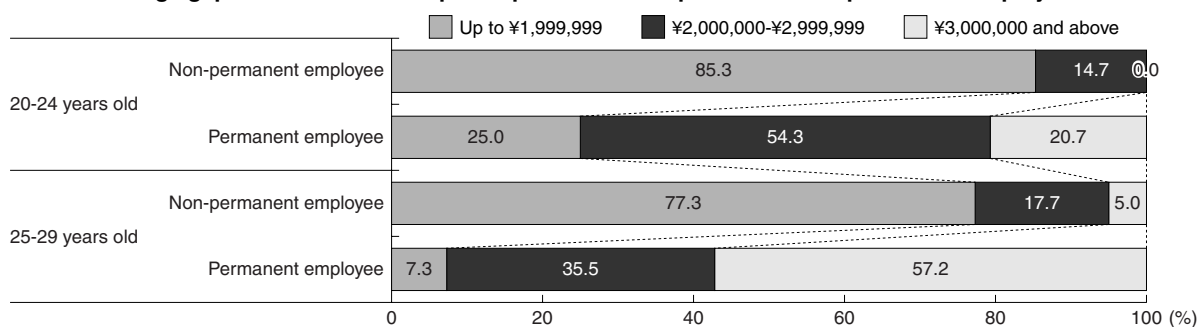
An increase in the number of younger people with financial worries could lead to an increase in the proportion of unmarried persons among the young and so accelerate the decline in the birthrate.¹⁴⁾

(2) Widening income gap due to differences in forms of employment

There is a clear income gap between persons in stable employment and those not so employed. Fig. 3-3-6 shows a comparison of the annual incomes of 20-29 year olds in the two groups. Whereas the proportion of 20-24 year olds with annual incomes of ¥1,990,000 or less is 25.0% among permanent employees, the proportion among non-permanent employees is an overwhelming 85.3%. Moving up to the 25-29 year old age group, a majority (57.2%) of permanent employees have annual incomes of at least ¥3,000,000, whereas the proportion among non-permanent employees is just 5.0%, and 77.3% still have annual incomes of ¥1,990,000 or less. The above would suggest that the gap in incomes according to form of employment widens with age.

Annual income and the crude marriage rate are intimately linked, and the proportion of persons with spouses decreases as annual income declines (Fig. 3-3-7 1)).¹⁵⁾ Accordingly, it is likely that an increase in the number of low-income freeters would spur a rise in the

Fig. 3-3-6 Comparison of annual income of non-permanent and permanent employees
Large gap in annual income opens up between non-permanent and permanent employees



Sources: Nomura Research Institute, Ltd., *Questionnaire of Young Workers* (November 2005), *Questionnaire of Young Arubaito Workers* (November 2005).

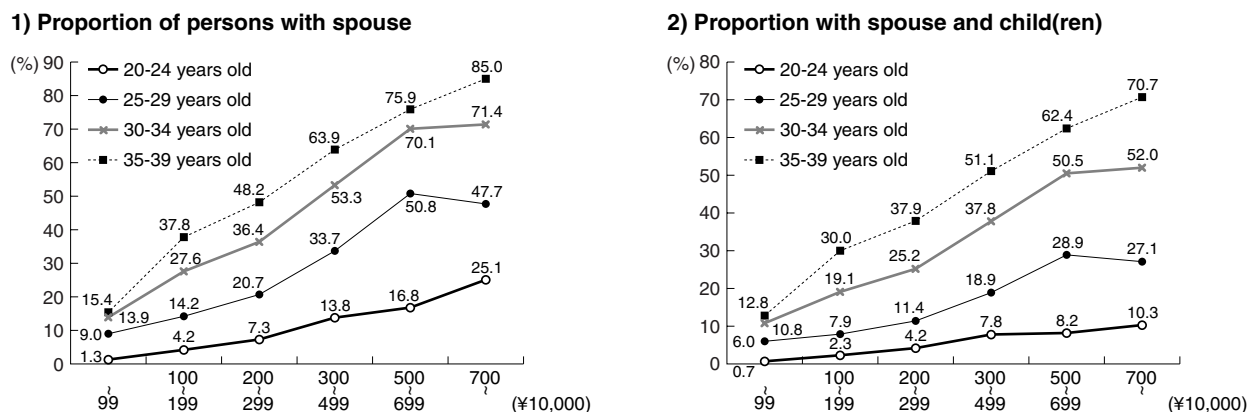
12) The *White Paper on the Labour Economy 2005* employs as a similar concept to NEETs the term “young non-employed persons.” These are defined as persons aged 15-34 in the non-labor force who are not engaged in housework or commuting to school or college. These numbered 640,000 in both 2003 and 2004. Young non-employed persons are defined by four “negatives”: non-employment, non-job seeking, non-commuting to school or college, and non-engagement in housework. (The first two negative attributes define the non-labor force.) Although “young non-employed person” is not strictly speaking a complementary definition to “freeter” in terms, for example, of willingness to work, it may be regarded as being roughly equivalent to the term “NEET” (see Fig. 3-3-3).

13) *White Paper on the National Lifestyle 2003*.

14) In No. 535 of *The Japanese Journal of Labour Studies* (2005), Higuchi and Sakai explain, “Employment experience in early life not only has a major impact on subsequent employment status and income, but it also affects marriage and reproductive behavior, and this effect has grown even greater since the 1990s.”

15) According to the National Institute of Population and Social Security Research’s *Population Statistics of Japan* (2005), the number of children born outside marriage in Japan as a proportion of the total number of births is extraordinarily low, being just 1.9% in 2003, and there is also a close relationship between the proportion of persons with spouses and the proportion of persons with children. The proportions of persons with “spouse and child(ren)” by annual income (Fig. 3-3-7 2)) were tabulated on this basis.

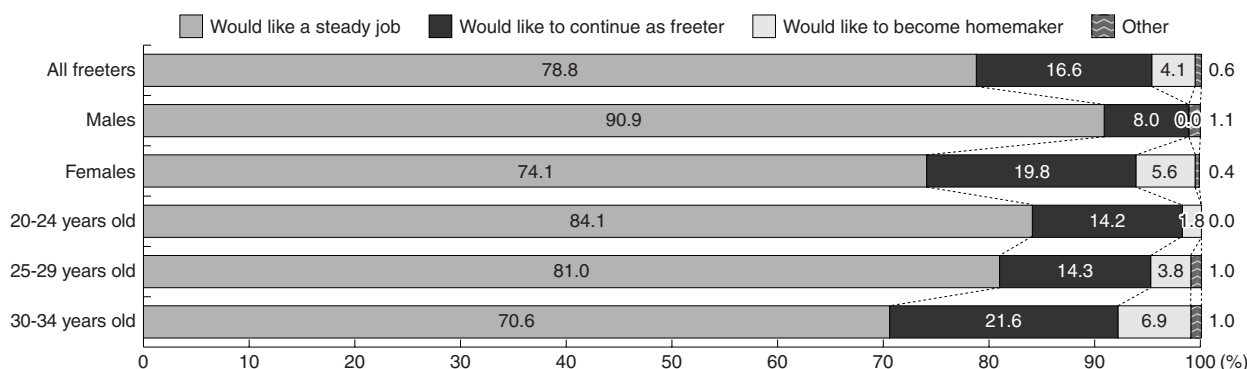
Fig. 3-3-7 Proportion of people with spouses and children by annual income and age
 Proportion with spouse and child(ren) decreases as annual income declines



Source: Recompiled from MIC, *Employment Status Survey* (2002).

- Notes: 1. Totals for persons who “mainly work.”
 2. In Fig. 2), the figures are for persons with a spouse and a household member aged under 15.

Fig. 3-3-8 Career outlook of freeters
 Majority of freeters want a steady job



Source: Cabinet Office, *Survey of Opinion among Young People* (2003).

- Notes: 1. The present forms of employment considered were “part-time or *arubaito* worker” and “dispatched worker.”
 2. “Would like a steady job” consists of those who responded “permanent staff or employee” or “self-employed” to the question “How would you like to be employed?”
 3. “Would like to continue as freeter” consists of those who responded “part-time or *arubaito* worker” to the above question.
 4. “Would like to become homemaker” refers to those who responded “full-time homemaker” to the above question.

non-marriage rate and decline in the birthrate.

3. Background to increasing instability of employment among younger people

(1) Changes in employment awareness of new graduates

One of the factors behind the increasing instability of employment of younger people is the rise in the number of younger people who take no action to find employment (“NEETs”).

These NEETs consist of a mixture of people who have no intention of finding employment in the first place, and people who are interesting in finding employment but have taken no concrete steps toward finding a job (thus although not unemployed or freeters, they are similar), as a consequence of which some have

noted that they cannot be considered to comprise a uniform group. Regarding at least those with no interest in working, however, there appear to be limits to how far the problem can be solved by SMEs acting as sources of employment.

Those interesting in working, however, can probably be dealt with by roughly the same methods as for freeters.

(2) Difficulty of making the transition from non-permanent to permanent employee

A second factor is the rise in number of persons in unstable forms of employment. Freeters, who consist mainly of part-time and *arubaito* workers, are a prime example of this. If we examine the views of persons who are presently freeters, however, we discover that the proportion who responded that they “would like a steady

job” is 84.1% among 20-24 year olds, 81.0% among 25-29 year olds, and 70.6% among 30-34 year olds. And if we narrow our focus to men only, we find that 90.9% “would like a steady job,” and only 8.0% “would like to continue as freeter” (Fig. 3-3-8). Regarding moreover what form of steady employment they would like, 73.6% of younger people expressed a desire to work as a “permanent employee of company, etc.” (Fig. 3-3-9), indicating that people who are presently freeters would prefer to work as permanent employees rather than continuing as freeters.

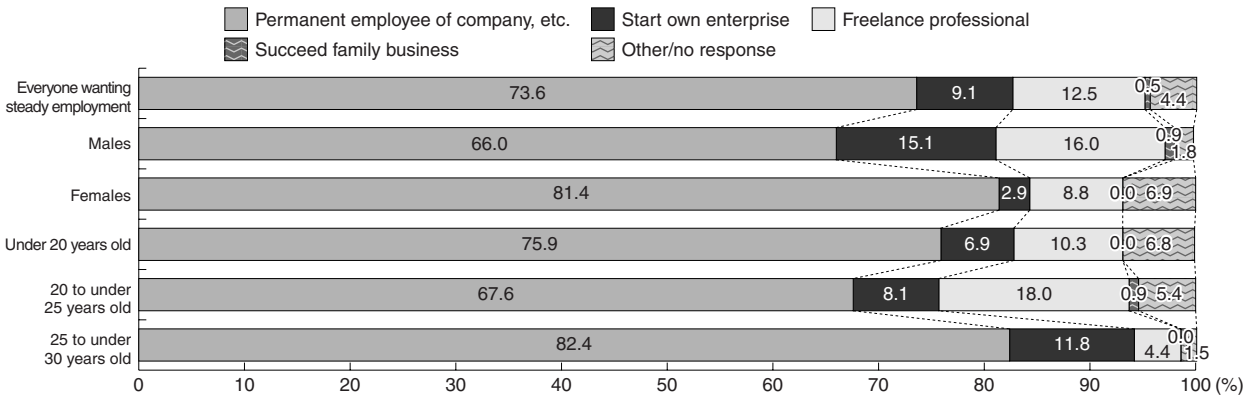
However, more than one in two people who became freeters straight out of school/university are still freeters, indicating that there are obstacles to making the transition from freeter to permanent employee (Fig. 3-3-10).

(3) Increasing movement from permanent to non-permanent employment

Underlying the rise in number of freeters in unstable employment, and especially older freeters, is not only the number of people who become and remain freeters right from graduation, but also the growing number of freeters who were once permanent employees. If we look at experiences before becoming a freeter, we find that more than one in three freeters was once employed as a permanent employee (Fig. 3-3-11).

While it is not necessarily a bad thing to work as a freeter in one’s youth, the small number of younger people who want to be freeters of their own volition suggests that it is crucial that action be taken both to prevent fresh graduates and younger people presently

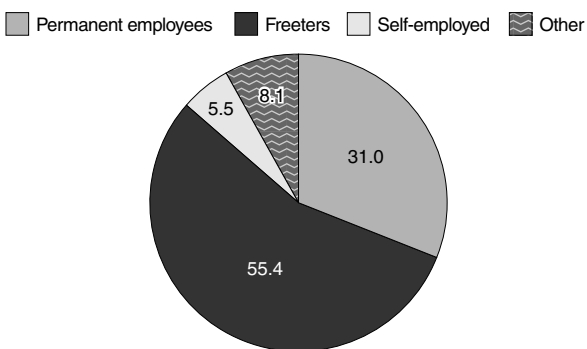
Fig. 3-3-9 Desired form of steady employment
Freeters would like to work as permanent employees



Source: Works Institute, Recruit Co., Ltd., *Survey of Employment, etc. of Arubaito* (2000).

Fig. 3-3-10 Present forms of employment of people who were freeters at time of graduation

Over half of people who are freeters when they graduate remain freeters

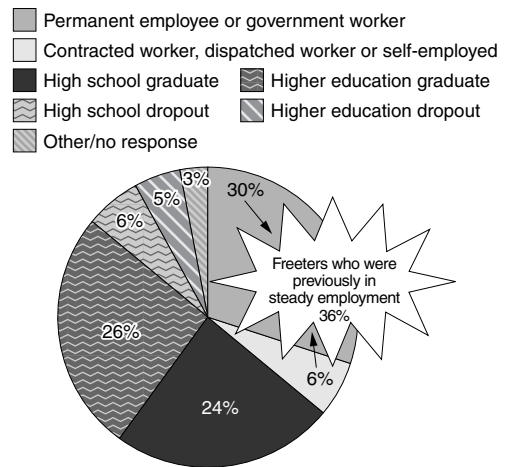


Source: Cabinet Office, *Survey of Opinion among Young People* (2003).

- Notes:
1. Only respondents who answered “part-time or arubaito worker,” “dispatched worker” or “non-employed” to the question “Which best describes how you were employed immediately after leaving school?” are included above.
 2. The age profile of the above at the time of the survey consisted of 38.3% 20-24 year olds, 38.3% 25-29 year olds, and 23.5% 30-34 year olds.

Fig. 3-3-11 Experience before becoming freeters

Over one in three people who become freeters had previously been employed as permanent employees



Source: The Japan Institute of Labour, *Survey of Work Styles of Younger People* (2001).

working as permanent employees from becoming freeters against their will, and, should they become

freeters, to prevent this situation from continuing indefinitely into the future.

Section 3 Hiring and appointment of younger workers by SMEs

There are currently more than two million freeters, roughly double what there were 10 years ago. The increasing instability of younger people’s employment and incomes due to the rise in number of freeters has a serious negative impact both on society and on the young as individuals as well. It is therefore imperative that this trend be curbed. In this section, we examine the reasons behind the increase in number of freeters from the point of view of freeters’ views on employment and enterprises’ views on freeters, and explore solutions that will enable the number of freeters to be reduced.

1. Recruitment of younger workers by SMEs and image of freeters

That SMEs find it harder to recruit younger workers as permanent employees than they would like was touched upon in the last part of the preceding chapter (Part III, Chapter 2). Let us, however, take another look at the situation vis-à-vis employment of younger workers by SMEs. According to *A Survey of Employment of Young Workers* (November 2005)¹⁶⁾ by the Nomura Research Institute, 26.0% of enterprises responded regarding the hiring of fresh graduates as permanent employees that they found it “easy,” while the proportion that found it “difficult” was 38.3%. Regarding hiring of mid-career workers, 21.3% said that they found it “easy” and 44.5% said that they found it “difficult” (Fig. 3-3-12).

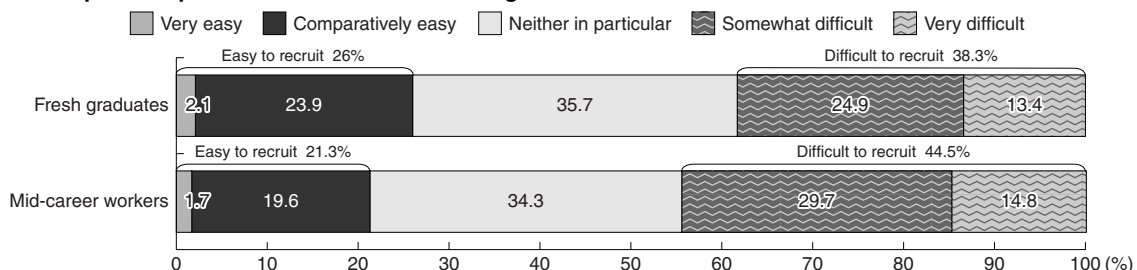
Regarding the specific problems encountered by SMEs in employing younger people, many enterprises

cite “lack of human resources sought and few applicants with necessary abilities” and “few applicants even if position is advertised” (Fig. 3-3-13). If they are to be able to hire enough younger people as permanent employees, then, SMEs will have to broaden their net to include freeters as well as fresh graduates.

For SMEs struggling to hire fresh graduates, the growth in number of freeters may also be regarded as providing wider opportunities to hire younger workers. Asked what size of enterprise they would like to work at as permanent employees, a majority of freeters responded that they had no preference between large enterprises and SMEs, indicating that as long as they can work as permanent employees, freeters are not particularly concerned about enterprise size (Fig. 3-3-14).

However, freeters tend to have a more negative image than fresh graduates, and more than a few enterprises are consequently hesitant about employing them. Asked how they viewed freeters when hiring younger workers, almost one in three enterprises responded that they had a “negative assessment” (Fig. 3-3-15).

Fig. 3-3-12 Hiring of younger people as permanent employees
 More enterprises report recruitment of both fresh graduates and mid-career workers to be “difficult” than “easy”

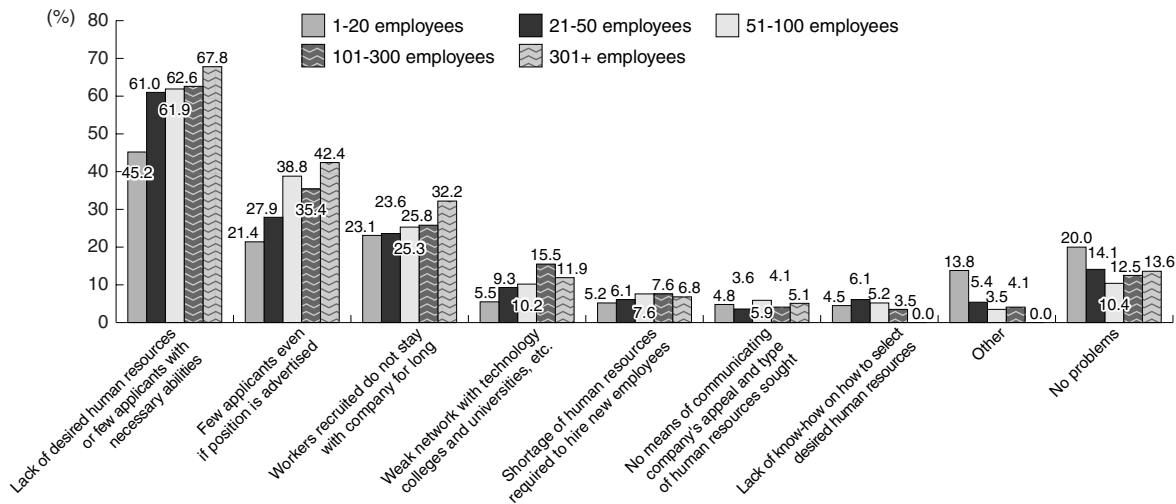


Source: Nomura Research Institute, Ltd., *A Survey of Employment of Young Workers* (November 2005).

- Notes:
1. “Younger people” here means 16-34 year olds.
 2. “Mid-career workers” here means hires who are regarded as having skills and knowledge of immediate use to their employers.
 3. Enterprises that responded that they did not recruit either fresh graduates or mid-career workers are excluded.

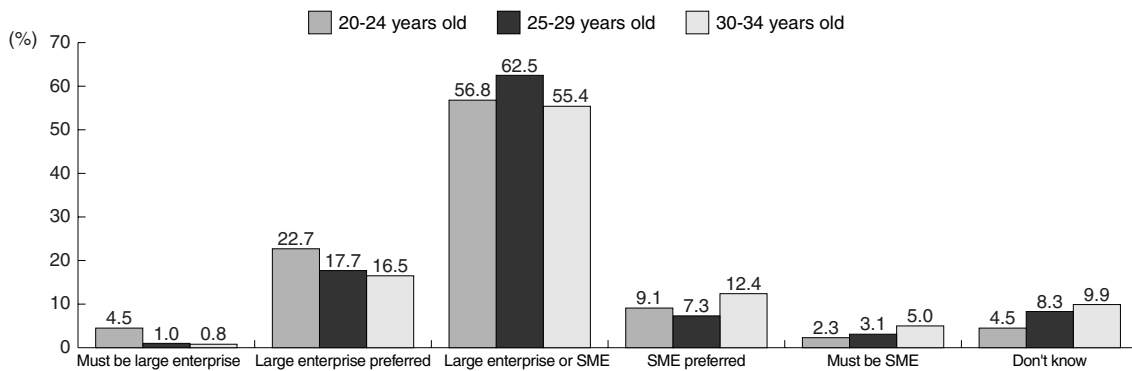
16) A questionnaire survey of 10,000 SMEs as defined according to the Small and Medium Enterprise Basic Law. The response rate was 17.8%.

Fig. 3-3-13 Obstacles to recruitment of younger people as permanent employees
Main obstacles to recruitment of younger people as permanent employees are lack of human resources sought and few applicants with necessary abilities



Source: Nomura Research Institute, Ltd., *A Survey of Employment of Young Workers* (November 2005).
 Note: Totals exceed 100 due to multiple responses.

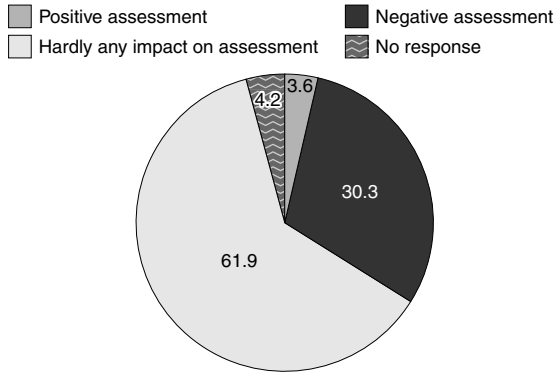
Fig. 3-3-14 Desired size of source of employment as permanent employee
Freeters do not mind what size their employer is provided that they can be employed as permanent employees



Source: Nomura Research Institute, Ltd., *Survey of Younger Arubaito Workers* (November 2005).

Fig. 3-3-15 View of former freeters when recruiting younger workers

Approximately 30% of enterprises view freeters negatively when recruiting, and hardly any regard them in a positive light



Source: MHLW, *Survey on Employment Management* (2004).

2. Enterprises' satisfaction with younger workers

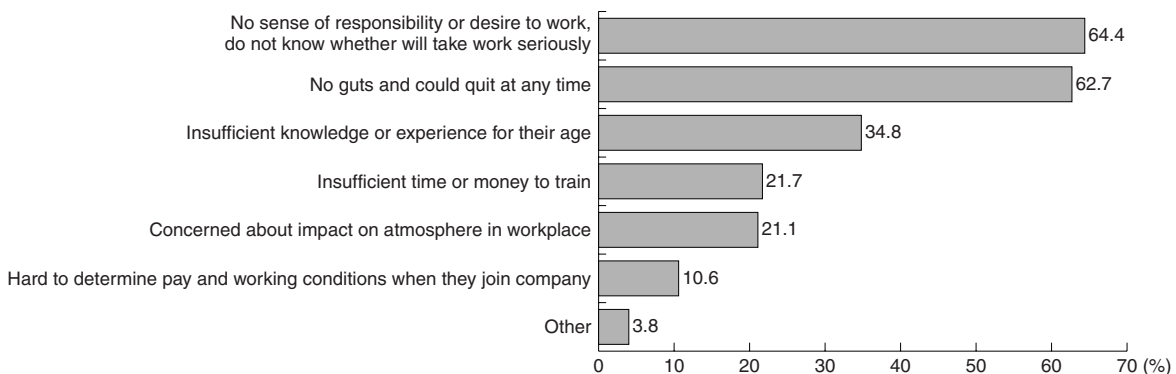
Is there then any difference in SMEs' satisfaction with workers between former freeters and fresh graduates after their hiring as permanent employees? Regarding firstly enterprises that considered an applicant's having been a freeter in a negative light, let us verify what image they had of freeters at the time of hiring. According to Fig. 3-3-16, the main concerns

regard freeters' approach to their work, with 64.4% responding "no sense of responsibility or desire to work, do not know whether will take work seriously" and 62.7% responding "no guts and could quit at any time." The next commonest concerns are "insufficient knowledge or experience for their age" (34.8%) and "insufficient time or money to train" (21.7%), which are career related.

Regarding the top reasons given for assessing freeters negatively at the time of hiring, enterprises that actually hired freeters as permanent employees were asked about their satisfaction with permanent employees hired (Fig. 3-3-17). The results show that a majority of enterprises are satisfied with those items that are the main reason for avoiding freeters, namely "approach to work" and "motivation and sense of responsibility." Regarding other items as well, only around one in four enterprises was "not very satisfied" or "completely dissatisfied." In comparison with fresh graduates as well, 70-80% of enterprises of all sizes said that there was "no perceptible difference" between the two (Fig. 3-3-18).¹⁷⁾ To sum up, it appears unreasonable to regard freeters in a negative light simply on the grounds of their being freeters.

Although enterprises generally tend to steer clear of freeters, those enterprises that have actually hired freeters as permanent employees report that the difference between fresh graduates and freeters is less than had been expected when they were initially hired, and there is little difference in satisfaction between the two. When hiring younger people, SMEs need to assess them fairly without distinguishing between freeters and fresh graduates.

Fig. 3-3-16 Reasons given by SMEs for not hiring freeters
Top reasons dominated by concerns regarding approach to work

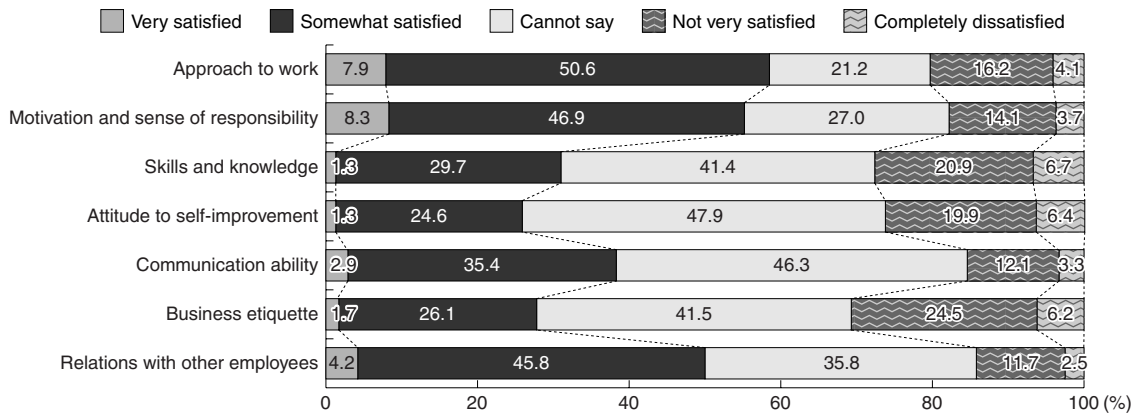


Source: SME Agency, *Fact-Finding Survey of Use of Human Resources and the Parenting Environment at Small and Medium Enterprises* (December 2005).

Note: Totals exceed 100 due to multiple responses.

17) Fig. 3-3-18 shows a comparison of overall assessments. For comparison of individual items, see Appended Note 3-3-5.

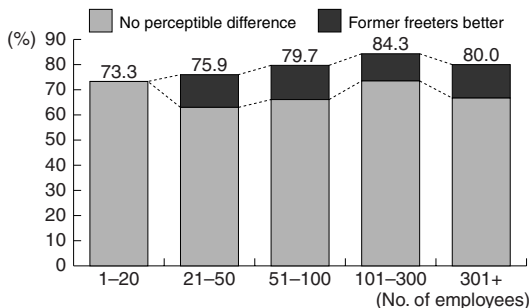
Fig. 3-3-17 Satisfaction with young freeters hired as permanent employees
Majority of enterprises are satisfied with attitude to work of young freeters



Source: Nomura Research Institute, Ltd., *A Survey of Employment of Younger Workers* (November 2005).
 Note: Only the responses of enterprises that hired freeters as permanent employees are included.

Fig. 3-3-18 Perception of difference between employment of freeters and fresh graduates as permanent employees

70-80% of enterprises of all sizes report no difference between former freeters and fresh graduates



Source: Nomura Research Institute, Ltd., *A Survey of Employment of Young Workers* (November 2005).

- Notes:
1. Only enterprises that hired freeters as permanent employees are included.
 2. Proportion of enterprises that responded "freeters are much better," "freeters are somewhat better," and "no perceptible difference" to the question "Do you sense a difference between freeters and fresh graduates hired as permanent employees?" Other options were "fresh graduates are somewhat better" and "fresh graduates are much better."
 3. The combined total of enterprises that responded "freeters are much better" or "freeters are somewhat better" is shown as "former freeters are better."

3. Appointment of own *arubaito* workers as permanent employees

Hiring from outside the enterprise is not the only way of taking on freeters as permanent employees. Another option is to promote *arubaito* already working at a company to permanent status. Below, then, we consider the appointment of *arubaito* workers from inside the company as permanent employees.

First we examine the environment for appointment of permanent employees. According to Fig. 3-3-19, 46.0% of enterprises with 300 or less employees have appointed their own *arubaito* workers as permanent employees, and the proportion of enterprises with appointment systems is 44.8%. Appointment from among company's own *arubaito* workers thus does not appear to be unusual, and has become one effective route by which freeters can become permanent employees.

However, in order for a young person working at an enterprise on an *arubaito* basis to be hired by that enterprise as a permanent employee, he or she must of course be judged within the enterprise to meet certain standards. And it is easier for an enterprise to judge whether to employ someone as a permanent employee if, rather than giving *arubaito* workers and permanent employees completely different tasks to do, work is shared to an extent between the two. Fig. 3-3-20 is a graph depicting whether enterprises have employed part-time and *arubaito* workers as permanent employees, and the state to which work is shared between permanent employees and part-time and *arubaito* workers. From this, it can be seen that enterprises that have employed them as permanent employees are more likely to share work between permanent employees and part-time and *arubaito* workers than enterprises that have not.¹⁸⁾

18) In 2005 *White Paper on Small and Medium Enterprises in Japan*, there was found to be little difference in duties and responsibilities between part-time workers and permanent employees at smaller enterprises.

Case 3-3-1

Enterprise actively recruits young people with no experience as permanent employees

Sampo Co., Ltd. is a software developer based in Taito Ward, Tokyo and has a workforce of 100 employees. Established in 1981, it develops administrative support systems for businesses engaged in various fields, including the financial and medical sectors.

Sampo recruits widely to obtain mainly technicians, and actively recruits older, semi-retired people, foreign workers, as well as young people. With respect to this latter category, it makes an effort to recruit both fresh graduates and those already employed. Among the currently employed, it takes on those who have never been permanent employees, recruiting two to three annually.

Recruitment criteria for these young people with no permanent employee experience include "arubaito experience in the same field" and "self-study leading to corresponding knowledge." The most important criterion, however, is "enthusiasm for work." This is because if the person is enthusiastic about working, it is possible to bring them up to speed in technology and know-how through training once they have joined the

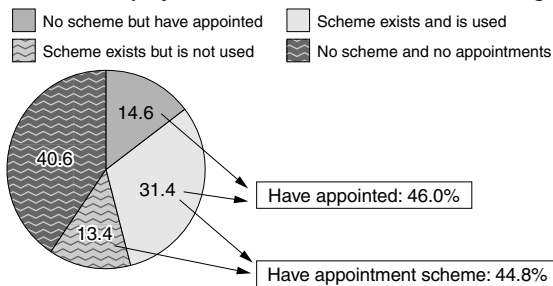
company.

The company not only recruits freeters as permanent employees, but in some cases also employs them on an *arubaito* basis, later promoting them to permanent employee status after a certain period of time. In either case, the company adopts a flexible attitude that also takes into account the employee's wishes.

Remuneration for newly employed freeters as permanent employees is determined immediately after they join the company taking into account a number of factors, including work experience in the same field and whether or not they possess qualifications. Once they have been in the company for two to three years, they are evaluated in the same way as fresh graduates and others with previous work experience. The work of these ex-freeters is by no means inferior to that of fresh graduates, and some have even become key personnel. In this way, through its wide-ranging recruitment activities, the company is able to recruit competent staff, including young people with no previous permanent employee experience.

Fig. 3-3-19 Appointment of own *arubaito* workers as permanent employees

46.0% of enterprises have appointed *arubaito* workers as permanent employees, and 44.8% have schemes for doing so



Source: Nomura Research Institute, Ltd., *Survey of Younger Arubaito Workers* (November 2005).

Note: Enterprises with up to 300 employees.

What is the situation like regarding the sharing of work between permanent employees and part-time and *arubaito* workers at SMEs? According to the SME Agency's *Survey of Use of Human Resources* (December 2004), the proportion of part-time and *arubaito* workers doing work on a par with permanent employees increases as size decreases (Fig. 3-3-21). Putting all this evidence together, conditions at smaller enterprises appear more conducive to employing *arubaito* workers as permanent employees in terms of ease of assessment.

Considering next the determining factors in appointing an *arubaito* worker from within a company as a permanent employee, the commonest factor, regardless of size, is "motivation." Regarding determinants that do differ according to size, a greater emphasis is placed on "ability" and "results" at enterprises with more employees, which is perhaps due to the fact that larger

Fig. 3-3-20 Appointment as permanent employees and assignment of work tasks
High proportion of enterprises that have appointed part-time and *arubaito* workers as permanent employees share work tasks between permanent employees and part-timers/*arubaito*

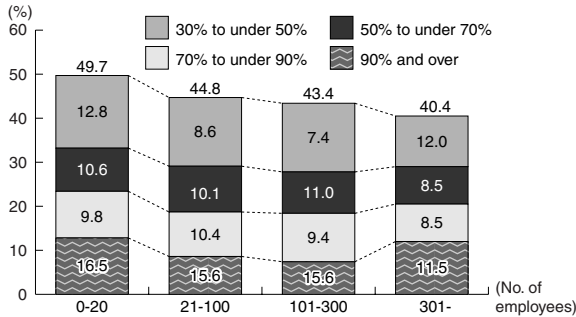


Source: SME Agency, *Fact-Finding Survey of Use of Human Resources and the Parenting Environment at Small and Medium Enterprises* (December 2005).

Note: Enterprises that have hired graduates aged less than 35 as part-time or *arubaito* workers in the past three years.

Fig. 3-3-21 Proportion of part-time/*arubaito* workers doing work of same level as permanent employees

Proportion of part-time/*arubaito* workers doing work of same level as permanent employees increases at smaller enterprises

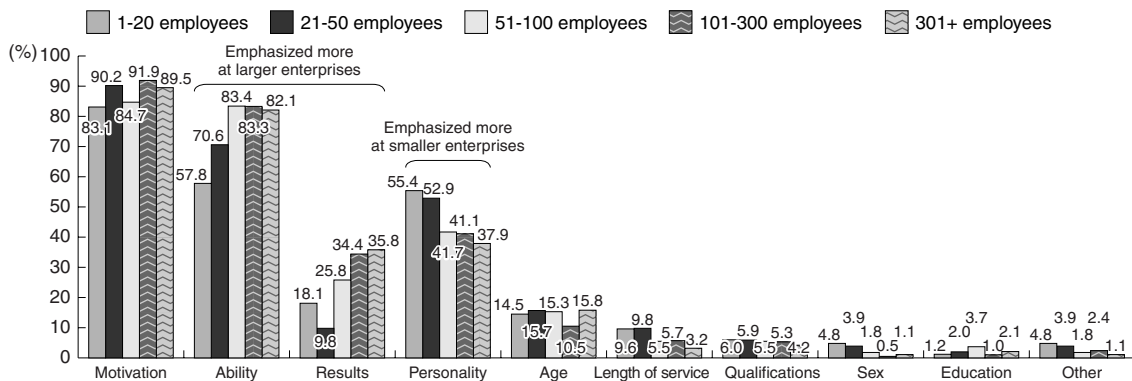


Source: SME Agency, *Survey of Use of Human Resources* (December 2004).

enterprises are able to make comparisons between *arubaito* workers themselves and so take a more merit-based approach to their appointment as permanent employees. On the other hand, the proportion of enterprises responding “personality” increases at enterprises with fewer employees, demonstrating the greater stress placed on judging people by their personal character that is possible only at smaller enterprises with a decidedly more familistic management style (Fig. 3-3-22). As the appointment of a worker from within the company depends on an assessment of that person as a worker already employed by the company, employers are able to an extent to ascertain how well they work, their contribution to the enterprise, character, and so on, making it comparatively easier to obtain detailed and accurate information compared with hiring someone from outside the company.

Fig. 3-3-22 Factors emphasized when appointing part-time/*arubaito* workers as permanent employees

Enterprises of all sizes emphasize “motivation,” but larger enterprises tend to emphasize actual ability while smaller enterprises go more for personality



Source: SME Agency, *Fact-Finding Survey of Use of Human Resources and the Parenting Environment at Small and Medium Enterprises* (December 2005).

- Notes: 1. Totals exceed 100 due to multiple responses.
- 2. Responses of enterprises that said that they had appointed younger people initially hired as part-time or *arubaito* workers as permanent employees.

Case 3-3-2

Company appoints *arubaito* workers to permanent positions

Company K is based in Suginami Ward, Tokyo, and has a workforce of 148 and capital of ¥40 million. Established in 1951, it is a medium-sized precision machinery manufacturer engaged in the design, manufacture and sale of measurement equipment for mainly railroad construction and maintenance purposes.

When recruiting young employees, it recruits fresh graduates, taking on two to three university science graduates annually, as well as hiring people mid-career. The company opens its doors to young people, hiring some mid-career as permanent employees, including people who have had once been just casual “freeters.”

Around half of these ex-freeters are given permanent positions after having worked as *arubaito* for the company. The company does not have a clear-cut system for appointing *arubaito* workers to permanent positions. However, in the case of these workers with *arubaito* work experience, the company already has an understanding of how the person shapes up with regard to criteria considered important when recruiting permanent employees,

including their 1) character; 2) enthusiasm for work; 3) communication skills; and 4) technical capabilities. Consequently, the company has the advantage of being able to determine relatively easily whether the person is suited to be a permanent employee.

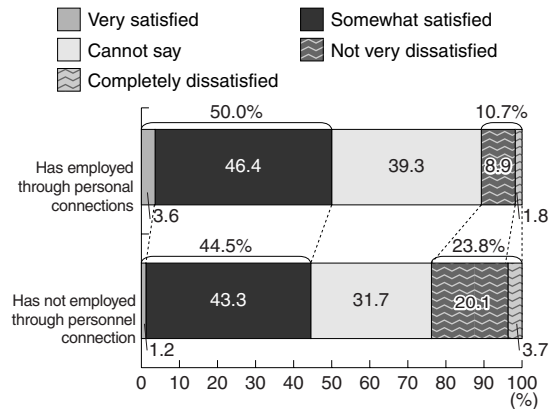
The process of appointing an *arubaito* worker to a permanent position basically respects the wishes of the worker. When an *arubaito* worker signals that he or she would like to be employed on a permanent basis, the first step is for the head of the worker's department to determine suitability for appointment on the grounds of character and work attitude. If the worker is deemed suitable, a recommendation from the department head is sent to the company president, and after two interviews have taken place, the decision is made whether or not to take on the worker on a permanent basis.

It appears that permanent employees who started out as *arubaito* workers are no different at all from other permanent employees in terms of work enthusiasm, technical skills and the like, and make an active contribution to the company.

Column 3-3-1 Satisfaction with job-hopping part-timers employed through personal connections

According to a *Survey on Employment Management* (2004) by the Ministry of Health, Labour and Welfare, of the companies that had taken on as regular employees people previously characterized as job-hopping part-timers (known as "freeters"), about 15% gave "personal connections" as a reason. A high percentage of SMEs are family enterprises, and proprietors can have a lot of discretion in deciding policies. This may have something to do with there being a lot "personal connection" hiring in SMEs. And while the image of employment based on personal connections is generally not good, how satisfied are the hiring companies in fact with such employees? Among SMEs that have hired freeters, satisfaction with those where the hiring was connection-based is higher than at companies where such hiring was not based on connections. For the company, the advantage is a clearer sense of the "identity" of the employee in advance, while the employee, similarly, knows much more about the company before joining it. In this sense, there is no need to think of "connections hiring" as wholly negative. Rather, for an SME, it can be an effective recruiting route.

Satisfaction with regular employees who used to be freeters



Source: Nomura Research Institute, Ltd., *A Survey of Employment of Young Workers* (November 2005).
 Note: Only enterprises that hired freeters as permanent employees are included.

Based on the above analysis, the three main points to be drawn regarding hiring and appointment of younger workers as permanent employees are as follows.

- 1) Freeters would like to work as permanent employees, but find it difficult to become permanent employees due to the negative image held of them by enterprises.
- 2) In actuality, the difference between permanent employees who were hired straight out of college or school and permanent employees who were formerly

- freeters is not as great as enterprises had imagined prior to hiring. When SMEs hire younger people, it is important that they assess their motivation and abilities fairly without being prejudiced against them simply on account of their being "freeters."
- 3) Appointment from being an *arubaito* worker at a company is one effective route by which freeters can become permanent employees. Appointments are made on more of a merit basis at larger enterprises, and based more on personal character at smaller enterprises.

Section 4 Retention of younger workers at SMEs

As was explained in the preceding sections, many freeters would prefer to work as permanent employees, and SMEs should consider the use of freeters as one means of acquiring high-caliber younger workers. At the same time, in order to stabilize the employment of young people, it is important to consider how to retain younger workers so that young people presently working as permanent employees do not become freeters.

In this section, we demonstrate what measures need to be taken in order to ensure that the younger workers hired by SMEs are retained and make a valuable contribution to the workforce. We also seek to identify what positive effects the actions taken by enterprises to

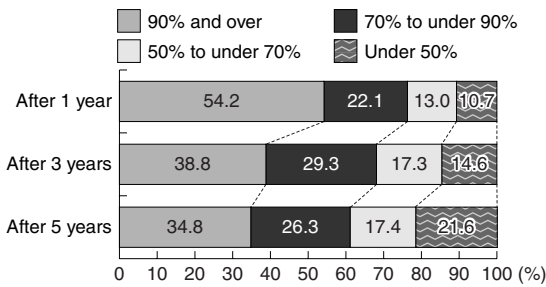
retain younger workers have on enterprises themselves.

1. State of retention and loss of younger workers

We begin by looking at the state of retention of younger workers (permanent employees) at SMEs. According to Fig. 3-3-23, the proportion of enterprises with a retention rate of at least 90% is 54.2% one year after joining the company. However, this figure plummets to 38.8% three years later and to 34.8% after five years. Furthermore, while the proportion of enterprises with a retention rate of less than 50% is

Fig. 3-3-23 Retention rate of younger workers (permanent employees) at SMEs

Many younger people quit within five years of joining SMEs



Source: Nomura Research Institute, Ltd., *A Survey of Employment of Young Workers* (November 2005).
 Note: The retention rate of younger workers is here defined as the retention rate of 16-34 year olds hired as permanent employees.

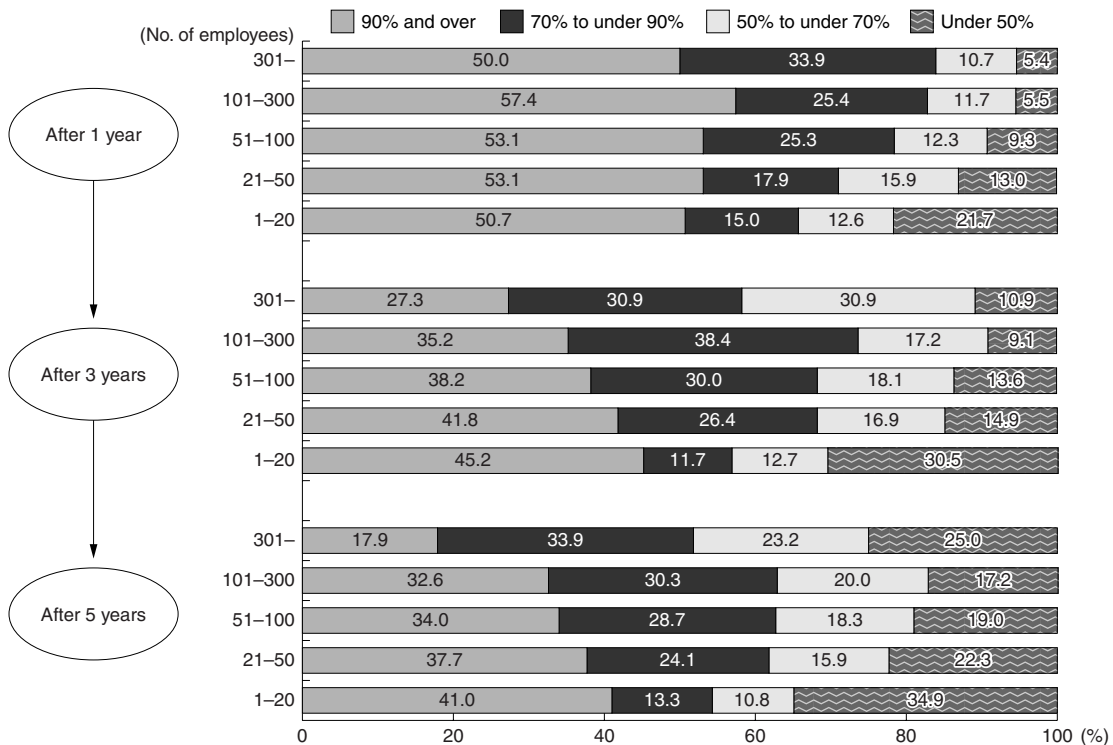
10.7% after one year, the proportion roughly doubles to 21.6% after five years. From this, it may be concluded that quite a lot of younger permanent employees quit within five years of joining a company.

Breaking down the retention rate by number of employees additionally reveals that whereas the proportion of enterprises with a retention rate of at least 90% is higher among smaller enterprises after three

years and after five years, the proportion responding that the retention rate was below 50% also increases as size decreases. In other words, the smaller an enterprise is, the more polarized the situation becomes regarding retention of younger workers (Fig. 3-3-24).

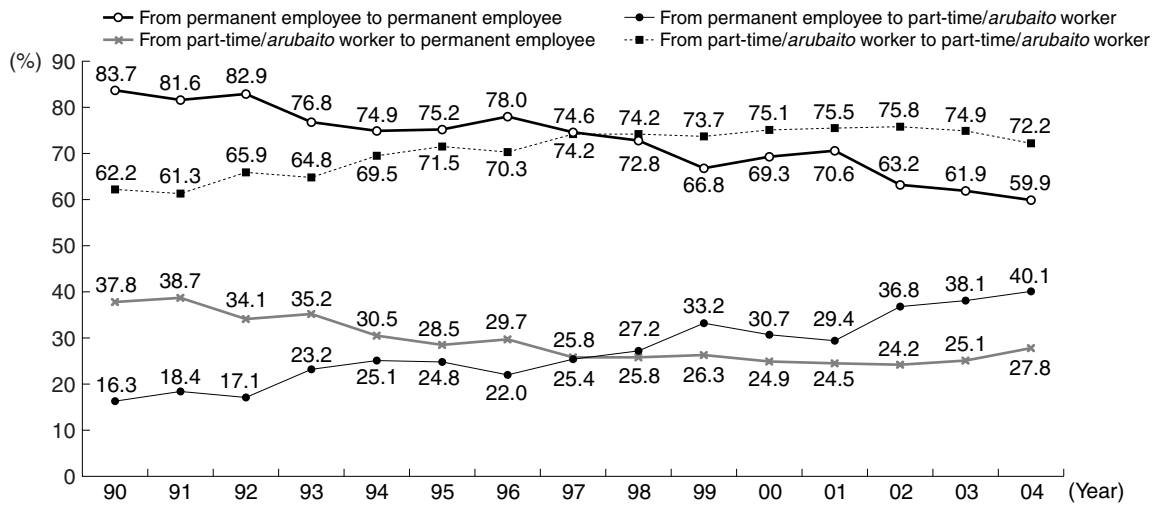
So what form of employment do younger workers who leave an enterprise take at their new places of employment? According to MIC's *Labor Force Survey*, the proportion of persons who changed their form of employment "from permanent employee to part-time or *arubaito* worker" is increasing. On the other hand, the proportion of workers changing jobs who go "from permanent employee to permanent employee" is gradually declining. In other words, there is an increased probability that if a worker working as a permanent employee leaves his or her job, he or she will be employed as a part-time or *arubaito* worker at his or her new place of employment. In addition, although there has been an improvement of late in the proportion of workers going from "part-time or *arubaito* worker to permanent employee," the decline since the 1990s means that it is more difficult for people to return to permanent employment having once become freeters (Fig. 3-3-25). In order to help stabilize the employment of younger people, efforts need to be made by enterprises to avoid employees leaving their jobs.

Fig. 3-3-24 Retention rate of younger workers (permanent employees) by size of enterprise
 Situation becomes polarized as size decreases



Source: Nomura Research Institute, Ltd., *A Survey of Employment of Young Workers* (November 2005).
 Note: The retention rate of younger workers is here defined as the retention rate of 16-34 year olds hired as permanent employees.

Fig. 3-3-25 Change in form of employment before and after changing job
Increasing proportion of young people switching from being permanent employees to part-time/arubaito workers



Source: Recompiled from Cabinet Office, *White Paper on the National Lifestyle 2003* up to 2001, and from MIC, *Labor Force Survey (Detailed Tabulation)* from 2002 onward.

Notes: 1. Persons aged 15-34 who had changed jobs and had been employed in their present jobs for not more than one year.
 2. Figures for February of each year according to the *Special Survey of the Labor Force Survey* up to 2001, and averages obtained from data for February and August according to the *Labor Force Survey (Detailed Tabulation)* for 2002 onward.

2. Information gap between SMEs and younger people

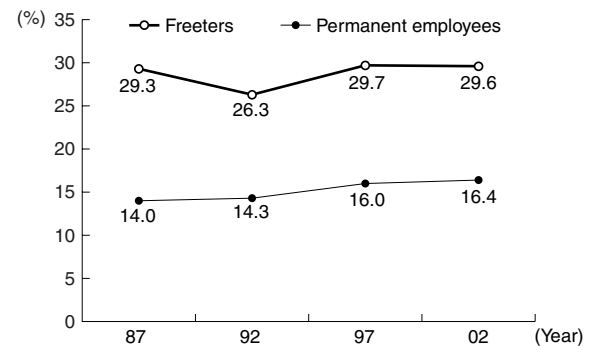
A reason typically given for younger workers not remaining at enterprises is changing attitudes on the part of younger people, but is this really the case? The proportion of younger workers wanting to change jobs is not actually particularly high among either permanent employees or freeters (Fig. 3-3-26). What has made the loss of younger workers a problem despite this appears to be the increase in younger workers becoming freeters and NEETs due to their not matching the enterprise that they joined, and one of the reasons for this is the gap between expectations before joining a company and the reality after joining a company concerning the working environment.

So in what sort of areas do such gaps between expectations and reality before and after joining a company arise? To answer this question, a survey was made of both SMEs and younger employees regarding nine items, including “management philosophy and policy” and “business performance and potential.”

Fig. 3-3-27 is a table showing the factors that SMEs focused on explaining at the time of recruitment and the items that younger workers reported did not turn out as expected after joining a company.¹⁹⁾ According to this, a high proportion of SMEs focus on explaining their “line of business” and “duties after hiring,” and a high proportion of younger workers, too, report that these factors turn out “better than imagined” or “as imagined.”

Fig. 3-3-26 Changes in proportion of younger workers wanting to change jobs

The proportion wanting to change jobs is not particularly high among either permanent employees or freeters



Source: Recompiled from MIC, *Employment Status Survey*.

Note: Proportion of respondents aged 15-34 who were normally engaged in gainful employment and wanted to change job.

Conversely, a low proportion of enterprises focus on explaining “policy on training after recruitment,” and a low proportion of younger workers, too, report that these factors turn out “better than imagined” or “as imagined.” In other words, whereas the kind of work involved turns out largely as expected due to enterprises having explained this subject sufficiently at the time of hiring, younger workers find that the reality of how they will grow and develop after hiring does not match up to expectations due to SMEs’ failure to explain this subject in sufficient detail to job applicants.

19) See Appended Note 3-3-6 for details of items explained in depth by SMEs at the time of recruitment, and Appended Note 3-3-7 for details of factors that younger workers find do not match up to the expectations held before joining a company.

Fig. 3-3-27 Comparison of factors emphasized at time of recruitment and gap between expectations and reality after joining company

Employers do not explain their “post-hiring training policy” well enough, leading to large gap between expectations and reality after joining a company

SME side Factors explained in detail at time of recruitment (higher rank indicates more thorough explanation)		Younger person side Factors that turned out as imagined after joining company (higher rank indicates smaller gap)	
1. Company's line of business	91.7%	2. Company's line of business	64.6%
2. Duties after hiring	86.8%	1. Duties after hiring	65.1%
3. Type of person sought	86.1%	4. Type of person sought	54.6%
4. Business performance and potential	79.1%	7. Business performance and potential	48.8%
5. Pay after hiring	78.3%	8. Pay after hiring	48.3%
6. Working hours after hiring	74.3%	3. Working hours after hiring	59.0%
7. Management philosophy and policy	74.1%	6. Management philosophy and policy	53.5%
8. Policy on training after hiring	72.8%	9. Policy on training after hiring	44.7%
9. Leave and fringe benefits, etc.	62.3%	5. Leave and fringe benefits, etc.	54.5%

Explained thoroughly by enterprises and small gap between expectations and reality after joining company
 Not explained thoroughly by enterprises and large gap between expectations and reality after joining company

Sources: Nomura Research Institute, Ltd., *A Survey of Employment of Young Workers* (November 2005), *Questionnaire of Young Workers* (November 2005).

- Notes:
- The number preceding each factor indicates the ranking.
 - “Factors explained in detail” are factors that enterprises said that they “strongly emphasized” or “somewhat emphasized” in response to the question “What do you focus on communicating based on the actual situation at your company when recruiting young workers?” Other options were “not particularly emphasized” and “not emphasized at all.”
 - Factors regarding which there is a “small gap between expectations and reality after joining company” are factors that respondents said were “better than imagined” or “as imagined” in response to the question “Was the actual situation after hiring different from what you imagined?” The other response was “worse than imagined.”

Case 3-3-3

Enterprise clearly states training policy at time of recruitment

I & L Software Co., Ltd. is located in Tokyo's Shinjuku Ward and has a workforce of 86. It was established in 1989 with a workforce of four. The company started out as a subcontractor for communications and control-related software, but today the bulk of its business comes from contracts for developing embedded, UNIX, open-source and Web software. The company does not employ any employees on contract or on a part-time basis, and all its employees have permanent employee status.

The company primarily employs people with previous work experience. Graduates fresh out of university are recruited for supplementary purposes. There are two main reasons for this policy: 1) It is difficult to formulate a personnel policy because of the excessively long period between unofficial confirmation and the time when an employee actually joins the company; and 2) a discrepancy arises between the number actually recruited and the number it had planned to recruit because it does not know how many among those it has confirmed unofficially will actually join the company.

The company pays no attention whatsoever to whether young employees aged up to around 25 have had previous work experience or not. It has recruited those with no previous experience as permanent employees, employing 12 such employees over the past three years. The company clearly states its philosophy at the recruitment stage and endeavors to recruit only those who share the same philosophy.

New employees undergo intensive internal and external training for the first three months. The company puts out a training schedule for employees who have been in the company for two years or more, and it is up to employees to indicate if they are interested. With the aim of training IT professionals, the company divides skills into the following five categories: 1) interpersonal skills; 2) business skills; 3) basic knowledge of software quality; 4) basic knowledge of software development techniques; and 5) specialist IT skills. Separate training schedules are prepared for each of these categories. The company adopts a six-grade system, and in order to proceed to a higher grade an employee must at least have completed the specified training courses. A company representative explains that employees are given the same work, regardless of whether they have previous part-time experience or are fresh graduates from top universities, and as such everyone is given the same chance irrespective of academic record or work experience. As a result, the company endeavors to evaluate employees on the contribution they make to the company.

While the company's training schedule is fairly demanding, the company clearly states its training policy and provides details of training courses at the recruitment stage. Because those recruited are taken on having allowed for and agreed to this training, the company has a good retention rate and the skill level of its employees is improving.

This demonstrates that in order to retain younger workers, employers need to focus on communicating information on training methods, as well as information regarding job content, at the recruitment and hiring stages in order to minimize the gap between younger workers' expectations and the reality before and after joining a company.

3. Association between rate of retention of younger workers and performance of SMEs

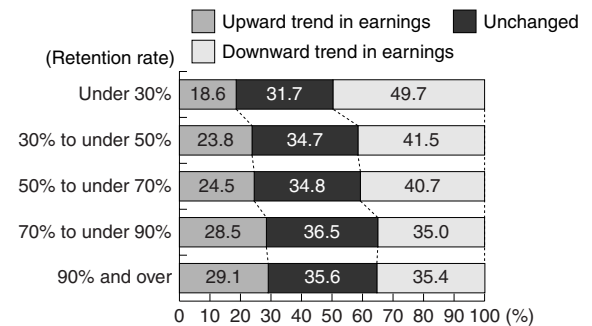
As previously noted, retention of younger workers is necessary in order to help stabilize the employment of younger people. From the point of view of SMEs, however, what advantages does retaining younger workers have?

Let us begin by looking at the relationship between the rate of retention of younger workers²⁰⁾ and enterprise performance.²¹⁾ According to Fig. 3-3-28, the better the retention rate is, the greater is growth in performance.²²⁾ While it is naturally conceivable that there also exists a reverse causal relationship such that enterprises that perform better have better rates of retention of younger workers, the retention of younger work does in some part appear to have a positive effect on enterprise performance. So what concrete benefits does an increase in the rate of retention of younger workers bestow on an enterprise? An investigation of enterprises whose rate of

retention of younger workers five years after hiring is at least 50% reveals that many feel that retention results in an “energized workplace and raised morale of employees” or “allowed use of skills and knowledge acquired by younger workers after hiring.” In terms of cost and use of new skills and ideas as well, retention of younger workers contributes to improved performance

Fig. 3-3-28 Relationship between retention rate of younger workers and business performance

Positive correlation between retention rate of younger workers and business performance

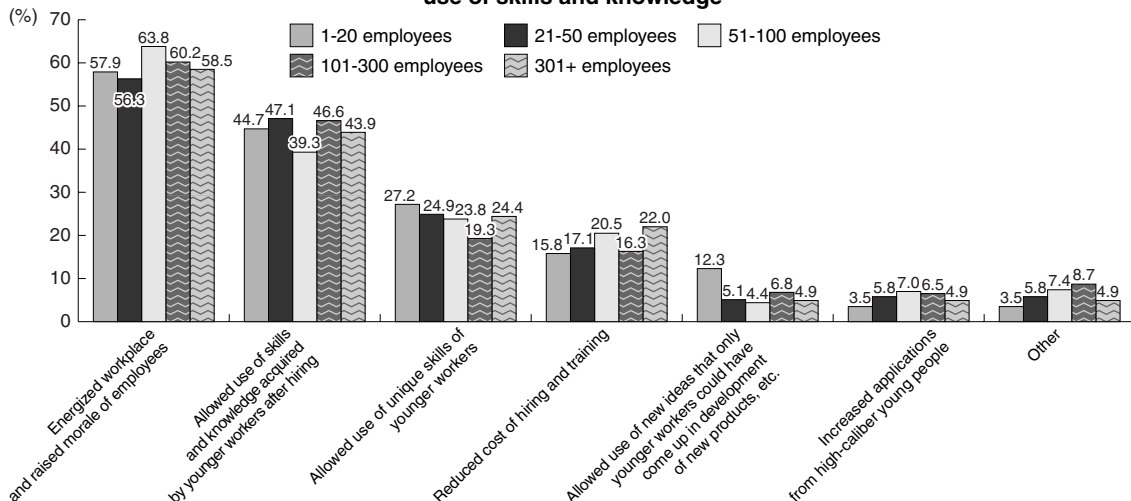


Source: Nomura Research Institute, Ltd., *A Survey of Employment of Young Workers* (November 2005).

- Notes:
1. The retention rate of younger workers is here defined as the retention rate after 5 years of 16-34 year olds hired as permanent employees.
 2. The trend in ordinary profit over the past three years is here used as the metric for business performance.

Fig. 3-3-29 Advantages of retention of younger workers that have a positive effect on business performance

Retention of younger workers positively impacts on business performance by energizing workplace and allowing use of skills and knowledge



Source: Nomura Research Institute, Ltd., *A Survey of Employment of Young Workers* (November 2005).

- Notes:
1. Totals exceed 100 due to multiple responses.
 2. Enterprises whose rate of retention after 5 years of younger workers hired as permanent employees was at least 50%.

20) In Fig. 3-3-28, the retention rate five years after hiring is used. However, similar results are obtained even if the retention rate after three years or one year is used (Appended Note 3-3-8).

21) In Fig. 3-3-28, the trend in ordinary profit over the previous three years is used. However, similar results are obtained even if current business confidence is used instead (Appended Note 3-3-9).

22) See Appended Note 3-3-10.

(Fig. 3-3-29).

Thus by taking steps to retain younger workers, SMEs themselves enjoy a variety of benefits, and these contribute in turn to an improvement in performance.

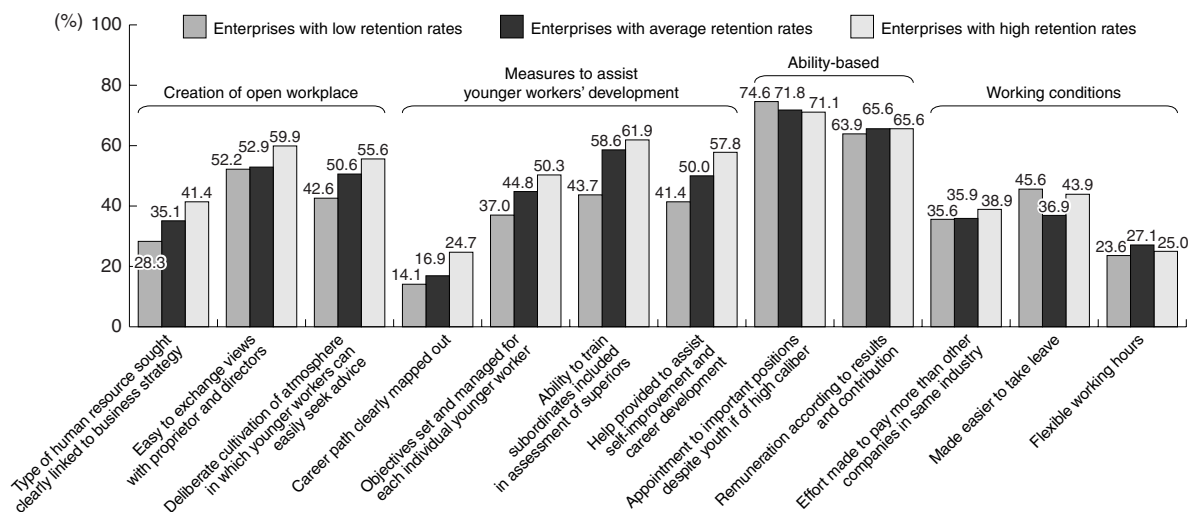
Next, we examine exactly what activities have an effect on the retention of younger workers. From Fig. 3-3-30, it can be seen that there is little difference between enterprises with high retention rates and those with low retention rates in implementation of measures affecting working conditions, such as working hours, leave, and wages. The introduction of merit-based systems, such as performance-based pay and promotion regardless of age, also appear not to be related to the retention rate. The measures that are associated with differences in the retention rate can be broadly categorized into two groups: 1) measures to create a more “open” workplace in which views can be exchanged and advice more easily sought, and 2) measures to encourage the growth of younger workers’ development, such as by delineating clear career paths, adopting management by objective, and providing training. The former do not incur any specific costs, and are comparatively easy for SMEs to implement. Regarding the latter, the question is one of how to support the growth and personal fulfillment of younger employees, which coincides with the factors identified earlier that enterprises should focus upon communicating at the time of recruitment. If an employer seeks solely results from younger workers and does not provide with them with opportunities for growth and challenges, younger workers may eventually

begin to wonder whether it is worth staying at that enterprise. In other words, the keys to improving the rate of retention of younger workers are the adoption of an explicit policy on training and implementation of measures to encourage growth.

To summarize the analysis thus far, the two key points to retaining younger workers in the workplace are as follows.

- 1) In order to minimize the expectations gap after a younger worker joins an enterprise, it is important at the recruitment and hiring stages not only to provide information on a company’s line of business and what work a new employee will be involved in after joining a company, but also to communicate information regarding training methods in order to demonstrate how a new employee will grow and develop after joining.
- 2) Effective approaches to raising the rate of retention of younger workers and generating a positive effect on enterprise performance are the adoption of an explicit policy on training after hiring, raising of vocational abilities and motivation, and creation of a more hospitable atmosphere for younger workers to work. Offering high wages and introducing merit-based systems are unrelated to the rate of retention of younger workers.

Fig. 3-3-30 Actions of SMEs that generate differences in retention rates
Actions that lead to differences in retention rate of younger workers are those that create a more open workplace and assist younger workers’ development



Source: Nomura Research Institute, Ltd., *A Survey of Employment of Young Workers* (November 2005).

- Notes:
1. Proportion of enterprises that responded “largely applicable” or “somewhat applicable” to the question “Which of these items describes action taken by your company?” Other options included “cannot say,” “not very applicable,” and “completely inapplicable.”
 2. “Retention rate of younger workers” here means the rate of retention after five years of 16-34 year olds hired as permanent employees.
 3. “Enterprises with low retention rates,” “enterprises with average retention rates,” and “enterprises with high retention rates” are here defined respectively as enterprises whose rate of retention of younger workers after five years is less than 50%, from 50% to less than 70%, and 70% or over.

Case 3-3-4

Company retains strengths by putting resources into training

Johnan Service Co., Ltd., located in Tokyo's Ota Ward, is engaged in IT support, construction of remote monitoring systems, communications equipment installation, and other activities. It has been recruiting three to five young employees every year for the past 25 years. Most of its recruits are fresh graduates, most of whom are graduates of vocational colleges. Although annual recruitment and training is a burden on the company, given its involvement in a labor-intensive industry, the company believes that it is an important business strategy for securing competent personnel.

Recruiting fresh graduates annually, up-front investment in human resources is considerable. With the retention of young employees a major challenge for the company, it endeavors to retain young employees by putting resources into training. While

they basically hone their work skills from on-the-job training, the company has approved employees take part in external training sessions. The company bears the cost of participation in these training sessions, and provides generous support, in terms of both money and time, by allowing employees time off their normal duties for the duration of training.

The benefits of training are gradually becoming apparent. The skills of retained young workers, particularly those in technical fields, have improved, and are utilized in a variety of services. The company has been able to retain the advantage of having its own employees fulfill maintenance and other functions without having to subcontract, which is also contributing to the accumulation of technical skills and know-how across the company.

Case 3-3-5

Company undertakes a variety of initiatives to retain young employees

GaiaX Co., Ltd. is based in Shibuya Ward, Tokyo and has a workforce of 106. A young company established in 1999, in addition to its mainstay planning, operation, and management of website and blog services for companies, it has recently been putting resources into the development and operation of online games. At 27, the average age of its permanent employees is extremely young, and there is even one who became a department head at the age of 23.

The company's three-fold approach to human resource recruitment entails recruiting fresh graduates, hiring people mid-career, and taking on interns. It puts the most energy into recruiting fresh graduates. The reason being that because most of the work the company does is innovative, it will consider only those who are capable of coming up with fresh ideas. It believes that those with previous work experience tend to be bound by their previous employment, while fresh graduates have the ability to come up with fresh ideas. Specialists requiring experience are covered by means of outsourcing and dispatch. The two recruitment criteria are ability and work attitude. With regard to ability, the company places more importance on being able to think flexibly and come up with innovative ideas than being a professional. As for work attitude, it seeks those who are keen to tackle a variety of new tasks and view their involvement in pioneering work as ample remuneration for their work.

To retain outstanding young employees and to encourage new employees to stay, the company undertakes a variety of initiatives, as shown below.

(1) Matching at the recruitment stage

1. The company's philosophy and a profile of the type of employee it is seeking are explained in considerable detail on its website.
2. At the recruitment stage, it sends weekly emails to students who have been accepted. Rather than containing work details, these emails mostly contain information on the company's vision and culture. The company does this because it believes that providing information on its organizational culture, even more than that job descriptions and

work-related matters, contributes to employee satisfaction after they have joined the company.

3. The company's president participates in every seminar held for students. Participation in each seminar is limited to around 40 students, and it holds as many as 40 seminars a year. It holds numerous discussion meetings with a ratio of one employee for every eight students, at which it consistently endeavors to convey the company's philosophy and culture.

(2) Measures for retaining young employees after recruitment

1. Students whose positions have been confirmed take part in weekly training sessions up until the time they join the company. Comprising mainly lecture-style sessions, the students learn about the company's industry, financial situation, management issues, culture, etc. By attending these sessions, the students gain a fairly good understanding of the company's general situation by the time they join the company.
2. Once employees have been in the company for a year, they are given free rein so that that they can constantly create work by themselves.
3. Employee salaries are reviewed on a quarterly basis. Based on a system of results-oriented management, four times a year the employee, department head, and executives verify the results for the previous period and formulate a new plan for the next three-month period. It is the employee who proposes the plan, which encompasses all aspects from a work portfolio through to results and remuneration.
4. Once every two weeks, employees gather to discuss company-wide issues and business vision and strategies. Similar discussions are held twice a year at overnight seminars.
5. The company has a flat organizational structure comprising a fully transparent evaluation system that allows colleagues and subordinates to evaluate one another.

Although these measures incur considerable costs, they bear fruit in that many employees join having been attracted to the company's culture. There have been no instances in which an employee has resigned due to having been mismatched.

Column 3-3-2 Assisting young people in the U.K. in finding employment – Connexions –

The numbers of unemployed young people and freeters (job-hopping part-timers) have been increasing in Japan, as have their ages, and various actions are being taken to deal with the social issues. But employment problems among the young are not limited to Japan. Other industrialized countries are racking their brains to overcome similar difficulties. In the U.K., a service called "Connexions" has shown promising results, seeking to help young people while they are still in school. The Connexions service is outlined here.¹⁾

Launched in April 2001, Connexions aims to help people 13 to 19 years old make good decisions for the lives, educations and careers – help get the off to a good start. Multifaceted, comprehensive, and emphasizing self-reliance, it is nevertheless – inasmuch as most of its target audience is in school (compulsory in England from age 5 through 16) and as the core of its efforts is helping them to decide their future – most readily identified as an educational program. But given its job-finding mission, it can equally be considered effective labor policy. The following are the three primary characteristics of the service:

(1) Integrative, continuous service in a region

Similar but separate services were previously offered by various supporting organizations, and those tended to be limited and were often interrupted midway. Solving the complex problems of the young and maintaining continuous support were proving to be very difficult. Under Connexions, data on all young people in a region are accumulated in long-term databases, called "Connexions Customer Information Systems" (CCISs)²⁾. In parallel with this, networking among the supporting organizations is developed. The end result is a system offering young people integrated, continuing support, including a broad range of consultations and information.

(2) Aimed at teenagers

The service covers everyone 13 to 19 years old. This enables them to be approached while they are still in school, something Connexions emphasizes, as the problems of the young while in school are particularly complex. The intention is to do something to connect them to the society while they are in school.

(3) Young people themselves involved in the service

Connexions includes mechanisms, as well, for the young people to participate in its operation and decision-making. Reflecting their ideas in its content makes it easier for them to accept. It also demonstrates that their opinions matter, that they can in fact change things in the world – something that can be a powerful motivator.

More precisely, Connexions activities consist of those in and those outside of school. In-school activities are focused on giving information and guidance through the student's personal adviser (PA)³⁾. A PA looks to the individual needs of the student, in cooperation with the school and his or her parents. Activities outside of school are in the nature of following up after completion of compulsory education, based on information in the CCISs. Those who have gone on to the next level of education are contacted once a year, and those who are unemployed, every three months, to determine and offer needed support.

In summary, the results/significance of Connexions are that (1) motivation to work is created and an ability to plan and make decisions about the future is fostered among young people; (2) continuity and consistency in support are achieved; and (3) systematic, comprehensive support and information services are realized. Its difficulties, in turn, are (1) the necessity to develop the abilities of PAs and other related parties; and (2) the need to build up more organic cooperation systems among the related organizations.

In Japan, the growing number of freeters and NEETs has become a problem requiring that appropriate action to be taken as soon as possible. There is, moreover, no denying that in-school education in Japan and work after graduation are treated now as separate issues. Connexions' example of giving young people comprehensive support toward their future working lives starting while they are still in school may be instructive for Japan, where the youth unemployment rate is high.

Notes: 1. Reference: Japan Institute for Labour Policy and Training, *JILPT Research Report No. 35*.

2. CCISs are follow-up databases of private information on everyone aged 13 through 19 years in the jurisdictional area of each Connexions partnership (organizations in each area implementing the service). The starting point for the databases is basic data (name, sex, address, contact, etc.) of a child when he or she is 13 years old. Such information is provided by his or her school to the relevant Connexions partnership, marking the start of the service for that individual. Each supporting activity is conducted based on the databases.

3. In Connexions, the PAs, who have direct contact with the young people, play a great role. PAs come from diverse backgrounds, and include career counselors, teachers and social workers.

Section 5 Situation regarding balancing of work and parenting

Up to Section 4, we considered the employment issues that need to be addressed if younger workers are to be able to obtain stable incomes. In the following sections, however, we turn our attention to consider another important challenge – the question of how to combine work and parenting.

In order to create a society that is more amenable to having and raising children, balancing the demands of work and parenting is as important as securing stable employment and income.

As the situation stands at present, however, the burden of parenting in the case of working married couples with children is considered to fall excessively on the shoulders of the mother.

If we look at the situation regarding the taking of parental leave according to the results of MHLW's *Basic Survey on Women Workers' Employment Management* (fiscal 2004), the proportion of persons who took parental leave among persons who gave birth or whose spouse gave birth during employment was 70.6% in the case of women and 0.56% in the case of men. In addition, as observed in Fig. 3-3-1 at the beginning of this chapter, approximately 70% of women employed one year before birth withdraw from employment. Breaking the labor force participation rates of women down by age group produces an "M-shaped" curve due to the slump in the labor force participation of women in and around their early thirties, which the age at which

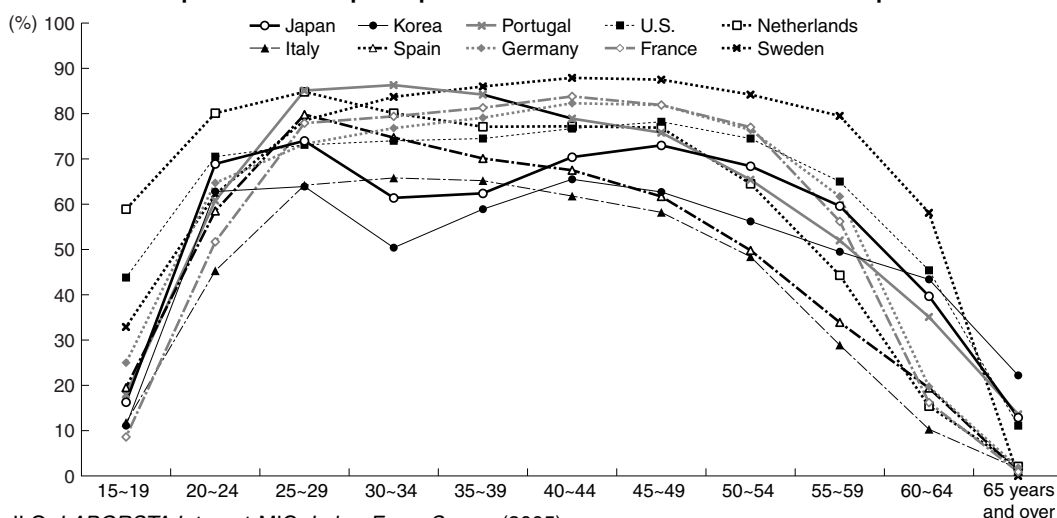
women tend to have and raise children (Fig. 3-3-31).

Regarding the reasons for withdrawal from employment of women who leave their jobs around this age, marriage and parenting accounts for well over half (64.5%) (Fig. 3-3-32). However, it cannot be said that all of these women actually want to quit their jobs in order to marry and raise children. In the same figure, it can be seen that an extremely high proportion (63.3%) of non-employed women aged 25-34 who withdrew from employment due to marriage or parenting want to work. In other words, almost two in three women might enter the labor market if an environment were to be created that enables them to work while caring for children.

However, once a woman leaves employment to have and raise a child, she can find it extremely difficult finding reemployment. According to MHLW's *Statistics on Employment Changes Before and After Having a Child*, the proportion of women employed one year before birth who are reemployed after leaving their jobs is only around 18%²³⁾ (see Fig. 3-3-1 2) at the beginning of this chapter). As described later, moreover, a high proportion of those who are reemployed return to the workforce on a part-time or similar basis, and it is exceedingly difficult to return to employment as a core permanent employee (see Fig. 3-3-36).

This situation is not only harsh on mothers who want to work, but is also a loss to society as a whole in that it means that skilled resources with the desire to work are

Fig. 3-3-31 Female labor force participation rates in major countries by age group
Dip in labor force participation rate for women in their thirties in Japan

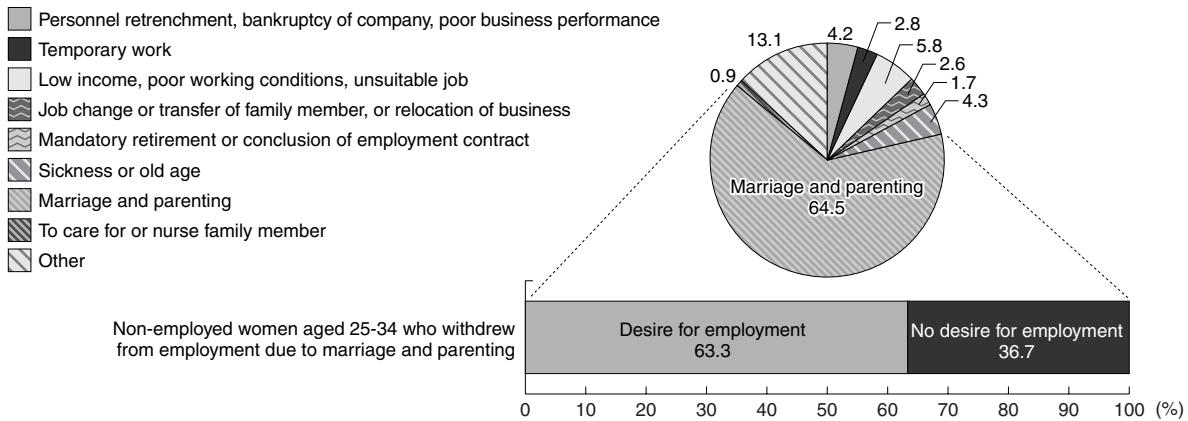


Sources: ILO, LABORSTA Internet; MIC, Labor Force Survey (2005).

Note: Figures for the U.S., Spain, and Sweden are actually for 16 year olds and above.

23) Compiled based on MHLW, *Statistics on Employment Changes Before and After Having a Child: A Linkage Analysis of Vital Statistics, Statistics by Occupation and Industry, and a Longitudinal Survey of Children Born in the 21st Century – Special Report on Vital Statistics* (2004).

Fig. 3-3-32 Reasons for withdrawal from employment of non-employed women aged 25-34
Approximately 60% withdraw from employment due to marriage and parenting



Source: MIC, *Employment Status Survey* (2002).

- Notes: 1. Women who withdrew from employment between October 2000 and September 2001.
 2. "Desire for employment" here refers to non-employed women who "would like to be employed."

not fully utilized.

From the point of view of the "self-fulfillment" of the individual, the same in fact applies to men as well.

Men face the reverse problem in that they cannot participate in parenting even if they want to due to the difficulty of balancing work and parenting demands.

According to the *2005 Annual Report on the State of the Formation of a Gender Equal Society and Policies to be Implemented to Promote the Formation of a Gender Equal Society*, approximately one in two (51.6%) fathers want to place equal emphasis on work and home/parenting. In reality, however, only 25.9% are able to place equal emphasis on the two (Fig. 3-3-33).

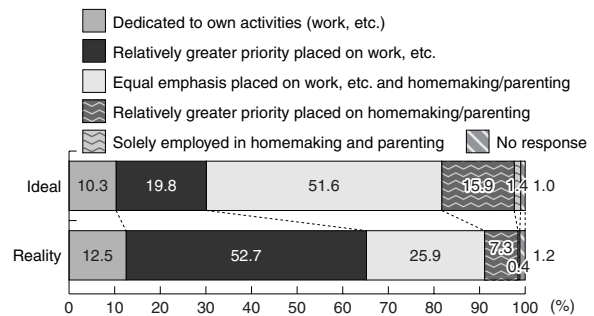
In terms of the amount of time spent on parenting, MIC's *Survey on Time Use and Leisure Activities* (2001) shows that, on average, men spend approximately 25 minutes and women approximately 3 hours on parenting per week in households including a married couple and child under the age of 6 years. Husbands thus participate far less in parenting than wives.

The evidence suggests that, being excessively busy with work and unable to obtain the understanding of their superiors and colleagues for their greater involvement in parenting, men cannot spend as much time on parenting as they would like.

In order to provide an environment in which the demands of work and parenting can be balanced, it appears that measures need to be taken to assist all members of society, regardless of sex.

Below, then, we analyze how people are balancing the demands of work and parenting focusing in particular on the situation at SMEs.

Fig. 3-3-33 Prioritization of parenting by fathers
Approximately 30% of fathers place equal emphasis on work, etc. and on homemaking and parenting



Source: Cabinet Office, *Annual Report on the State of the Formation of a Gender Equal Society and Policies to be Implemented to Promote the Formation of a Gender Equal Society* (2005).

Section 6 Obstacles to balancing work and parenting

We begin by identifying what factors in general act as obstacles to balancing work and parenting at enterprises.

1) Understanding in the workplace for people who work while caring for children

The first factor is the existence in the workplace of an atmosphere that makes employees hesitant to use arrangements put in place to make it easier to balance work and parenting, even where they exist.

Fig. 3-3-34 is based on the results of the *Business Survey Regarding Small Business Support for Balancing Work and Family* and the *Survey Regarding Work and Parenting at Small Businesses* conducted by the Fujitsu Research Institute (December 2005), and shows the reasons given by enterprises and employees for the lack of use of arrangements such as parental leave, shorter working hours, and flextime established at enterprises that responded that little use was made of these

arrangements.

According to this, approximately equal proportions (around 40%) of enterprises responded “atmosphere makes employees hesitant about using” and “employees place priority on work and prefer not to use.” Among employees, in contrast, approximately three in five (58.2%) answered “atmosphere makes employees hesitant about using,” far exceeding the approximately one in five (20.3%) that responded “employees place priority on work and prefer not to use.”

It thus seems that employees find that lack of understanding in the workplace to be more of an obstacle to use of parenting support arrangements at companies, even where they exist, than management imagines.

2) “Three losses”

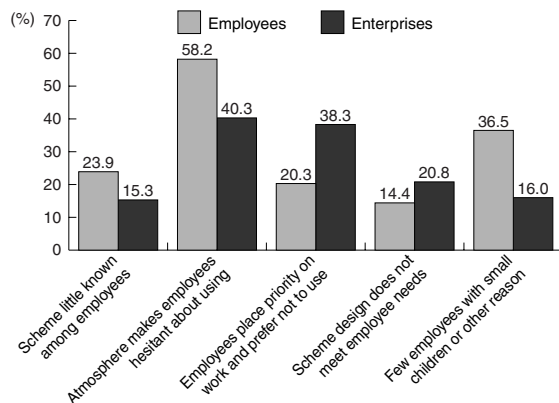
The second factor is the opportunity-cost hurdle of the three losses suffered by both sexes in the event that they take parental leave. These are loss of income, loss of career, and loss of knowledge about their work: loss of income, in that employees lose 60% of their income during parental leave; ²⁴⁾ loss of career in that the time out taken due to the parental leave has a negative effect on evaluations and promotion prospects after returning to work; and loss of knowledge about work, in that employees who take parental leave are left behind as work-related knowledge and know-how constantly progresses.

3) Shortage of childcare support arrangements while parent is working

The third factor is the insufficiency of arrangements to assist childcare while parents are working.

Support for childcare presently includes day-care centers and crèches for children, “childcare givers,” ²⁵⁾ “after-hours childcare” at kindergartens, and so on. However, demand outstrips supply, and the national waiting list for places at licensed day-care centers, for example, is 23,338. ²⁶⁾ Although the number of children awaiting places is declining, a detailed breakdown shows that 67.8% are aged 0-2 years, and the five prefectures ²⁷⁾, ordinance-designated cities, and core cities account for 73.9% of the total. In other words, the large majority of children awaiting places are very young and live in urban areas. If a woman wants to continue working after giving birth and taking parental leave, therefore, there appears to be a mismatch between the location of supply and

Fig. 3-3-34 Reasons for little use of schemes to make it easier to balance work and parenting
Perception gap between employees and enterprises



Sources: Fujitsu Research Institute, *Survey Regarding Work and Parenting at Small Businesses* (December 2005), *Business Survey Regarding Small Business Support for Balancing Work and Family* (December 2005).

Note: Employees and enterprises that responded regarding “parental leave,” “shorter working hours,” “flextime or other flexible working-hour arrangements,” and “child taken to place of work (including business crèche)” that such “schemes exist but are little used” to the question “Are there schemes in the workplace to make it easier to balance work and parenting or are flexible allowances made in practice though such schemes do not exist?”

24) During parental leave, 40% of pre-parental leave income is covered by employment insurance.

25) “Childcare givers” (*hoiku mama* – family welfare workers and family childcare centers) is the collective term for persons licensed by local government to provide childcare services in their own homes for children aged less than 3 years who require childcare by applying their skills and knowledge about childcare.

26) From “The Situation Regarding Day-Care Centers for Children (April 1, 2005)” published by MHLW.

27) The five prefectures are those in the Greater Tokyo area (Saitama, Tokyo, and Kanagawa) and two in the Kinki region (Osaka and Hyogo).

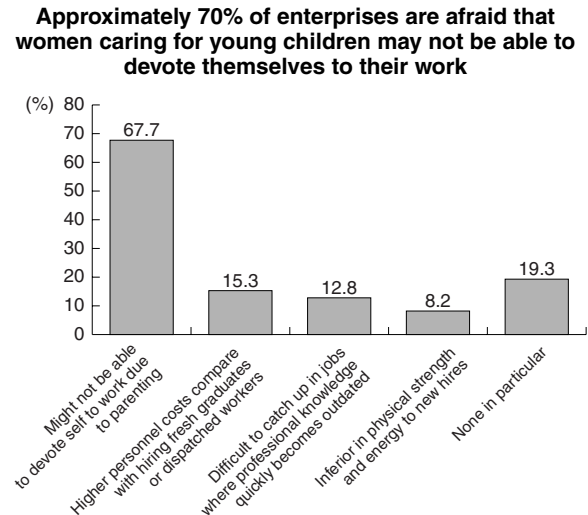
demand resulting in a shortage of childcare places for younger age groups and in urban areas.

According to the Fujitsu Research Institute’s *Business Survey Regarding Small Business Support for Balancing Work and Family*, 67.7% of enterprises consider “might not be able to devote self to work due to parenting” to be a disadvantage of reemploying women who left work to give birth and look after a child (Fig. 3-3-35). While inability to devote oneself to one’s work could conceivably consist of both the psychological inability to devote oneself to one’s work and physical inability to spare the time to work, the physical side at least is no doubt affected in no small part by the lack of childcare providers with which to leave a child if he or she is sick, the short opening hours of day-care centers, and the unavailability of other forms of childcare support that would allow mothers to devote themselves to their work.

4) Difficulty of reemployment as a permanent employee

The fourth factor that makes it difficult to combine work and parenting is the employment environment, which makes it difficult for women to find reemployment

Fig. 3-3-35 Perceived disadvantages of reemployment of women who have withdrawn from the workforce to have or care for a child



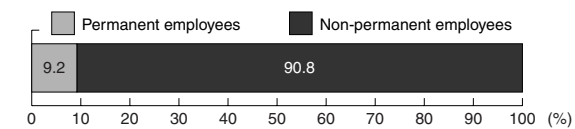
Source: Fujitsu Research Institute, *Business Survey Regarding Small Business Support for Balancing Work and Family* (December 2005).

if they leave their jobs to have and raise children.

For women who want to work after pregnancy and birth, one method of reemployment other than continuing to work at the same workplace after taking parental leave is to concentrate on childcare while their children are small and returning to work two or three years after birth. As noted above, however, finding reemployment is difficult, and among women who were permanent employees in particular, only around 10% return to employment as permanent employees once they leave their companies to have children (Fig. 3-3-36).

According to the Cabinet Office, the loss in lifetime income in the case of leaving work to have a child and then returning to employment as a part-time or *arubaito* worker compared with continued employment as a permanent employee is in the region of ¥200 million.²⁸⁾ Amid the difficulty of taking leave to care for a child and the excessive opportunity cost associated with leaving work to have a child (i.e., the loss of income that could have been received had one continued in employment without having a child), it is estimated that many households abandon the option of having children.

Fig. 3-3-36 Forms of reemployment of female permanent employees who withdrew from employment to care for child
Approximately 10% reemployed as permanent employees



Source: MIC, *Employment Status Survey* (2002).
Note: Women formerly employed as permanent employees who withdrew from employment to care for child and were reemployed = 100%

28) According to estimates published in Cabinet Office, *White Paper on the National Lifestyle* 2005.

Section 7 Features of SMEs that make them well suited to balancing work and parenting

Thus far, we have described the situation in general that makes it difficult to combine work and parenting at workplaces in Japan. But what is situation like at SMEs?

Looking firstly at arrangements to help employees to balance work and parenting, such as systems of parental leave, shorter working hours, and flextime, the situation is less advanced at SMEs than at large enterprises.²⁹⁾ However, it would be premature to conclude from this that the working environment at SMEs is therefore less conducive to combining work and parenting. This is because the mere existence of arrangements does not necessarily mean that full use is being made of them, and conversely, enterprises without such arrangements may respond flexibly to the needs of individual employees on a case-by-case basis.

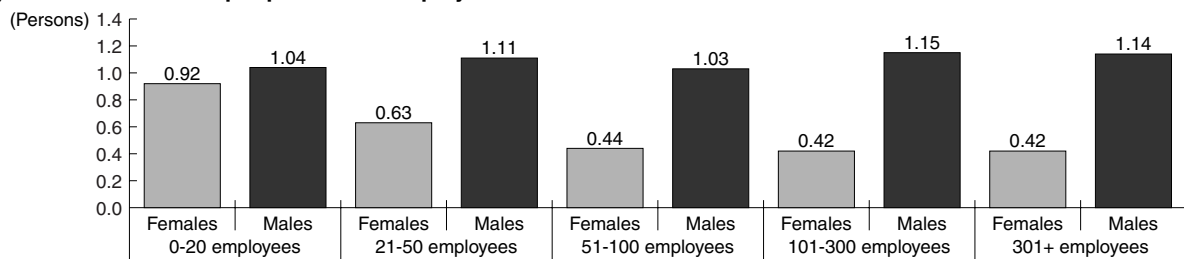
In order to measure whether a workplace actually makes it easier to combine work and parenting, we need to look at effect indicators. One effect indicator is the number of children per permanent employee. Looking at Fig. 3-3-37 1), it can be seen that in the case of males, the number of children tends to be slightly higher if they are employed at enterprises with more employees. On the other hand, women tend to have more children if they are employed at enterprises with fewer employees.

An analysis of differences in the trends between the sexes reveals that a higher proportion of male permanent employees are their households' main source of income,³⁰⁾ suggesting that larger enterprises that can be expected to provide a comparatively higher and more stable income offer stable environment that is conducive to raising more

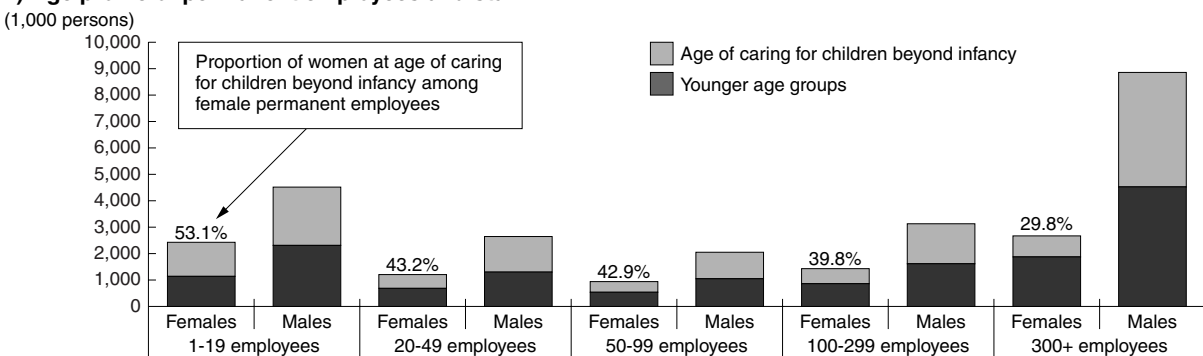
Fig. 3-3-37 Number of children per permanent employee and age profile of permanent employees by number of employees

A higher proportion of female permanent employees at smaller enterprises are of an age (40 and over) at which their children are beyond infancy, and the number of children per female permanent employee is also higher

1) Number of children per permanent employee



2) Age profile of permanent employees and staff



Sources: Fujitsu Research Institute, *Survey Regarding Work and Parenting at Small Businesses* (December 2005); MIC, *Employment Status Survey* (2002).

Note: "Younger age groups" refers to people up to age 39, and "age of caring for children beyond infancy" refers to people aged 40 and over.

29) Under the Law for Measures to Support the Development of the Next Generation enacted in July 2003, employers employing 301 or more workers are required to formulate and submit action plans describing targets and details of measures to achieve these targets in accordance with guidance on the formulation of action plans by ordinary employers setting forth targets to achieve through "measures to support the development of the next generation" and measures for their attainment. However, the vast majority of SMEs are required to "endeavor" to submit notification that they have formulated action plans as ordinary employers.

30) According to MHLW's *Survey on Employment Structure* (2003), 94.7% of male worker responded that they themselves are their households' main source of income.

children.

In the case of female permanent employees, on the other hand, the higher proportion of women of an age at which they are more likely to have children past infancy (40 years and above) at enterprises with fewer employees is likely a factor (Fig. 3-3-37 2)). In other words, whereas the proportion of female permanent employees who are younger than the typical age of giving birth is higher at larger enterprises, many of the

female permanent employees at SMEs are women who have returned work after leaving their jobs to have a child, leading to a higher number of children per female permanent employee.

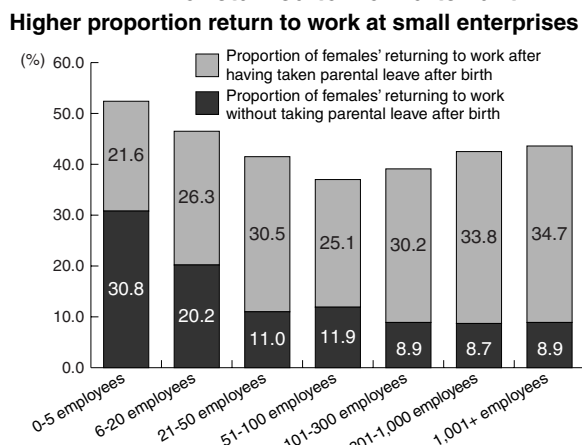
Regarding firstly the rate of continuation in employment, the proportion of women who return to work is lowest at enterprises with 51-100 employees and higher at larger and smaller enterprises, creating the U-shape shown in Fig. 3-3-38. At smaller enterprises, however, a high proportion of women return to work without taking parental leave, which perhaps indicates that “systems” are not as well developed as at large enterprises.

Regarding the reemployment of women who withdraw from employment to care for a child, a comparison of sizes of employers with fresh female graduates is shown in Fig. 3-3-39. Whereas the number of women employed straight out of college in the one-year period from October 2002 was approximately 300,000 (excluding employment by government and public offices), the number of women returning to employment (reemployment) as permanent employees or staff after caring for a child was just 17,000 (again excluding employment by government and public offices). However, a comparison by size of employer shows that a higher proportion of those employed at SMEs were reemployed as permanent employees or staff when they returned to work after caring for a child. This would suggest that SMEs are more active than large enterprises in employing women who leave the workforce to care for a child.

Thus the number of children per permanent female employee appears to be higher at SMEs owing to 1) the greater ease of continuing in employment at SMEs after having a child, and 2) the greater ease of being reemployed while still caring for a child.

However, it is still necessary to examine whether the

Fig. 3-3-38 Proportion of female permanent employees who were pregnant and gave birth in the past five years and who returned to work after birth



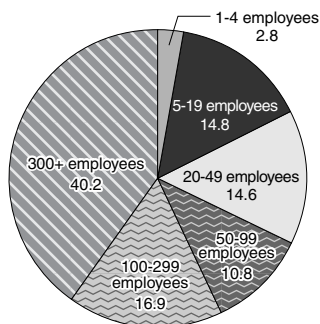
Source: Fujitsu Research Institute, *Business Survey Regarding Small Business Support for Balancing Work and Family* (December 2005).

- Notes:
1. Including female permanent employees who had already withdrawn from employment.
 2. The proportion who returned to work after birth is the combined total of the proportion who returned to work without taking parental leave after birth and the proportion who returned to work after having taken parental leave after birth.

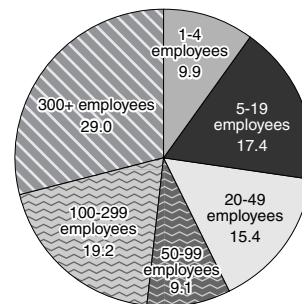
Fig. 3-3-39 Breakdown by size of employers of female permanent employees who withdraw from employment due to parenting and fresh female graduates

A large proportion of employers of female permanent employees who withdraw from employment to care for a child are SMEs

Breakdown of sizes of employers of newly graduated female permanent employees
No. of freshly graduated female permanent employees: 308,830



Breakdown of sizes of employers of female permanent employees who had withdrawn from workforce due to parenting
No. of female permanent employees who had withdrawn from workforce due to parenting: 16,750



Source: Recompiled from MIC, *Employment Status Survey* (2002).

- Notes:
1. Female permanent employees and staff who had withdrawn from the workforce due to parenting is the sum of women who were employed as permanent employees or staff within one year in 2002.
 2. Women in employment who were enrolled as students one year before the survey are treated as freshly graduated women.

above two effect indicators are really outcomes arising from greater ease of combining work and parenting.

Regarding, for example, the tendency for the average number of children born to be higher for female permanent employees working at SMEs than female permanent employees at large enterprises, could this be due to the tendency once observed in Japan for people on lower incomes to have more children?

It is certainly true looking at the household incomes of female permanent employees working at SMEs that a higher proportion of those with lower annual household incomes are employed at smaller enterprises.³¹⁾ Is there then a correlation between female permanent employees having more children and the lower annual household incomes of female permanent employees?

Looking at the relationship between the annual household income of married couples and proportion with children shown in Fig. 3-3-40 1), the proportion with

children increases with annual household income in the case of households with a fulltime homemaker, and no clear correlation is observed between household income and the proportion with children in the case of dual-income households. Similarly regarding the relationship between the annual household income and number of children per household of married couples shown in Fig. 3-3-40 2), the number of children per household rises with annual household income in the case of fulltime homemaker households, and no clear correlation is evident in the case of dual-income households.

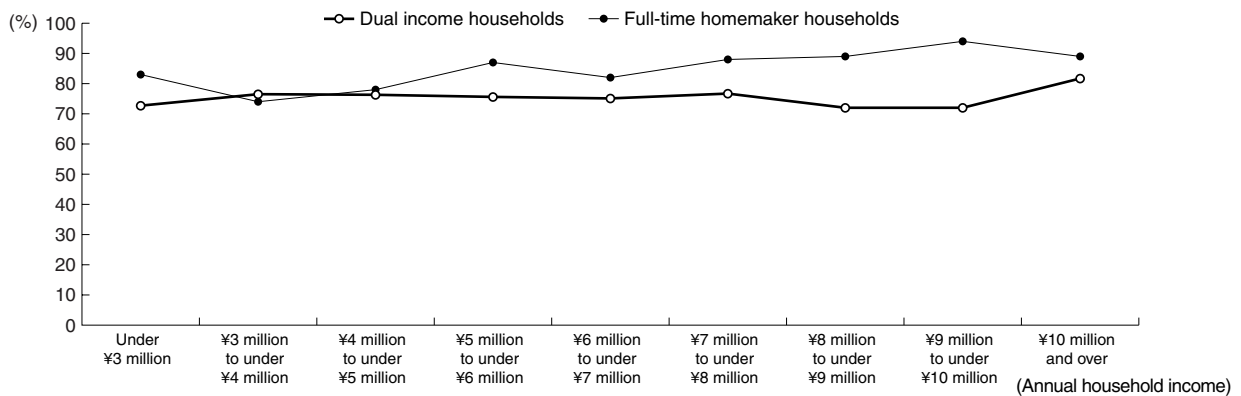
It can be seen from this that the number of children of female permanent employees is not higher in lower annual household income groups, regardless of whether they are fulltime homemaker households or dual income households.

In other words, the tendency for households with lower annual incomes to have more children no longer

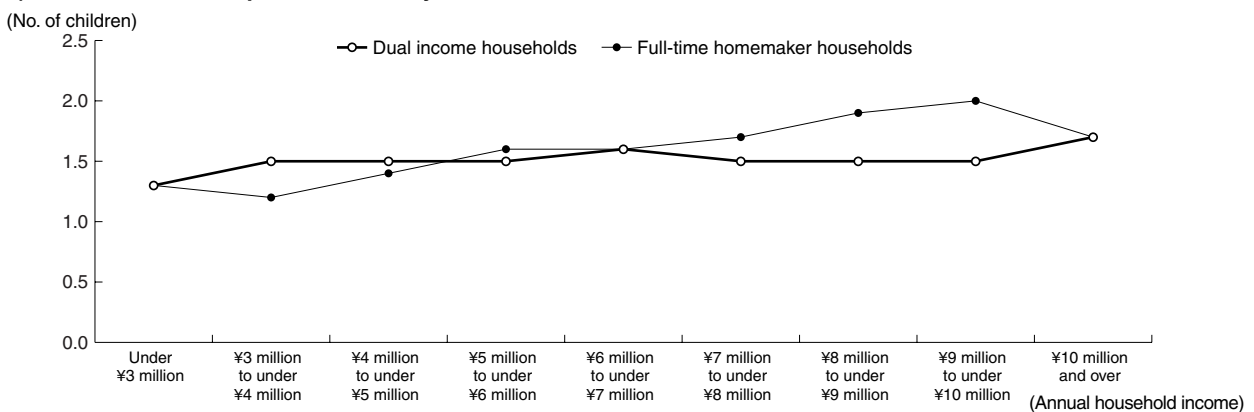
Fig. 3-3-40 Proportion of persons with children and number of children per household by household income

In the case of working couples, no relationship is observed between household income and proportion of persons with children and number of children

1) Proportion of persons with children by household income



2) Number of children per household by household income



Source: Fujitsu Research Institute, *Survey Regarding Work and Parenting at Small Businesses* (December 2005).

Notes: 1. Married persons only.
2. Persons who responded "yes" to the question "Is your spouse employed?" were treated as "dual income households," and persons who responded "no" were treated as "full-time homemaker households."

31) See Appended Note 3-3-11.

applies to contemporary Japan. Indeed, in fulltime homemaker households, the number of children increases with annual household income.³²⁾

It is also conceivable that a women working at an SME might, for example, have to work in order to support her family despite wanting to leave her job in order to concentrate on parenting, or else find it difficult to quit because her employer cannot find a replacement. In order to investigate this further, let us compare the “ideal life courses” of female employees with the reality broken down by size of employer. For this, life courses were grouped into the following five broad categories:

“Fulltime housewife” type: Withdrew from employment upon marriage or birth, and does not subsequently work.

“Reemployment” type: Withdrew from employment upon marriage or birth, and works again after caring for child.

“Combination” type: Married and has a child, but works for life.

“DINKS”³³⁾ type: Married but continues to work for life without having a child.

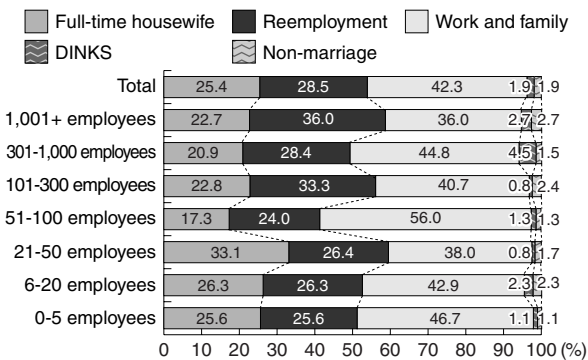
“Unmarried and employed” type: Continues working for life without marrying.

From Fig. 3-3-41, it can be seen that although some women currently in employment see the “fulltime housewife” type as their ideal life course, the proportion does not differ markedly according to number of employees.

In other words, the argument that more women at SMEs work because they have to although really they

Fig. 3-3-41 Ideal life course by number of employees of employer

Proportion of employees whose ideal life course is to be a full-time housewife does not tend to be more or less at any particular size of employer



Source: Fujitsu Research Institute, *Survey Regarding Work and Parenting at Small Businesses* (December 2005).

would like to quit does not stand up to scrutiny, and a majority of women at both large enterprises and SMEs want to continue working for the rest of their lives.

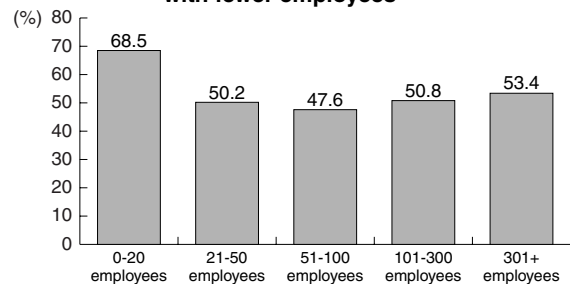
Based on the above analysis, the effect indicator of the number of children per female permanent employee appears to indicate, together with the high rates of continuation in employment and reemployment at SMEs, that SMEs provide a better environment for continuing to work while caring for children, rather than women working at them because “people on lower incomes have more children” or “working due to being unable to quit despite wanting to quit.”

In addition, asked whether they thought that their workplaces were conducive to combining work and parenting, a high proportion of employees at enterprises with fewer employees answered “yes” (Fig. 3-3-42). Thus even from the subjective point of view of employees who actually work there, enterprises with fewer employees are felt to be more conducive to balancing the demands of work and parenting.

Measures to make it easier to balance and work have traditionally tended to revolve around the establishment of concrete institutional arrangements, this being an area of activity that is easier for large enterprises to take (tendency (1) in Fig. 3-3-43). However, SMEs appear to be overcoming (1) the lack of understanding in the workplace of working while caring for children, (2) the “three losses” that arise when one takes time off work to care for children, (3) the lack of support for childcare while parents are at work, and (4) the difficulty of reemployment as permanent employees by different methods from large enterprises, allowing them to create

Fig. 3-3-42 Ease of balancing work and parenting at workplace

Easier to balance work and parenting at enterprises with fewer employees



Source: Fujitsu Research Institute, *Survey Regarding Work and Parenting at Small Businesses* (December 2005).

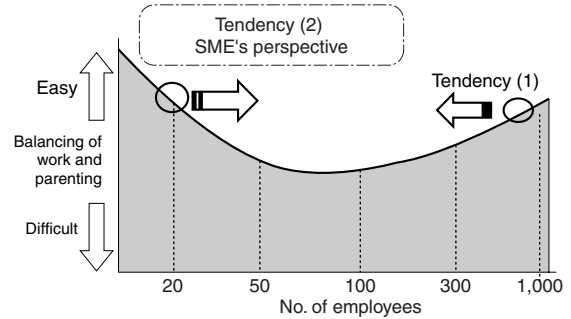
Note: Proportion of persons who responded “easy” or “somewhat easy” to the question “Overall, does your company have an environment that makes it easy to balance work and parenting?”

32) Regarding the proportion of “persons with a spouse and child(ren)” according to annual income, see Fig. 3-3-7. As in contemporary Japan the proportion of people who are married declines as annual income falls as shown in Fig. 3-3-7 1), the proportion of employees with children among people of the same annual income group as a whole (including single people) is clearly lower as annual income falls than the proportion with children by annual household income based on married persons only, shown in Fig. 3-3-7 2).

33) “DINKS” is an acronym of “Dual Income, No Kids.”

a working environment that is more conducive to combining work with parenting. Propagating these features of SMEs among enterprises in general could be an effective way of creating a society that makes it easier to have and raise children. In other words, it is possible that studying in depth exactly what is happening at SMEs could lead to new and previously unconsidered ideas on how to make it easier to combine work and parenting (tendency (2) in Fig. 3-3-43).

Fig. 3-3-43 Conceptual approaches regarding what kind of workplace makes it easier to balance work and parenting



Section 8 Background to why SMEs are well suited to balancing work and parenting

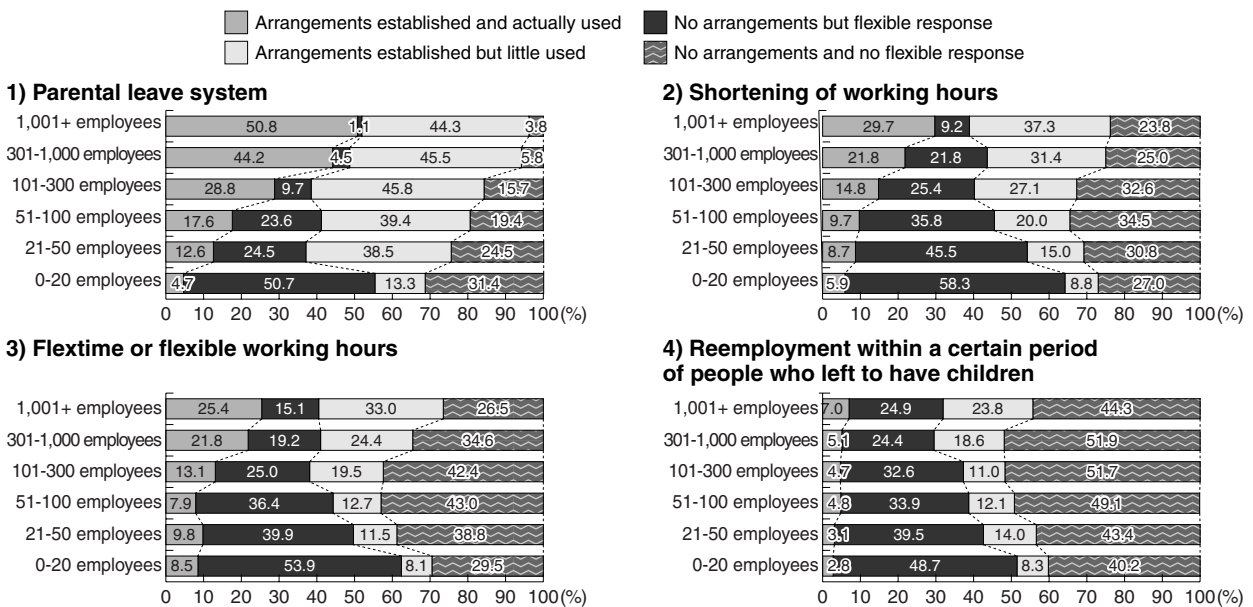
How specifically do SMEs overcome the hurdles to balancing work and parenting? If we look at the state of implementation and use of various measures that should make it easier to combine work and parenting, we find that enterprises with more employees are more likely to respond by establishing systems, and enterprises with fewer employees are more likely to respond flexibly without establishing systems (Fig. 3-3-44). SMEs thus overcome the hurdles to combining work and parenting not by establishing systems, but by responding flexibly according to employees' individual circumstances.

Below, we examine what features of SMEs give rise to an environment that is more conducive to combining work and parenting.

1) Evaluation of the intrinsic abilities of the individual

One of the factors that makes it difficult to combine work and parenting, as described earlier, is the difficulty of taking parental leave due to the “three losses.” However, a more detailed examination of this problem by number of employees reveals that the possibility that “promotions and pay rises might fall behind” is perceived as a problem more by permanent employees at large enterprises (Fig. 3-3-45).

Fig. 3-3-44 Introduction and use of support measures to assist balancing of work and parenting
Smaller enterprises more likely to “respond flexibly”



Source: Fujitsu Research Institute, *Business Survey Regarding Small Business Support for Balancing Work and Family* (December 2005).

Furthermore, the proportion of enterprises that responded that “taking leave for a certain period does not have a long-term impact on promotion, etc.” is higher at enterprises with fewer employees (Fig. 3-3-46).

One of the “three losses,” i.e., career loss, thus appears to be perceived as less of a hurdle at SMEs.

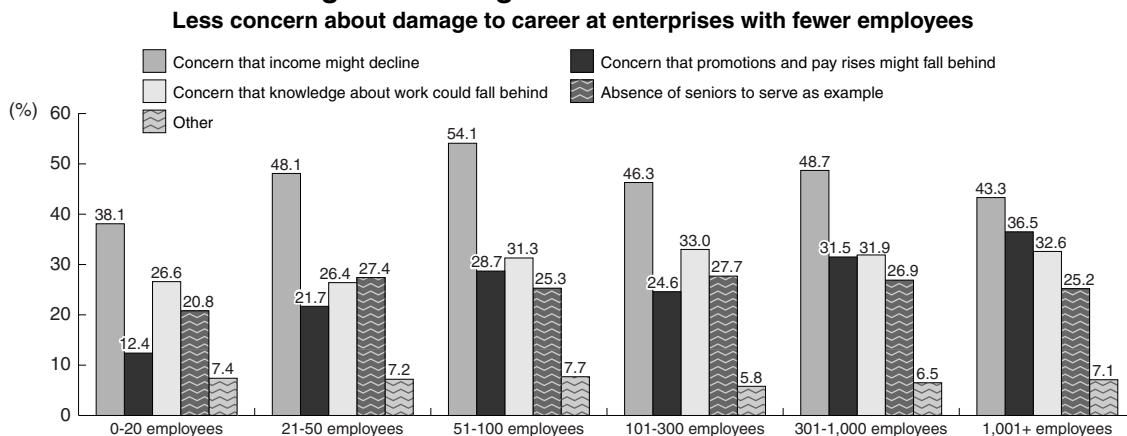
One likely reason for the reduced damage to one’s career at SMEs is probably that SMEs and large enterprises take different views of employees on parental leave. As can be seen from Fig. 3-3-47, enterprises with fewer employees are more likely to take the view that “as ability does not necessarily decline while on parental leave, taking leave has no particular impact on promotion.” Conversely, the proportion of enterprises responding “period of leave treated as blank period for personnel evaluation purposes resulting in lag in promotion” increases with enterprise size, evidencing an extremely clear contrast in approach between larger and

smaller enterprises.

The likelihood is that in the case of SMEs, personnel evaluation is characterized by the assessment of individual employees’ “intrinsic abilities” rather than quantitative results and performance, reducing the damage (“career loss”) caused by taking time off work to care for children.

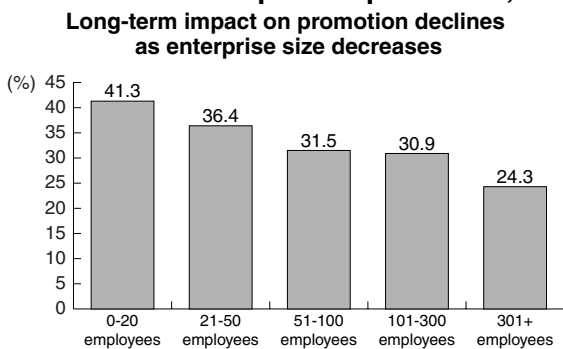
One reason why this form of evaluation is possible at SMEs may be that personnel rotation spans are longer at SMEs than large enterprises. In other words, the rotation cycle lengthens as the number of employees decreases, and transfers requiring a change of residence are also fewer (Figs. 3-3-48, 3-3-49). As employee rotation is not very frequent, long-term human relations can be built up between the assessor and the assessed, allowing the assessor to discern the “intrinsic abilities” of the employee subject to assessment. Another major factor allowing smaller enterprises to compensate their

Fig. 3-3-45 Reasons for permanent employees’ hesitancy about using parental leave and shorter working-hour arrangements



Source: Fujitsu Research Institute, *Survey Regarding Work and Parenting at Small Businesses* (December 2005).

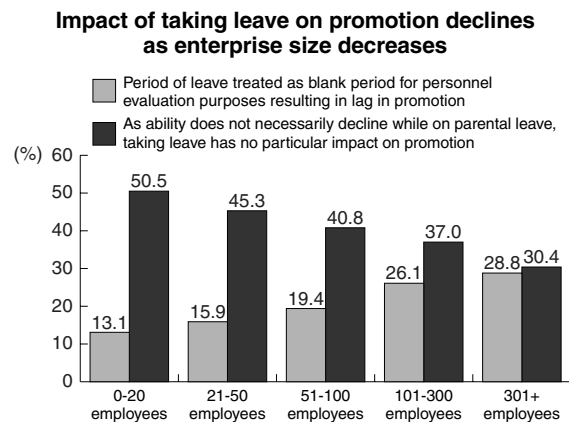
Fig. 3-3-46 Proportion of enterprises where taking leave for a certain period does not have a long-term impact on promotion, etc.



Source: Fujitsu Research Institute, *Business Survey Regarding Small Business Support for Balancing Work and Family* (December 2005).

Note: Enterprises that responded “agree” or “somewhat agree” to the statement “Taking leave for a certain period has no long-term impact on promotion, etc.”

Fig. 3-3-47 Personnel evaluation of employees who take leave to care for children



Source: Fujitsu Research Institute, *Survey Regarding Work and Parenting at Small Businesses* (December 2005).

Note: Enterprises with employees that have in the past taken parental leave.

employees according to their “intrinsic abilities” is that, provided that former colleagues are still present in the workplace when a woman returns from parental leave, employers can still tell how well she used to work when she returns to the workplace.

Managing personnel so as to enable personnel evaluators to ascertain the “intrinsic abilities” of employees through, for example, less frequent rotation of personnel, thus acts as an effective means of creating a workplace that is more conducive to balancing work and parenting.

2) Flatter organizations and greater on-the-spot decision-making powers

A further reason why temporary leave does not affect promotion at SMEs is that SMEs have fewer managerial positions and are hierarchically flatter than large enterprises.

As large enterprises tend organizationally to be more pyramid-shaped than SMEs and have more finely divided managerial positions, a blank of two or three years can have an impact throughout a person’s professional life by delaying promotion. SMEs, by contrast, generally have flatter organizations, and temporary blanks due to parental leave, for example, are not thought to have much of an impact on one’s career.

In recent years, some large enterprises, too, have taken steps to flatten their organizations as part of organizational reforms. Although most such reforms have been designed primarily to speed up decision-making, another possible outcome is the creation of a working environment like that described above that is more conducive to balancing work and parenting.

By flattening their hierarchies and cutting down the number of managerial positions in between, enterprises should also be able to respond more flexibly to the individual circumstances of employees regarding balancing work and parenting.

At enterprises with fewer employees, the greater proximity of the proprietor, i.e., the ultimate decision-making authority, to the workplace makes it possible to act responsibly according to the needs of individual

employees and the situation in the workplace. In other words, the proximity of the ultimate decision-making authority to the workplace is thought to be one factor that allows an enterprise to respond more flexibly to its employees’ needs.

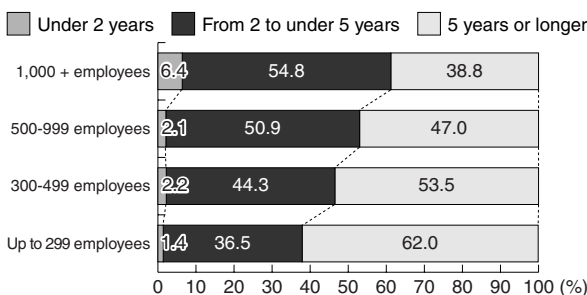
By giving the authority of a proprietor to those in charge on the frontline regarding at least treatment (pay, etc.) of staff, as well as flattening the managerial hierarchy, in order to create a similar situation at enterprises with more employees, it should be possible to respond more flexibly to employees’ needs.

Case 3-3-6 describes the actual case of one enterprise that, despite being a large enterprise, enabled itself to respond as flexibly as an SME and create a workplace conducive to balancing work and parenting by delegating a considerable amount of the president’s authority to staff in the workplace.

Here we change perspective to examine whether deliberate action by enterprises to “delegate powers to subordinate positions” and “flatten the organizational hierarchy” actually makes it easier for employees to balance work and parenting. Fig. 3-3-50 depicts an analysis of the association between revision of organizational and operational structures by enterprises in the past three years and the extent of use of various measures to assist balancing of work and parenting. It can be seen from this that measures leading to the delegation of powers to subordinate positions and measures to flatten organizational hierarchy strongly encourage use of measures to assist balancing of work and parenting.

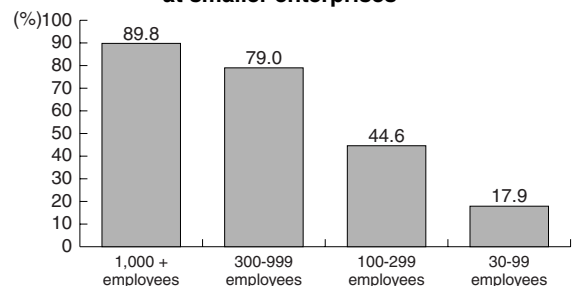
In this analysis, the action found to have the greatest impact on increasing the level of use of support measures was “rationalization of departmental overlap.” This is thought to make it easier for employees to use support measures such as shorter working hours due to the reallocation of work among employees and the elimination of unnecessary tasks reducing the volume of work in the workplace as a whole and creating enough slack to allow other employees to take on some of the work of employees caring for children.

Fig. 3-3-48 Permanent employee rotation cycle
Length of rotation cycle increases as enterprise size declines



Source: Japan Institute for Labour Policy and Training, *Fourth Survey of the Lives of Working People* (2004).

Fig. 3-3-49 Proportion of enterprises where personnel transfers require a change of residence
Transfers do not require changes of residence at smaller enterprises



Source: MHLW, *General Survey of Employment Conditions* (2004).

**Case
3-3-6**

Delegating authority to the shop floor creates a work environment conducive to combining work and child rearing

Mirai Industry Co., Ltd. is located in Gifu Prefecture and has a workforce of 800. It manufactures devices for electrical machinery.

The company has a policy of proactively employing women, and implements a number of measures to enable its female employees to continue working, such as shortening work time. Furthermore, for the past thirty years women have held sales positions, creating a work environment in which there is no conscious division of roles between male and female workers.

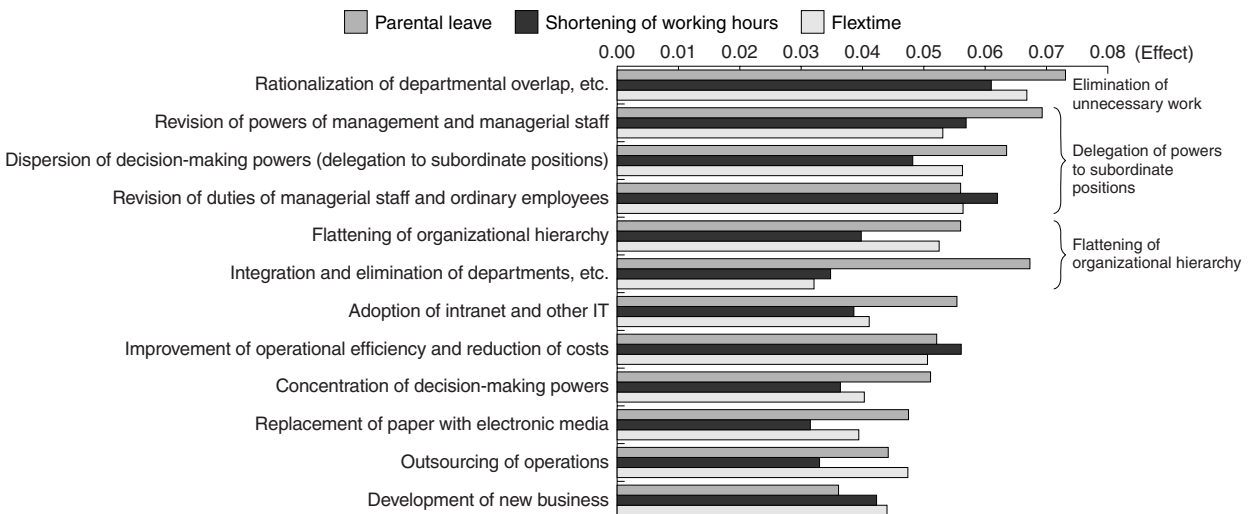
One notable feature is the company's short working hours. As a general rule, employees are not made to do overtime, they have 140 days off a year (the average for Japanese companies is 120), which increases to 160 days a year when including paid leave. More specifically, employees have 11 consecutive days off work over Golden Week (the week between April 29 and May 5, which includes several national holidays), ten days for summer vacation, and 20 days over New Year. If a public holiday falls on a Tuesday or Thursday, the Monday or Friday is also given as a day off work, creating a four-day holiday. Employee salaries are at the very least considerably higher than the average for the region. The company's founder, who is currently an adviser for the company, says, "There's a limit to how much salary alone can make people happy. It doesn't cost any money if you are innovative in reducing work hours." Reducing work hours raises employee satisfaction

and maximizes their willingness.

Supervision of employees is also dispensed with as much as possible, and delegating authority to the factory floor to the maximum extent possible generates products that differentiate the company from others. There are no sales targets or quotas whatsoever. Instead, each person sets targets based on plans to introduce new products and customer requests. For example, a salesman is given absolute authority when conducting sales talks. The method of reporting, liaison, and consultation that is common practice among most companies is considered unnecessary. The same company adviser explains the company's culture this way, "It's best to have employees, who know the shop floor better than anyone, to think for themselves rather than consulting an ignorant superior."

Under this management policy, the company's employees have raised efficiency and productivity within their set work hours and are said to be totally committed to ensuring competitiveness. In fact, the company has maintained an ordinary income to sales ratio, which demonstrates its earnings power, of 10% or higher. In other words, even though it is a large company with a workforce of 800, considerable delegation of authority to the shop floor – a feature of SMEs covered in this chapter – has not only resulted in maintaining satisfactory business performance while having shorter working hours, but has also created a work environment that is conducive to combining work and child rearing.

Fig. 3-3-50 Relationship between revision of corporate organization and operations and level of use of arrangements to assist balancing of work and family
Elimination of unnecessary work, delegation of powers to subordinate positions, and flattening of organizational hierarchy encourage use of measures to assist balancing of work and family



Source: Fujitsu Research Institute, *Business Survey Regarding Small Business Support for Balancing Work and Family* (December 2005).

- Notes:
1. "Effect" expresses the extent to which the revision of corporate organization and operations encourages use of measures to assist the balancing of work and family within the enterprise.
 2. For details of how "effect" was calculated, see Appended Note 3-3-12.

3) Working environment closer to home

As can be seen in Fig. 3-3-51, employees of smaller enterprises tend to live closer to work, and this may be another feature of SMEs that makes it easier to combine work and parenting.

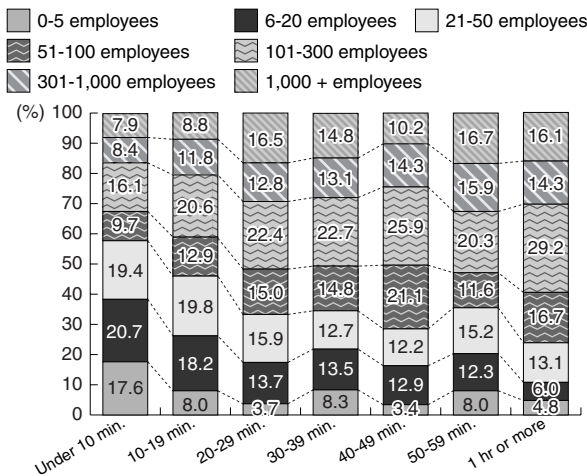
An examination of the relationship between commuting times and number of children reveals that the number of children per female employee increases the nearer the workplace is to home (Fig. 3-3-52). This indicates that for women, working nearer to home makes it easier to have and raise children.

From the point of view of creating a working environment that is more conducive to combining work

and parenting, therefore, it may be more advisable to establish business establishments near employees' residences and in the suburbs rather than in the center of cities. Of course in some industries, such as manufacturing for example, the proximity of homes and business establishments could conversely create all kinds of problems, making it necessary to consider the situation in each line of business and work. Generally speaking, however, "compact town development"³⁴⁾ that puts homes and places of work in closer proximity to each other appears to be one effective way of making it easier for employees to balance the demands of work and parenting.

Fig. 3-3-51 Commuting times of female employees

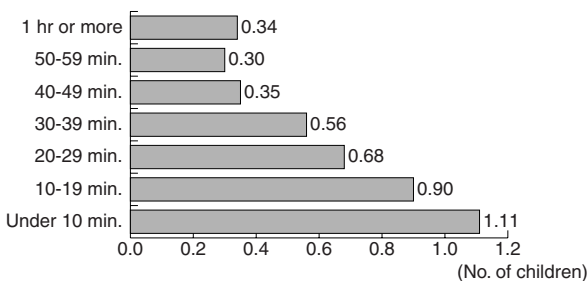
Proportion of smaller enterprises increases as commuting times decline



Source: Fujitsu Research Institute, *Survey Regarding Work and Parenting at Small Businesses* (December 2005).

Fig. 3-3-52 Number of children born per female employee by commuting times

Number of children per female employee increases as commuting times fall



Source: Fujitsu Research Institute, *Survey Regarding Work and Parenting at Small Businesses* (December 2005).

4) Environment in which children can be brought to the workplace

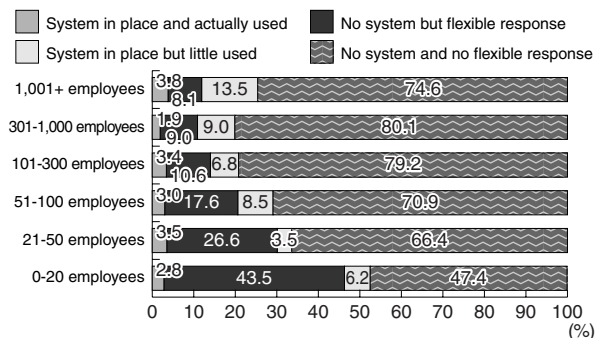
When the home and workplace are in close proximity, many employees also take their children to work. If we break down the establishment and use of conditions allowing children to be brought to the workplace according to number of employees, we find that smaller enterprises have environments that are more amenable to employees bringing children to the workplace (Fig. 3-3-53).

Bringing children to the workplace represents, in a sense, the combination of work and parenting in its purest form. So is the presence of such an environment related to ease of combining work and parenting? A comparison of actual enterprises where children can be brought to the workplace and those where they cannot reveals that the former have a higher proportion of female permanent employees who return to the workplace after birth (Fig. 3-3-54).

It may be concluded from this that a workplace environment that allows employees to bring their

Fig. 3-3-53 Establishment and use of system allowing children to be brought to workplace (including company crèches)

Flexibility increases as size of enterprise declines



Source: Fujitsu Research Institute, *Business Survey Regarding Small Business Support for Balancing Work and Family* (December 2005).

34) See Part III, Chapter 4.

children to work makes up for SMEs' lack of concrete arrangements to provide support for childcare while parents are working.

If we compare the commuting methods and commuting times of employees who do and who do not bring their children to work, we discover that whereas employees who bring their children to work tend to have shorter commutes and to commute more by car or on foot, a higher proportion of employees who do not bring their children to work have longer commutes and travel more by public means of transport, such by train or by bus (Figs. 3-3-55, 3-3-56). It may be surmised from this that creating an environment in which children can be brought to the workplace is more effective where commuting times are shorter and more employees can travel to work by car or on foot.

Breaking down the frequency with which employees bring children to the workplace according to children's ages, 30% of employees bring a child to the workplace every day when aged less than one year (Fig. 3-3-57). Considering this in conjunction with the previously

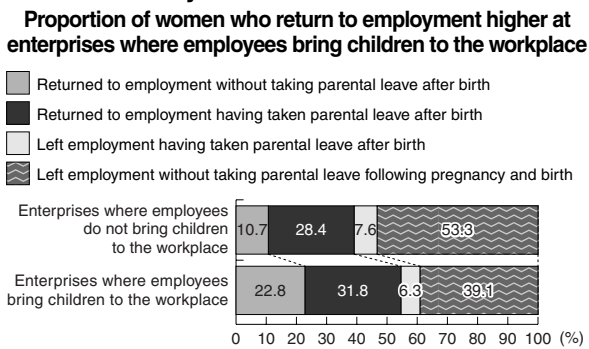
described long waiting lists for day-care places for small children, establishing crèches in the workplace for small children appears to be one effective means of helping women to return to the workplace after giving birth.

From the above, it may be concluded that developing an environment in which employees can bring children (especially very small children) to the workplace translates into greater ease of combining work and parenting for employees.

So what kind of workplace provides an environment amenable to bringing children to work?

For the Fujitsu Research Institute's *Survey Regarding Work and Parenting at Small Businesses*, employees who answered that they brought, or had brought, children to the workplace when necessary were asked in detail about conditions at the workplaces to which they brought children. This showed that approximately 60% of employees kept their children by their side, and approximately 30% said that their workplaces had company crèches or similar places in which to leave their children. However, when employees who brought

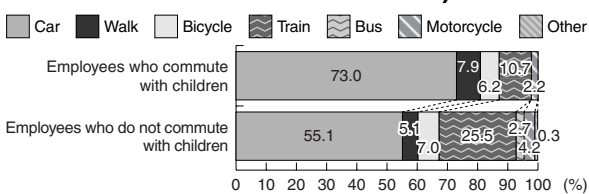
Fig. 3-3-54 Proportions of female employees who had a child in the past five years and returned to employment after birth at enterprises where employees bring children to the workplace, and enterprises where they do not



Source: Fujitsu Research Institute, *Business Survey Regarding Small Business Support for Balancing Work and Family* (December 2005).

Note: Including female permanent employees who have already left employment.

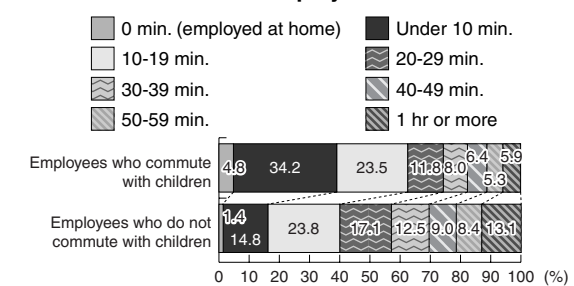
Fig. 3-3-55 Employees' means of commuting (according to whether children can be taken to work)



Source: Fujitsu Research Institute, *Survey Regarding Work and Parenting at Small Businesses* (December 2005).

Fig. 3-3-56 Commuting times of employees (according to whether they commute with children)

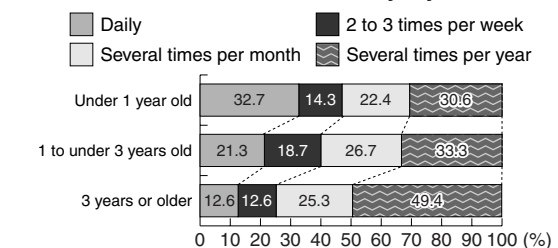
Employees who commute with children have shorter commutes than employees who do not



Source: Fujitsu Research Institute, *Survey Regarding Work and Parenting at Small Businesses* (December 2005).

Fig. 3-3-57 Frequency with which first child is brought to workplace

Higher proportion of employees bring smaller children to work everyday



Source: Fujitsu Research Institute, *Survey Regarding Work and Parenting at Small Businesses* (December 2005).

Note: Employees who brought first child in each age group to the workplace.

children to their workplace were asked what aspects made it difficult to bring children to the workplace, high proportions answered “would inconvenience colleagues,” “would not be able to concentrate on work” or “nowhere for children to settle down” (Fig. 3-3-58), and this tendency is more pronounced among employees that answered “no” regarded whether they thought their workplaces were amenable to bringing children to work. This suggests that one key to making the workplace more amenable to bringing children to work is by providing space for children that is somewhat removed from the actual workplace so that employees do not have to work with their children by their side.

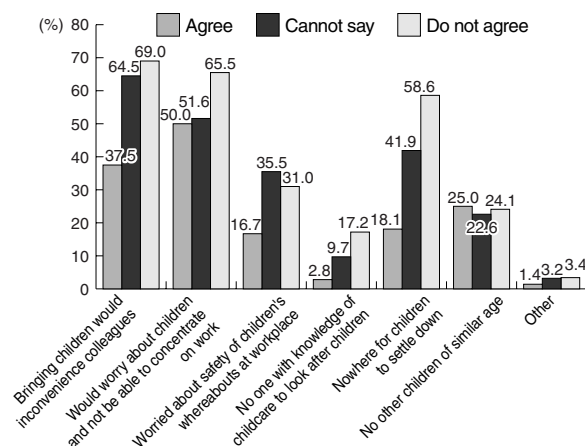
Similarly, asking employees who brought children to the workplace what points were most important to creating an environment that made it easier to bring children to the workplace reveals the following three factors to be considered to be particularly necessary (Fig. 3-3-59):

- 1) Provision of space for children at employers
- 2) Provision of staff to look after children
- 3) Understanding in the workplace for employees bringing children to work

The above indicates that in order to create a workplace that makes it easier to bring children to work, it is necessary to provide space for children in the workplace and to have the human resources to look after them so as to enable employees to concentrate on their

Fig. 3-3-58 Obstacles to bringing children to workplace

Employees who do not think it easy to bring children to workplace are more likely to sense as an obstacle the absence of an environment allowing employees themselves and their children to settle down



Source: Fujitsu Research Institute, *Survey Regarding Work and Parenting at Small Businesses* (December 2005).

- Notes:
1. Employees who responded “agree,” “somewhat agree,” “cannot say,” “somewhat disagree,” and “disagree” to the question “Is your workplace amenable to bringing children to work?”
 2. In the graph, “agree” and “somewhat agree” are grouped together under “agree,” and employees who responded “somewhat disagree” and “disagree” are grouped together under “disagree.”

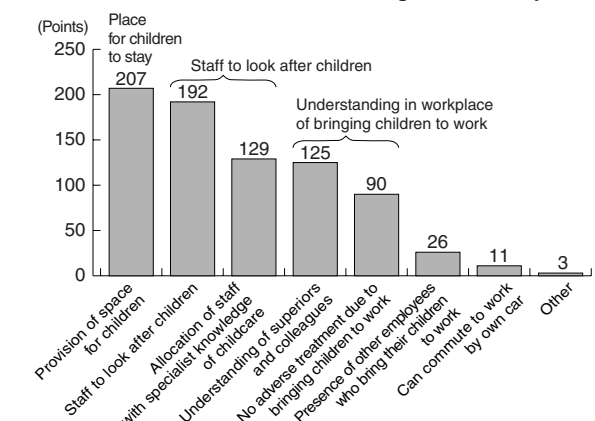
work and their children to settle down. Allocating human resources to look after children is considered to be one important way in which the workplace can be made more amenable to bringing children to work, but this need does not in fact appear to have much impact as an obstacle to bringing children to the workplace (Fig. 3-3-58). This suggests that the people looking after children may not necessarily have to be people with specialist knowledge, such as qualified nursery staff. Instead, a variety of resources could be used, including employees and spouses of employees with experience of raising children, former employees, mutual support in the community, and collaborative groups formed among SMEs themselves.

5) Diversity of appointment of women at SMEs

The proportion of women in managerial positions could be one factor that affects the ease with which the demands of work and parenting can be balanced in the workplace. If we consider the question from the point of view of the role of women in the workplace, we find that at large enterprises, the proportion of employees who are women is a largely uniform 50% or less at all enterprises, and the proportion of women tends to fall in higher managerial positions. In contrast, the proportion of women among employees and in management positions increases on average as enterprise size declines. Underlying this is the fact that SMEs exhibit considerable diversity, with some being more male-dominated than large enterprises while others may have an entirely female management from the president down (Fig. 3-3-60).

Fig. 3-3-59 Priorities in order to make environment more amenable to bringing children to workplace

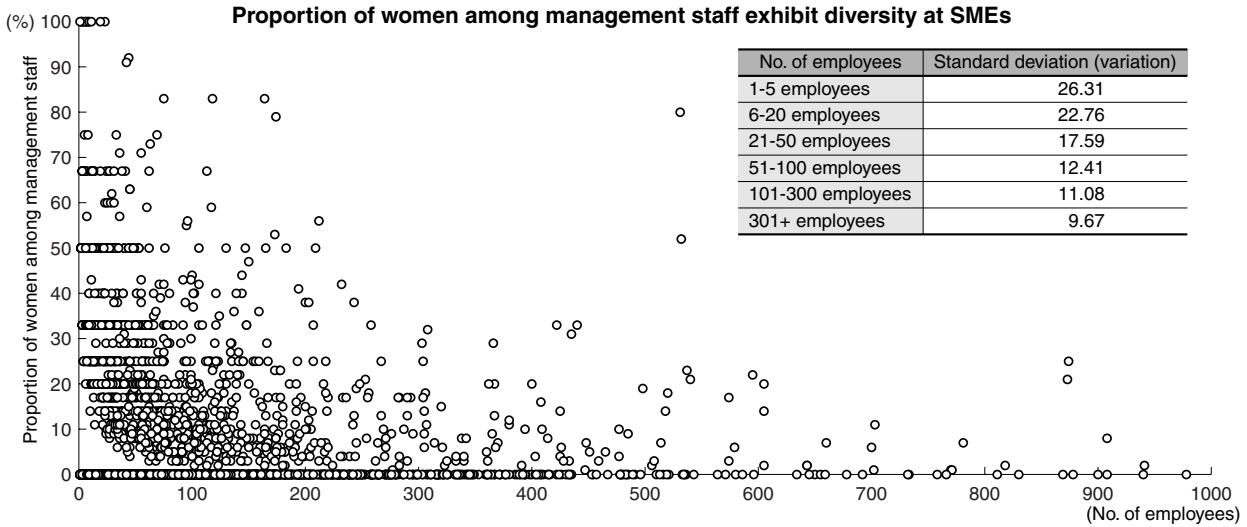
Important to secure space, people to look after children, and to obtain understanding in the workplace



Source: Fujitsu Research Institute, *Survey Regarding Work and Parenting at Small Businesses* (December 2005).

Note: Respondents were asked to assign 3 points to their top priority, 2 points to their second priority, and 1 point to their third priority for making the workplace more amenable to bringing children to work.

Fig. 3-3-60 Distribution chart showing number of employees and proportion of women among management staff



Source: SME Agency, *Fact-Finding Survey of Use of Human Resources and the Parenting Environment at Small and Medium Enterprises* (December 2005).

A clear correlation can be observed between female involvement in management at enterprises and ease of combining work and parenting (Fig. 3-3-61). This is probably due to the fact that a high proportion of female superiors and management personnel have themselves raised children and so are more understanding of parental needs.

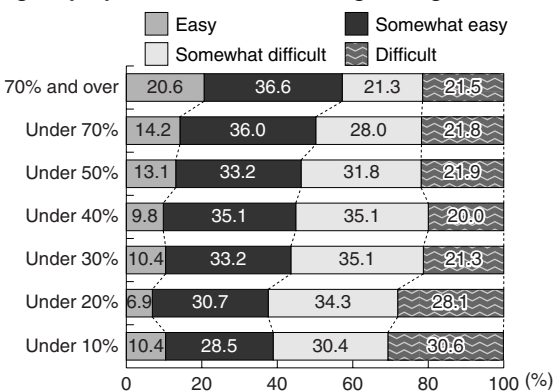
For people looking for jobs that are more conducive to balancing work and parenting, therefore, the proportion of women in management positions could serve as one indicator of whether a workplace offers an environment that is conducive to balancing work and parenting. Propagating such a measure is in the interests

of both job seekers and enterprises. This is because from the point of view of job seekers, it provides a useful metric for choosing a place of employment if he or she particularly wants to balance work and parenting, while from the point of view of employers, it can be used as a means of generating favorable publicity when recruiting human resources.

To summarize the above analysis, the five key concepts that make it easier to balance work and parenting suggested by the features of SMEs are as follows.

Fig. 3-3-61 Ease of balancing work and parenting at workplace (by proportion of women among management staff)

Easier to balance work and parenting at workplace with higher proportion of women among management staff



Source: Fujitsu Research Institute, *Business Survey Regarding Small Business Support for Balancing Work and Family* (December 2005).

- 1) Personnel evaluation based on the “intrinsic abilities” of employees can reduce the damage to careers, or “career loss” (revision of personnel evaluation and rotation practices).
- 2) Reducing the number of levels of management can also reduce the damage to careers arising from taking parental leave, and flattening management and delegating powers to subordinate positions serve to promote measures to help employees to balance work and parenting (revision of forms of organization and allocation of powers within the enterprise).
- 3) As the proximity of workplaces to employees’ homes creates an environment in which it is easier for women to combine work and parenting, pursuing town development that brings homes and residents closer together is an effective way of supporting the balancing of work and parenting demands (compact town development, etc.).

- 4) Creating an environment that allows children to be brought to the workplace makes it easier to combine work and parenting, and a variety of ideas can be applied to securing the space and people to look after children in the workplace.
- 5) Encouraging the wider use of measures such as the proportion of women in management positions as indicators of ease of balancing work and parenting provides an effective measure not only for job seekers, but also for enterprises advertising themselves when recruiting human resources.

Thus far, we have considered the issues and key points involved in creating a working environment that makes it easier to balance work and parenting. Now we consider how the establishment of such a working environment can benefit enterprises in a business sense, particularly SMEs with few spare business resources.

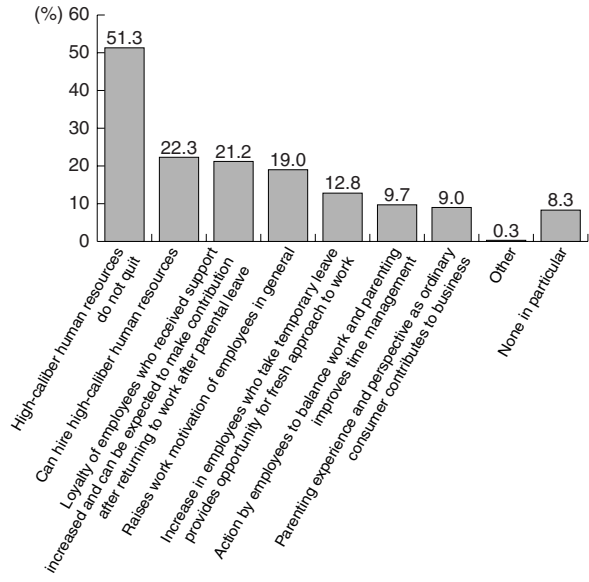
Fig. 3-3-62 shows that many enterprises consider measures to support the combination of work and parenting to benefit enterprise performance in the following ways: “high-caliber human resources do not quit,” “can hire high-caliber human resources,” “raises work motivation of employees in general,” and “loyalty of employees who received support increased and can be expected to make contribution after returning to work after parental leave.”

In other words, measures to assist the balancing of work and parenting could be said to have a positive effect on business management by contributing to the retention of employees, recruitment of new human resources, and motivation of employees.

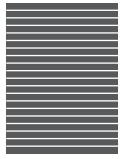
Case 3-3-7 provides one example of the concrete effects on business management, including a decline in the proportion of product defects, resulting from focusing on the development of a working environment that makes it easier to combine work and parenting.

For SMEs, the abilities and motivation of human resources are a business lifeline. Measures to help employees to balance work and parenting are not, as the preceding analysis has demonstrated, limited to actions that can be taken only by enterprises with resources to spare, and it might be a good idea for enterprises to take such measures as a part of their business strategies, drawing on the analysis in this chapter and other sources, as a means of attracting and retaining high-caliber human resources.

Fig. 3-3-62 Positive impact on business performance of measures to assist balancing of work and parenting
Effective as means of retaining human resources, securing human resources, and motivating employees



Source: Fujitsu Research Institute, *Business Survey Regarding Small Business Support for Balancing Work and Family* (December 2005).



Case 3-3-7

Reducing product defect ratio through a work environment conducive to combining work and child rearing

Kamite Co., Ltd. is located in Akita Prefecture and has a workforce of 25, of which 16 are female. It is a manufacturing company engaged primarily in press die design and manufacture, as well as press forming.

The company's philosophy consists of the following three tenets; 1) "Contribute to customer growth and development following the principle of having a small but select team;" 2) "Aim to create a bright and enjoyable workplace in pursuit of the growth and happiness of both employees and the company;" and 3) "Firm and sincere commitment to contributing to the growth of the regional society." To achieve the first two principles, the company makes an effort to support combining work and family. That is, in order to contribute to customer growth and development following the principle of having a small but select team, it puts resources into the training of human resources, as it believes that even if an employee is absent for a time due to child-care leave, it is important for the company that the employee returns to work with his or her skills and that these skills are continually improved. In aiming to create a bright and

enjoyable workplace in pursuit of the growth and happiness of both employees and the company, it believes that it is beneficial to establish a workplace where it is easy to combine work and family.

Meetings between the president and individual employees are held at the company once every three months, at which they discuss issues such as what employees think about their work, their career, their opinions on the various systems in place, and requests. It is through these meetings that the company has instituted systems to support combining work with family. These include a system allowing child-care leave up until the day before a child's third birthday, a system for shortening working hours once child-care leave is over, and a company day-care center. Furthermore, it takes the opportunity of covering for a staff member on child-care leave by reviewing all its business processes to eliminate any slack. As a result, it has come to be seen as having a positive effect on the company's business, not only because it does this increases employee motivation, but also because it has lowered the product defect ratio to 20 ppm (parts per million).

Section 9 Summary of Chapter 3

In this chapter, we have analyzed what action needs to be taken to create a society that makes it easier to have and raise children from two perspectives: from the point of view of the employment of younger people, and from the point of view of balancing work and parenting.

Regarding the employment of younger people, engaging in wide-ranging hiring activities that do not discriminate against job applicants based on how they used to be employed and retaining younger employees by clearly disclosing training policies and taking steps to promote employee development have been clearly shown to have positive benefits for both SMEs struggling to recruit younger workers, and for younger people seeking more stable jobs and incomes.

Regarding the balancing of work and parenting, it has been shown that smaller SMEs tend to offer working environments that make it easier to combine work and parenting. In the future, making the most of their features

and creating a workplace that makes it easier to combine work and parenting to attract high-caliber human resources should have a positive effect on the business management of larger SMEs as well.

For its part, the Government should perhaps provide backing for the wider spread of the features of SMEs identified in this analysis.

The measures described thus far for creating a society that makes it easier to have and raise children have benefits for business management, and are also beneficial to the public as individuals in that they contribute to the formation of a society that encourages greater self-fulfillment and a higher quality of life. It is therefore in the future interests of everyone in Japan for effective measures such as these to be implemented by enterprises as a part of business strategy, ultimately maintaining and increasing the vitality of society as a whole.

Chapter 4 The creation of bustling town centers, development of new local communities, and SMEs

The Japanese population began to decline in 2005. A breakdown of population changes over the past few years according to region shows, however, that, as described in Part III, Chapter 1, it is only in certain areas (primarily in and around major urban areas) that population growth is occurring, and population decline, including the depopulation of rural areas due to population movements after birth, is already considerably advanced in provincial areas.

With the Japanese population projected to fall in the future, it is argued that “compact town development” so as to concentrate urban functions as far as possible in central areas and keep down the cost of use and maintenance of existing infrastructure will offer an effective means of maintaining the affluence of residents’ lifestyles by maintaining sustainable local government finances and communities, especially in provincial areas where population decline is projected to be particularly rapid.

In December 2005, an interim report entitled “Developing Compact and Bustling Town Centers” was released by the Joint Council of the Industrial Structure Council and the Small and Medium Enterprise Policy Making Council,¹⁾ and this proposed that future measures should revolve around:

- 1) Concentration of various urban functions in city centers rather than suburban areas (“concentration of urban functions in city centers”); and
 - 2) Pursuit of action to strengthen the commercial functions of city centers and make them more attractive as communities based on the needs of visitors and residents (“revitalization of city centers”).
- These, the report suggested, needed to be pursued in an integrated fashion as two sides of the same coin.

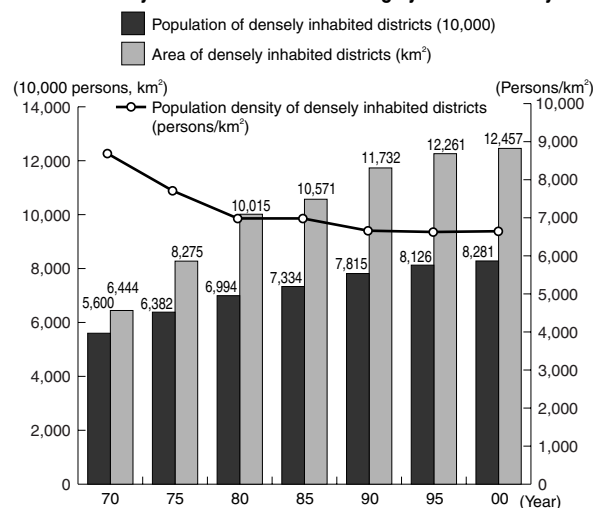
In this chapter, therefore, we examine the “town vitality” needed in order to develop the kinds of compact towns that will be needed by the demographically aging and declining society of the future.

Section 1 Populations and economic vitality of city centers at present

The Japanese population has risen continuously since World War II, sprawling into the suburbs in the process. An examination of this situation in terms of changes in densely inhabited districts (DIDs)²⁾ shows that the area of DIDs roughly doubled in the 30 years from 1970 to 2000 (Fig. 3-4-1). If we look at the population dynamics by district, it can be seen that densely inhabited districts have grown “thinner and broader” as a result of population decline in city centers and population growth in suburban areas³⁾ (Fig. 3-4-2).

This trend toward suburbanization is evident also from changes in the number of stores and value of commercial sales by location⁴⁾ according to the *Census of Commerce*. Between 1997 and 2004, the number of stores of at least 500m² has grown in all locations in both urban and provincial areas, except in commercial districts such as city centers (Fig. 3-4-3). A similar trend is exhibited in the value of sales. However, growth is particularly marked in the sales of large stores of at least 3,000m² in “industrial districts” and “other districts” in

Fig. 3-4-1 Trends in densely inhabited districts
Area of densely inhabited districts has roughly doubled in 30 years

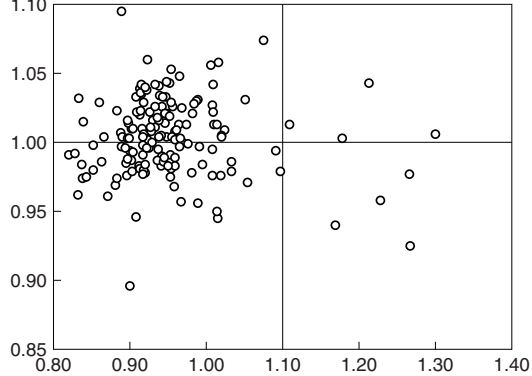


Source: MIC, *Population Census* (2000).

- 1) Interim report of the Joint Meeting of Distribution Committee, Industrial Structure Council; and Commerce Subcommittee, Business Support Committee, Small and Medium Enterprise Policy Making Council, “Developing Compact and Bustling Town Centers” (December 22, 2005). The council met on 14 occasions from September 2004 to review related measures based on changes in the environment surrounding city centers arising from the policy shift represented by the “Three Town Development Laws” (i.e., the Law Concerning the Integrated Promotion of the Development and Improvement of City Centers and Revitalization of Commerce, Large-Scale Retail Stores Location Law, and City Planning Law).
- 2) Districts formed by adjacent districts having a population density of at least 4,000 persons per square kilometer, and which have a total population of at least 5,000, where “districts” are defined as the “basic districts” used in the Population Census. “Basic districts” generally are urban subsections that form areas (*chocho* and *aza*, etc.) of municipalities.
- 3) Areas of urban districts other than “city centers.”
- 4) See Appended Note 3-4-1.

Fig. 3-4-2 Change in population of city centers and suburbs

Population decline in central areas and increase in suburbs
(Suburban population in 2000 / suburban population in 1995)



Central urban population in 2000 / central urban population in 1995
(Calculated according to the 1995 and 2000 *Population Censuses*.
Suburbs = urban areas - designated city centers)

Scope: Urban areas with a population of at least 100,000 (10% commuter belt) of central cities for which basic plans for city center revitalization had been formulated by October 2003, excluding metropolitan Tokyo and ordinance-designated cities (total of 155 cities).

Source: METI.

major urban areas, and “other districts” in provincial areas (Fig. 3-4-4).

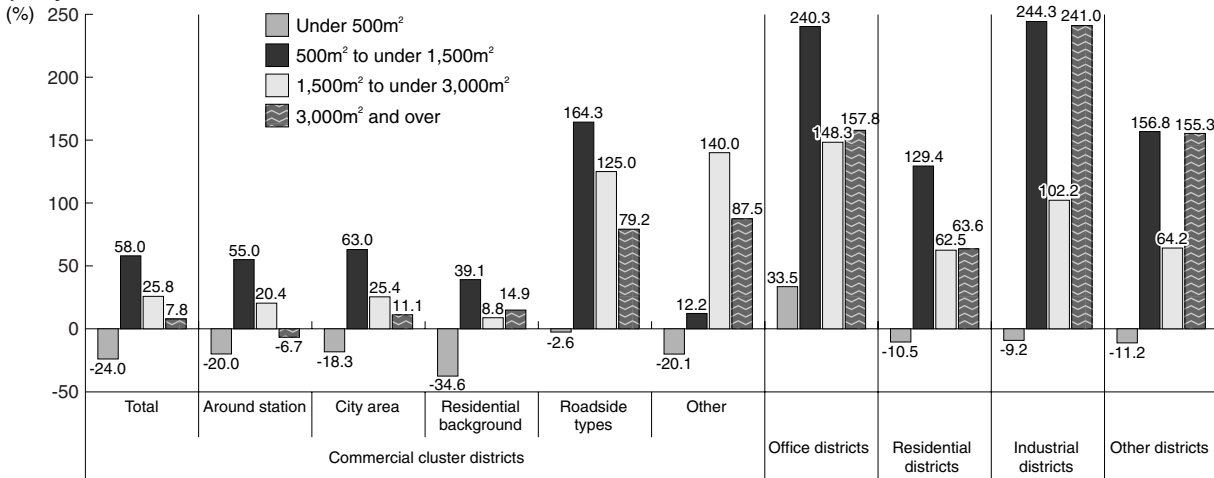
Reasons for the particularly rapid growth in large stores in “industrial districts” and “other districts” include the use of former industrial sites vacated by manufacturers expanding overseas and consolidating their operations, and the conversion of agricultural land.

On the other hand, in commercial districts, including city centers, sales are declining in almost all locations except “roadside” and “other” districts. The decline in sales is particularly conspicuous in provincial areas, indicating that city centers in provincial areas face especially severe conditions.

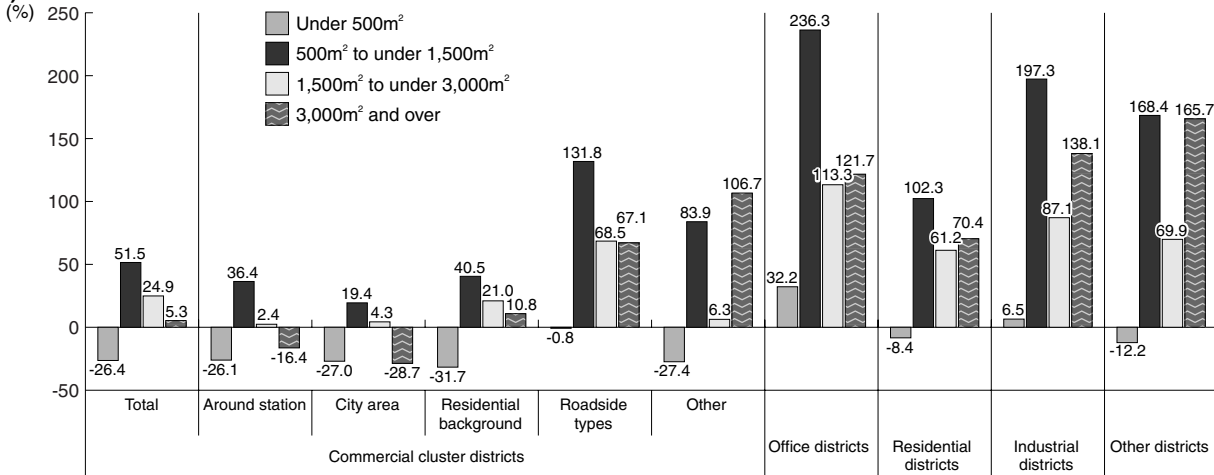
Looking next at trends in the number of stores and sales by size of store, it can be seen that there has been conspicuous growth in the number of stores of an area of 500-1,500m², and conspicuous growth in sales at stores of 500-1,500m² and 1,500-3,000m² in both major urban areas and provincial areas. In provincial areas in particular, growth in sales of stores of 1,500-3,000m² has been marked, reflecting the buoyant state of generally imagined “roadside business.” On the other hand, sales

Fig. 3-4-3 Rate of increase in number of stores by location and sales floor area (in 2004 compared with 1997)
Increase in number of stores of at least 500m² except in commercial districts

1) Major urban areas



2) Provincial areas

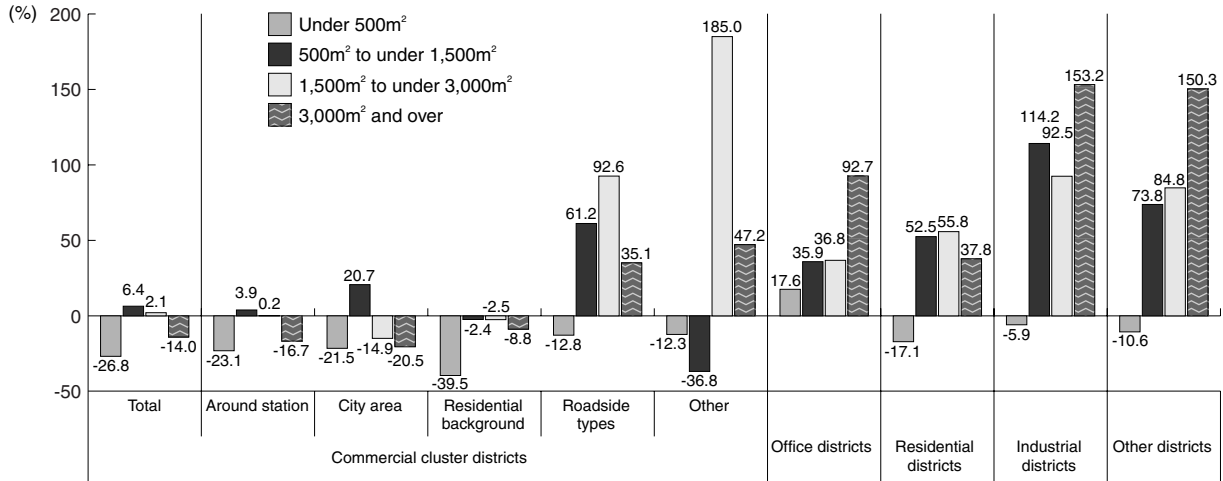


Source: Recompiled from METI, *Census of Commerce*.

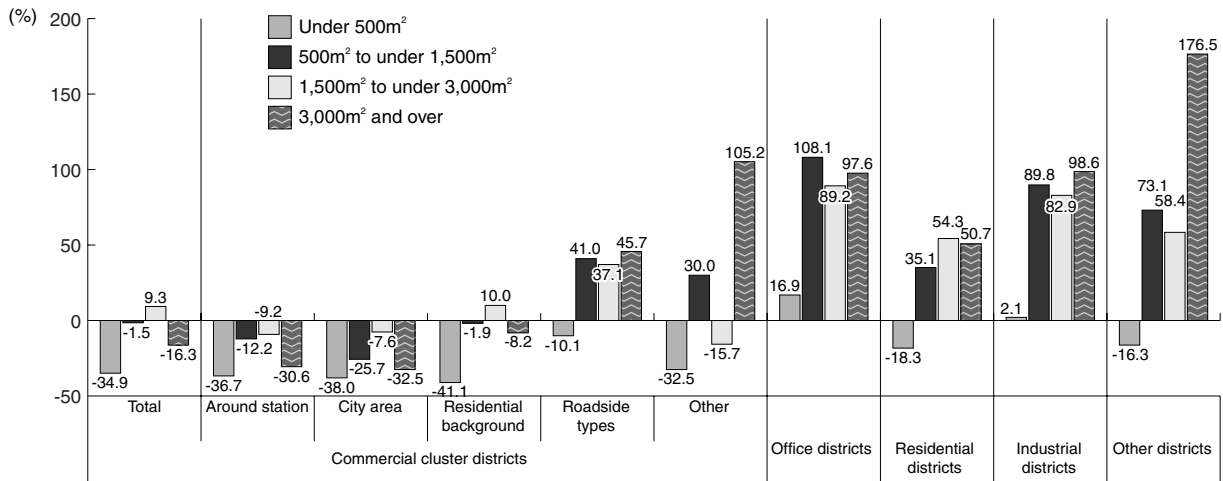
Fig. 3-4-4 Rate of growth in commercial sales by location and sales floor area (in 2004 compared with 1997)

Marked growth in sales of large stores of at least 3,000m² in industrial and other districts

1) Major urban areas



2) Provincial areas



Source: Recompiled from METI, *Census of Commerce*.

of superstores of at least 3,000m² have not grown as much as generally thought, and in major urban areas especially, it is evident that sales are declining (Fig. 3-4-5). One possible reason for the decline in major urban areas is the collapse and ailing state of leading distributors such as department stores and general merchandise stores (GMS) located in large numbers in front of stations and in urban areas.⁵⁾

As noted in the interim report mentioned above, this indicates that competition between businesses has evolved from the traditional style of competition between large businesses and small and medium retailers, to location-based competition between city centers and suburbs.

With this in mind, then, we focus next on the vitality of city centers as commercial clusters.

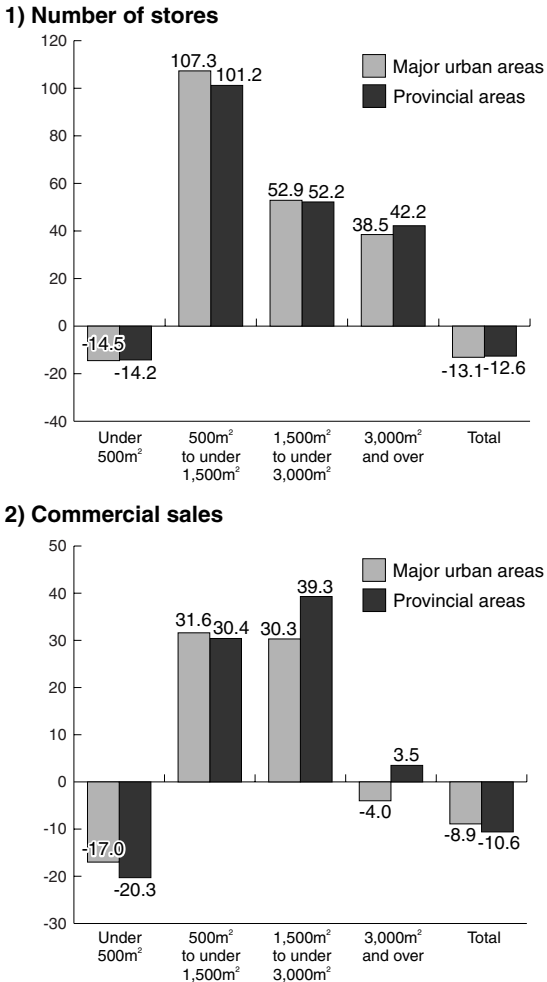
As previously described, populations are declining in city centers and rising in suburban areas. Below, however, we look at the data from the point of view of whether, in relation to population size, store sales might not be even more depressed.

Looking at Fig. 3-4-6, it can be seen that whereas in city centers sales per unit of population are increasing in eight of 155 urban areas, they increased in 36 suburban areas. Because the sales of retailers declined by a national average of over 10% (10.3%) between 1997 and 2002,⁶⁾ sales are declining more compared with population size in most cities in both city centers and suburban areas. As the distributions shown in Fig. 3-4-6

5) See Appended Note 3-4-2 “Trends in sales of department stores and general merchandise stores.”

6) See Fig. 2-3-24 in *2005 White Paper on Small and Medium Enterprises in Japan*.

Fig. 3-4-5 Trends in number of stores and commercial sales by size
Marked growth in stores from 500m² to under 3,000m² in size, but less growth among larger stores



Major urban areas: Tokyo, Nagoya, Osaka and environs
 Provincial areas: National - major urban areas
 Source: Recompiled from *Census of Commerce*.

indicate, however, it is clear that city centers are generally hollowing out and suffering an outflow of sales to suburban areas.

Looking more specifically at the two areas of Kofu City and Akita City and their environs, where the outflow of population from city center areas to suburban areas is pronounced, tabulating sales data by district subsection according to the *Census of Commerce* into two categories of goods—"daily necessities" and "shopping goods"—reveals the following.⁷⁾

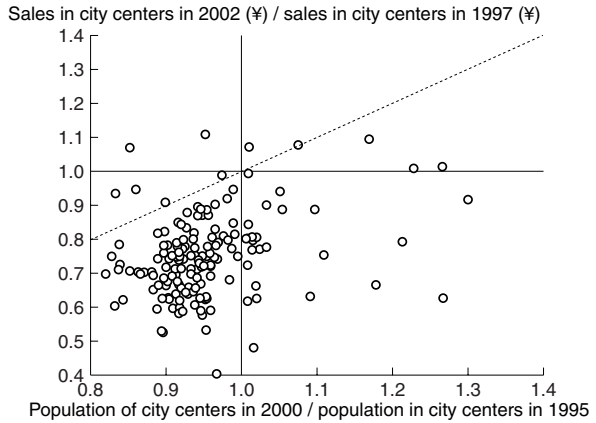
1) Daily necessities (food and beverages)

Districts in which the population has flowed into the suburbs are exhibiting a corresponding rise in sales. Overall, population density and sales by district are

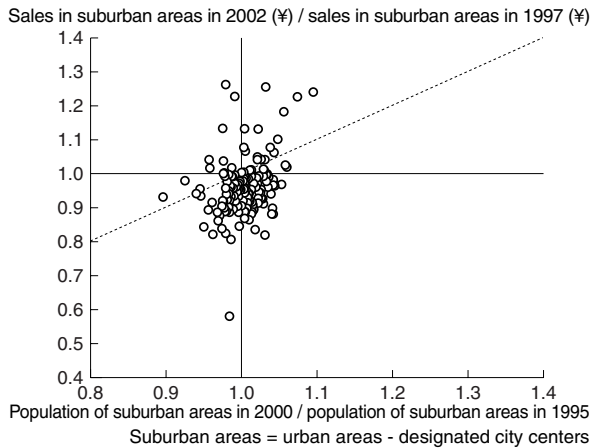
Fig. 3-4-6 Population change and change in sales by region

Growing hollowing out of city centers

1) City centers



2) Suburban areas



(Calculated from the 1995 and 2000 *Population Censuses* and the *Census of Commerce* for 1997 and 2002.)
 Scope: Urban areas with a population of at least 100,000 (10% commuter belt) of central cities for which basic plans for city center revitalization had been formulated by October 2003, excluding metropolitan Tokyo and ordinance-designated cities (total of 155 cities).
 Source: METI.

proportionately related.

2) Shopping goods (fabrics, furniture, automobiles)

As of 1997, districts along suburban main roads with high sales for their populations (i.e., districts attracting shoppers from surrounding areas) were spreading. As of 2002, however, such districts were declining across the board. On the other hand, sales are recovering in few districts, including city centers, and the assumption is that when a store closes in an area alongside a main road, sales in the area as a whole tend to fall dramatically as shoppers disappear to more distant areas.

It may be concluded from this that regardless of whether the locating of stores is supported or regulated, different approaches are required according to whether

7) See Appended Note 3-4-3 "Trends in population and retail sales by district in and around (1) Kofu City and (2) Akita City."

the products sold are daily necessities or shopping goods. Stores selling daily necessities appear to provide urban functions that are required if the local population is to be

maintained, while stores selling shopping goods provide urban functions that are required to maintain local economic vitality.

Section 2 The need for action to assist “compact town development”

Having enjoyed hitherto continued population growth, Japan is now confronted by long-term population decline for the first time in the modern era, requiring a variety of paradigm shifts, both institutionally and in terms of outlook.

In Part III, Chapter 1, it was described how Japan will become an exceedingly aged society in the 2010s, with approximately one in four of the population aged 65 or over. If the situation is broken down according to region, however, the proportion of the population aged 65 or over is forecast to be even higher than the national average in almost all regions except the three major urban conurbations.⁸⁾

Thus with the population projected to grow even more aged, town development is likely to assume greater importance in the future as a means of making life more convenient for the elderly.

Indeed, a survey of people’s views regarding the importance of city centers⁹⁾ reveals that providing a “hospitable environment for the elderly to live” is considered to be one of the most important roles of city centers (Fig. 3-4-7).

The *Opinion Survey of Elderly Living Alone*¹⁰⁾ shows that by far the commonest means of transport used by the elderly is “walking,” indicating the importance of providing a living environment in which residents can buy daily necessities within walking distance (Fig. 3-4-8).

From the point of view of local governments throughout Japan, which are facing severe financial difficulties, the question of how to invest and allocate limited financial resources to achieve “sustainable local government finances” amid the decline and aging of store proprietors in town centers has become an important issue (Fig. 3-4-9).

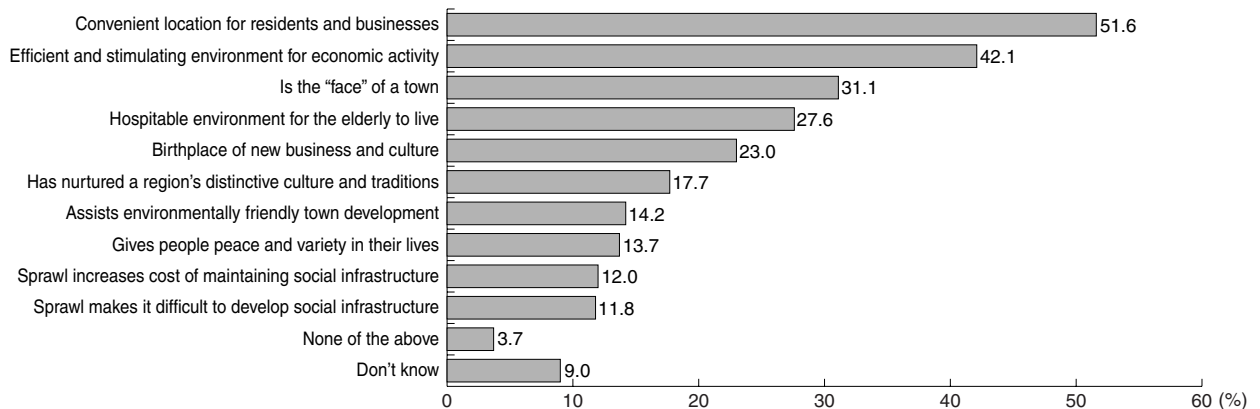
Let us look, then, at whether the revitalization of city centers contributes to municipal finances, taking as an example tax revenues in the city of Saga. Comparing the city center and suburban land rearrangement districts, we examine trends in fixed asset tax revenues, which represent around 40% of annual city tax revenues.¹¹⁾

Starting with fixed asset tax on land, the proportion of tax revenue of the city as a whole derived from tax

Fig. 3-4-7 Views on city centers

Also commonly viewed as being a hospitable environment for the elderly to live

View of the importance of city centers (unit: %, sample: 1,324)



Source: Dentsu Public Relations Inc., *Public Opinion Survey Regarding Publicity and Awareness Raising Activities Directed at the General Public Concerning City Centers* (November 2005).

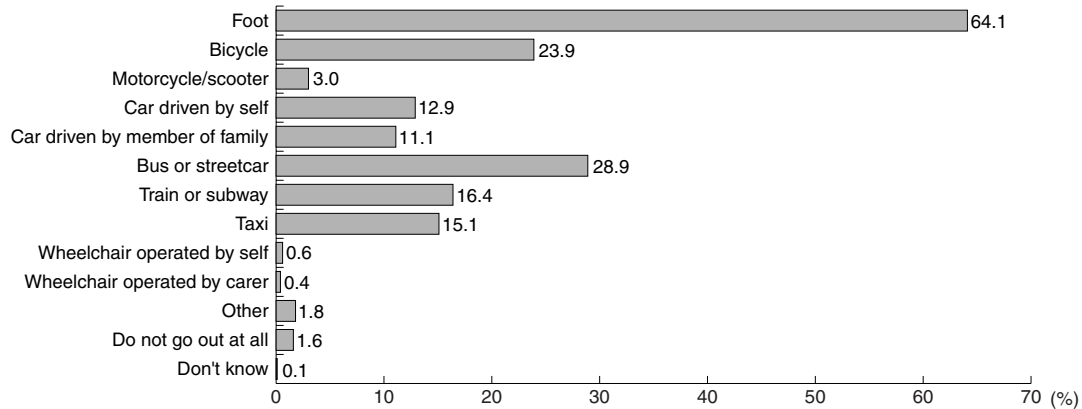
8) See Appended Note 3-4-4 “Trends in proportion of population aged 65 or over.”

9) Dentsu Public Relations Inc., *Public Opinion Survey Regarding Publicity and Awareness Raising Activities Directed at the General Public Concerning City Centers* (November 2005).

10) A survey conducted by the MHLW in December 2002.

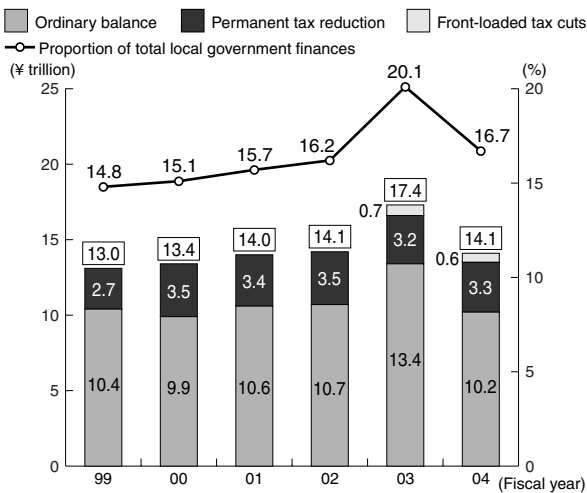
11) Excerpt from “the Saga City Center Revitalization Plan” (formulated in 1998 and revised in 2005): “The average year-end annual income of the City over the past five years (1999-2003) has been approximately ¥55.0 billion, of which approximately 50%, or ¥27.0 billion, has been freely usable (independent revenue sources) by the City. Of this amount, ¥21.4 billion (80%) has been derived from municipal tax, of which approximately 40% is accounted for by fixed asset tax.”

Fig. 3-4-8 Means of transport typically used by elderly
Commonest is walking cited by over 60%



Source: MHLW, *Opinion Survey of Elderly Living Alone* (December 2002).

Fig. 3-4-9 Trends in shortfall of local government revenues
Severe financial situation

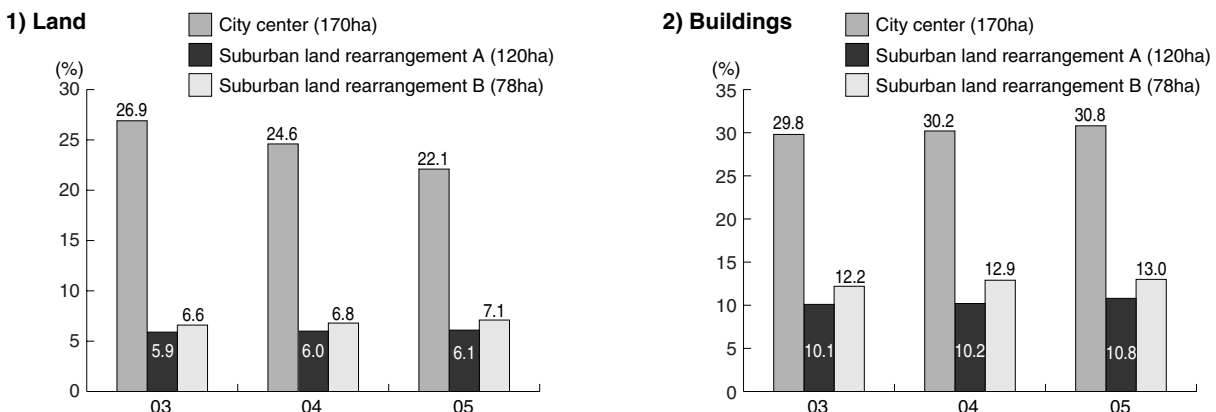


Source: Compiled from MIC's website and the *White Paper on Local Public Finance* (March 2005).

revenue from the city center is high at around 20 to 30%, and a decline in land prices in the city center can easily translate into a decline in tax revenue for the city as a whole. On the other hand, tax revenue from suburban land readjustment districts is around one half to one third of that from the city center per unit of land area. Thus even if land prices were to rise somewhat as a result of development of the suburbs, it would be difficult to make up for the decline in tax revenues caused by the hollowing out of the city center if the rise in suburban land prices were due to the movement of stores and homes to the suburbs from the city center (Fig. 3-4-10 1)).

If we look also at fixed asset tax on buildings, it can be seen that the density of buildings in suburban land rearrangement districts is not as high as in the city center. This means that the efficiency of recovery in investment in roads and water supply and sewerage systems required for land readjustment and expected future investment in repairs and improvements through fixed asset tax revenues is low (Fig. 3-4-10 2)).

Fig. 3-4-10 Area and tax revenue ratios of central urban and suburban areas in Saga City
Conspicuous decline in fixed asset tax revenue when central urban land prices fall. Poor return in tax revenues from investment in suburbs.



Source: Tax base per unit of area of districts in Saga City (2003-2005).

This example suggests that there is a strong probability that taking measures to raise tax revenues in

city centers might have a greater impact on increasing annual revenues than the development of suburban areas.

Section 3 Concentrating urban functions and the siting of public facilities

The concentration of urban functions is an important element of town development, and recent years have seen an increase in the number of local governments that are pursuing “compact town development.” For example, the cities of Kanazawa and Kyoto have established guidelines and ordinances on the formation of a healthier commercial environment, while the cities of Aomori and Toyama and the prefecture of Fukushima have taken steps to curb the suburbanization and to return urban functions to city centers. Other cities, such as Matsue and Shibata, have abandoned plans to relocate hospitals from their city centers to the suburbs, choosing to leave them in central areas instead. Throughout the country, all kinds of initiatives are being pursued in an effort to revitalize city centers.

Nevertheless, the relocation to the suburbs of public facilities that are considered to increase footfall in an area, such as local government offices and cultural facilities, has already been completed in many regions, and even now the movement to the suburbs continues (Fig. 3-4-11).

Naturally, there are financial obstacles to reinvesting large sums in relocating to city centers facilities that have already been established elsewhere at considerable cost, and the agreement of residents is also required. Significantly, however, some cities have succeeded in moving their public facilities from the suburbs back to central areas. These include the city of Chino, which moved its city art gallery from the suburbs to a municipal cultural facility in the city center, where it also established a local branch of the city library, the city of Naha, which moved a traditional crafts center to the former site of an international shopping center, and the city of Ashikaga, which relocated its chamber of commerce and industry to where a bank once stood.

Below, we look at the siting of public facilities in municipalities over the past 10 years according to the *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses*¹²⁾ (referred to below as the *Town Center Revitalization Survey*) conducted by the Mitsubishi Research Institute in December 2005.

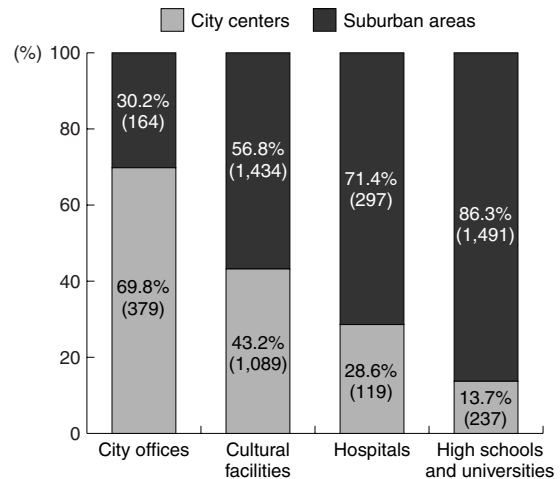
To summarize the overall trend shown in Fig. 3-4-12, almost two thirds of municipal offices are located in city centers, while the majority of cultural facilities and municipal hospitals are located in the suburbs. In

addition, around 40% of libraries and municipal community centers, which are considered to have a particularly strong customer-drawing effect, are located in suburban areas, indicating that towns have become more dispersed.

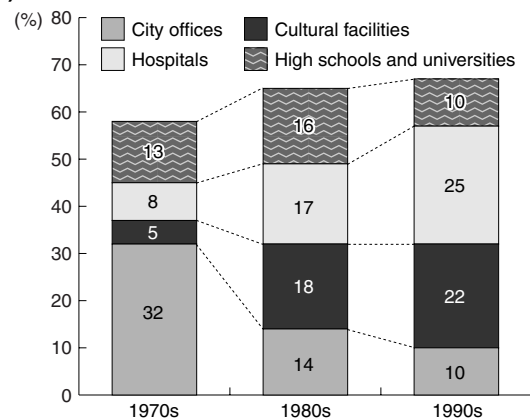
If we look at the relocation situation, although relocation of municipal offices is comparatively lower,

Fig. 3-4-11 State of location and relocation of public facilities
Relocation of city offices to suburbs is dying down and movement of hospitals and cultural facilities is gathering pace

1) State of location (city center and suburban areas)



2) State of relocation of suburbs



Source: Ministry of Land, Infrastructure and Transport, *Survey of Population Movements, Other Socioeconomic Trends, and Land Use* (2003).

12) A questionnaire survey of all 2,172 municipalities in Japan. Responses were received from 915 local governments, yielding a response rate of 42.1%.

2.9% of municipalities still relocated their offices to the suburbs in the past 10 years, and only 0.3% relocated within city centers. Regarding facilities used by residents, such as municipal libraries, cultural facilities, and municipal community centers, a major problem is that in addition to the relocation of such facilities from city centers to the suburbs, municipalities are in many cases choosing to locate completely new facilities in the suburbs as well. While high land prices and lack of vacant space in city centers may well pose a problem when establishing new public facilities, the long-term development of towns should also be taken into consideration.

Next, let us consider the relationship between the siting of public facilities in municipalities and the state of revitalization of city centers. Among local

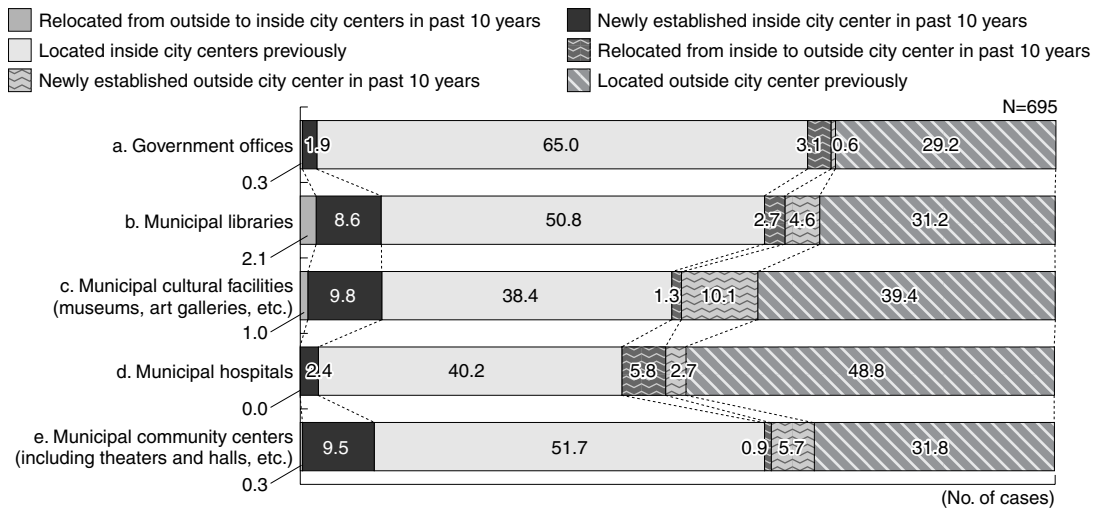
governments that have relocated public facilities that are considered to be particularly frequently used by residents—namely, municipal offices, municipal libraries, and municipal cultural facilities—from outside to inside their city centers, a strikingly high proportion reported that “activity is growing” (Fig. 3-4-13). The conclusion to be drawn is that the relocation of public facilities that are used by residents from outside to inside city centers contributes to an increase in visitors and shoppers due to use of these facilities.

The basis of revitalizing town centers therefore has to be not only the development of commerce and services in the narrow sense, as in the past, but also town development in the wider sense.

It is not only commercial facilities that draw visitors

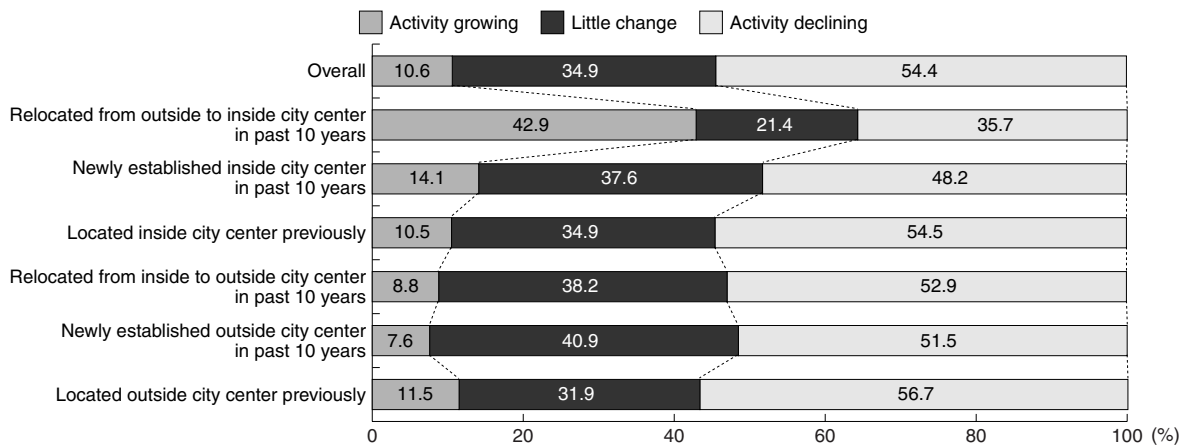
Fig. 3-4-12 Siting of public facilities in past 10 years

High proportion of public facilities located in suburbs, and trend toward relocation and fresh establishment in the suburbs continues



Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

Fig. 3-4-13 Siting of city offices, libraries, and cultural facilities, and revitalization of city centers
Extremely high level of revitalization in municipalities that have relocated facilities to city centers



Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

to central areas and create bustling town centers. A greater emphasis will come to be placed on how towns as a whole should develop, including the arrangement of various urban functions, such as homes, offices, schools, welfare facilities for the elderly, childcare facilities, libraries, and municipal offices. The revitalization of city

centers also depends on the allocation of public spending for this purpose to city centers. The extent to which public investment in public facilities can attract private investment, as in the case of Aomori City described in Case 3-4-1, is also something to be considered.

Case 3-4-1

Aomori City initiative to create a compact city under a local government-driven initiative

During the 30-year period from 1970 to 2000, Aomori City's urban area has sprawled outward. Not only have around a third of residents from the city center relocated to the suburbs, but the prefectural library, wholesale markets, and public facilities such as the Prefectural hospital have also been relocated to the suburbs. This has been accompanied by a rise in the total cost spent on infrastructure by the city to around ¥35 billion. It has also increased costs incurred for maintaining important infrastructure, such as snow-clearing costs. Furthermore, the city center has hollowed out, with traffic through shopping zones declining as much as 50%.

As a result, since 1998 the city has formulated a basic plan for revitalizing the city center and has worked on urban renewal by creating a "compact city" under the banner of "creating a walkable town." An urban area redevelopment project has seen the construction of a large complex called Auga in front of the station and the building of a city library, child-care, cultural center and other facilities within the complex. In addition, in order to ensure pedestrian space within the city center in wintertime, the city has installed a snow-melting system. As a result of initiatives like these, the city

has come alive as traffic around the station has increased by 40%, with visitors from Akita and Hakodate, primarily young women, also coming to Auga and other shopping areas. Coupled with this, private real estate companies have scheduled the construction of 13 condominiums, containing around 860 apartments, for a five-year period starting in 2001. It is expected that this will increase the population of the city center by around 2,000.

The first reason for the city's success is the continuation of consistent, strong leadership throughout, such as the mayor himself coming up with the compact city concept. The second reason is that, together with the administration, shopkeepers and a variety of interested parties have acknowledged their respective roles under the basic principle of a compact city, and have undertaken initiatives continuously. Among these, a "working force" made up of shopkeepers formulated a vision for a "disabled- and elderly person-friendly shopping district." While comprising a variety of projects, their success is attributed to the fact that a committee was established to implement each project, made up solely of motivated participants.

Section 4 Synergies between commercial functions and other urban functions leading to revitalization of city centers

One important area of activity alongside the concentration of urban functions in pursuit of the "compact town development" considered an effective means of readying society for population decline is action to strengthen the urban functions and raise the attractiveness of city centers according to the needs of visitors and residents.

To this end, a virtuous cycle needs to be set in motion so that medium to large stores and small and medium retailers generate synergies as a single commercial cluster, and commercial facilities generate synergies with other urban functions located in central areas.

If we divide Japan into two types of area—the three major urban conurbations (Tokyo, Nagoya, and Osaka) on the one hand and provincial areas, i.e., all other areas, on the other—in order to analyze the impact of the entry of medium/large stores in city centers on the sales of neighboring¹³⁾ small and medium retailers,¹⁴⁾ we obtain the following results (Fig. 3-4-14).¹⁵⁾

1) In both the three major urban areas and the provincial areas, the opening of new medium/large stores of all sizes (500-1,500m², 1,500-3,000m², and 3,000m² and above) near small and medium retailers was

13) Approximated by defining neighboring stores as those in the same square kilometer mesh.

14) Defined as retailers with a store area of 500m² excluding convenience stores.

15) Matsuura and Motohashi (2006), *A Quantitative Analysis of Entries and Withdrawals of Medium and Large Retailers, and the Revitalization of City Centers*, RIETI Policy Discussion Paper (joint study in collaboration with the Small and Medium Enterprise Agency). See Appended Note 3-4-5.

Fig. 3-4-14 Relationship between entry of medium and large stores and change in sales of small and medium retailers

Significant increase in sales of small and medium retailers when medium or large store of at least 500m² opens nearby

Trend in medium and large stores		Major urban areas	Provincial areas
3,000m ² and over	No change in number (at least one)	0.126	0.155
	New entry	0.269	0.422
	Increase	(0.141)	0.234
	Withdrawal	(-0.039)	(-0.073)
	Decrease	(0.004)	(-0.044)
1,500m ² to under	No change in number (at least one)	(0.058)	(0.068)
	New entry	0.178	0.245
	Increase	(0.054)	(0.149)
	Withdrawal	(-0.041)	-0.094
500m ² to under	No change in number (at least one)	(-0.024)	(-0.042)
	New entry	0.078	0.106
	Increase	0.097	0.193
	Withdrawal	0.104	0.112
1,500m ²	No change in number (at least one)	(-0.066)	-0.125
	New entry	(0.092)	(0.071)
	Increase	0.104	0.112
	Withdrawal	(-0.066)	-0.125
3,000m ²	No change in number (at least one)	(0.078)	0.106
	New entry	0.097	0.193
	Increase	0.104	0.112
	Withdrawal	(-0.066)	-0.125
500m ² to under	No change in number (at least one)	(0.092)	(0.071)
	New entry	0.078	0.106
	Increase	0.097	0.193
	Withdrawal	0.104	0.112

Source: RIETI, *A Quantitative Analysis of Entries and Withdrawals of Large Retailers, and the Revitalization of City Centers* (2006).

Note: ■ indicates significance at a level of 10% or over. ■ indicates significance at the 1% level.

associated with a statistically significant increase in sales at neighboring small and medium retailers.

2) The effect on sales growth of small and medium retailers caused by the nearby opening of a medium/large store was slightly higher in provincial areas than in the three major urban areas.

In addition, an examination of the rate of change in the number of small and medium retailers and the rate of change in the number of neighboring eating and drinking places and service providers (beauty, laundry, and bath services) reveals the following (Fig. 3-4-15).¹⁶⁾

1) In the three major urban areas, a positive correlation is observed between an increase in the number of small and medium retailers and the number of neighboring eating and drinking places and service providers in the following locations: “office districts” and “around-station, city-center, and residential-background type commercial districts.”

2) In provincial areas, on the other hand, there may exist a similar correlation to that in the three major urban areas in “office districts” and “road-side commercial districts,” but the correlation in other locations was not as strong.

16) Matsuura and Motohashi, *ibid.* See Appended Note 3-4-6.

17) “Retail stores cannot meet the diverse needs all consumers acting alone. In order to attract diverse consumers, it is important that other retailers be located nearby. Retailers are linked to other retailers by externalities to form a single commercial cluster as a whole. Individual stores of difference sizes, lines of business, and type need each other.” (except from Ishihara, *Town Development Textbook Volume 9: Revitalization of City Centers and Town Development Companies* (ed. Architectural Institute of Japan), Chapter 3 (p. 30).

Fig. 3-4-15 Correlation between rate of change in number of small and medium retailers and rate of change in number of eating and drinking places

Comparatively high correlation between increase in number of small and medium retailers and eating and drinking establishments in city centers of major cities

	Major urban areas	Provincial areas
Overall	0.125	0.139
Commerce	0.336	0.258
Around station	0.489	0.174
City area	0.231	0.114
Residential background	0.265	0.177
Roadside	0.198	0.381
Office	0.499	0.419
Residential	0.112	0.104

Source: RIETI, *A Quantitative Analysis of Entries and Withdrawals of Large Retailers, and the Revitalization of City Centers* (2006).

Notes: 1. Coefficients of correlation for meshes in which the number of small and medium retailers increases between 1997 and 2002 by location according to METI, *Census of Commerce*.
2. The colored sections in the table indicate locations in which the correlation was particularly high.

These findings indicate that the opening of new medium/large stores in city centers is highly likely to have a positive effect on the sales of existing small and medium retailers in the neighborhood. It can also be seen that when the number of small and medium retailers in city centers increases in major urban areas, the number of neighboring eating and drinking places and service providers is also very likely to increase.

Considered from the perspective of medium/large stores seeking to open in these areas, however, it appears important that city centers should be attractive as commercial clusters from a business point of view.

Moreover, in order for small and medium retailers to generate synergies with medium/large stores, it seems to be important that they take advantage of the externalities¹⁷⁾ between retailers to generate synergies with urban functions as a whole, including homes and other customer-drawing facilities.

In order for an increase in visitors to city centers using urban functions as a whole to translate into a concrete increase in store sales, the qualitative changes in the increased numbers of visitors attracted need to be understood (including users of facilities other than retailers that attract customers).

Let us therefore look at the measures described in Case 3-4-2, which were taken in Nagano City with the aim of revitalizing the city center through generating synergies between commercial facilities and other urban functions.

In Nagano City, the establishment of a hub facility adjoining public facilities and a food supermarket at the

initiative of the local government and a TMO generated new visitors and encouraged the construction of condominiums in the surrounding area, setting in motion a virtuous cycle that brought in more and more private-sector investment: attracted by the creation of a new market – i.e., the new visitors to the hub and condominium residents—and also existing tourists visiting the Zenko-ji temple, a town development company established a shopping complex in the town center, and this in turn led to the opening of several local brand-name retailers in anticipation of the expected extra

influx of shoppers to the area.

Assuming, then, that town commercial functions create synergies with other urban functions, leading to revitalization, comprehensive action that goes beyond just the commercial side is required, ranging from the rethinking of product lineups and services¹⁸⁾ in order to raise the attractiveness of individual stores to the remodeling of tenant mixes (i.e., the optimum combination of types and lines of business) of town centers as a whole, and the balancing of residential and commercial functions.

Case 3-4-2

Revitalization through a virtuous circle where the establishment of a new shopping complex and urban functions generates shoppers, attracting further private investment

Revitalization initiatives have been undertaken in Nagano City because of the long-term downward trend in traffic accompanying the decline in population in the city center. However, the situation worsened in 2000 when the Daiei and Sogo department stores, situated in the center of the main street, closed their doors in quick succession.

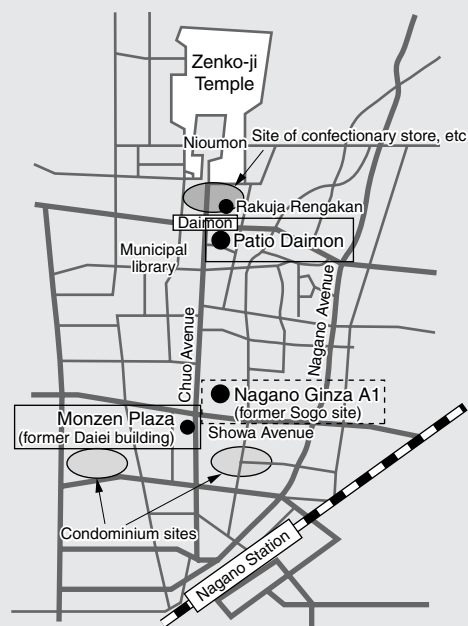
In response to this situation, Nagano City formulated a new strategy aimed at revitalizing the city center. Under the city's leadership, ties were strengthened between interested parties, particularly TMOs, and a town development company based on the joint public-private sector model was established to work on a project to create a hub with the aim of revitalizing the city center.

More specifically, the city purchased the former Daiei store in order to retain convenience for the residents of the city center and to bring back vitality. The building was tenanted by a food store and public facilities. Although it was forecast that the supermarket would operate in the red for a while, recognizing the importance of maintaining and providing convenience to those who lived in the city center as well as office workers in the surrounding area, the state and city provided subsidies for a three-year period. This proved successful, and soon afterward a succession of condominiums were located in the city center and the supermarket's catchment area expanded. The head office of the local broadcasting network and specialty stores are also pursuing a redevelopment project using the site of the former Sogo department store.

In line with the increase in residents living in the city center, it has now become even more important to strengthen the city center's commercial functions and enhance its attraction as a community. To this end, the town development company has acquired and renewed existing buildings, such as empty houses and the traditional warehouse in front of the gates to Zenko-ji Temple, a commercial cluster targeting both increasing number of local residents and tourists. Here, it is promoting the concept of a town that makes you feel like you are on a short

trip, a place where residents can enjoy a special day. One of the aims of Patio Daimon is to provide a place where shoppers and tourists are the stars of the show, which they cannot savor in large suburban stores, as well as for the elderly who will become the main users of central city facilities. In particular, by locating a European interior goods store, a bakery-cafe, other trendy Western-style shops and bringing in restaurants and the like to an old Japanese-style building, it is a facility that proposes a lifestyle to the elderly of the future. This is having a knock-on effect, as other stores are setting up nearby, showing their approval for the Patio Daimon concept. These include not only those from the city, but also those such as an old Japanese confectionary store headquartered elsewhere in the prefecture, and a restaurant hosting wedding receptions.

Main projects in Nagano City center



18) One example of action to raise the attractiveness of individual stores that provides useful pointers is the “Charte Qualité Commerce” in France. See *2005 White Paper on Small and Medium Enterprises in Japan*, Case 2-3-18 “Customer services to meet consumer needs: Reims in France” (p. 165).

Section 5 Community businesses that revitalize and support downtown areas

Amid the need for action on “compact town development” and the development of new commerce and services to meet the needs of an aging society with a falling birthrate, steps are required to raise the attractiveness and inhabitability of towns, as well as to concentrate urban functions and strengthen commercial clusters in city centers, if towns are to be revitalized. In the aging society of the future in particular, creating an environment in which people have all their daily needs within comfortable walking distance will also grow in importance, making it necessary to secure goods and services to support lifestyles within local communities. Efforts are being made throughout the country to provide these services lacking at the local level through “community businesses,”¹⁹⁾ and SMEs are attracting attention for their potential to play a leading role in these activities.

In order to explore trends in the presence of such businesses and services in *machinaka* (usually translated as “downtown” areas, although the term also has connotations more similar to “old quarter” in English) and local government involvement in their development, collaboration, and cooperation, a questionnaire survey was conducted of all local governments in Japan for the *Town Center Revitalization Survey*.

Surveys of “community businesses” have conventionally looked mainly at NPO corporations. However, these activities located in the intermediate realm of (profit-making) “businesses” and (non-profit) “services” are undertaken not only by NPOs and public-interest corporations, but also sole proprietors, voluntary groups, associations, joint-stock corporations, and all kinds of other entities.

Ignoring the conventional framework of what constitutes a “community business” and not limiting the scope to any particular form of corporation, this survey treated activities in the following four fields as “businesses that revitalize or support downtown area (revitalization businesses).”

Four categories of revitalization business

	Category	Activity
(1)	Town attractiveness Businesses that raise appeal and attractiveness of towns	“Tourism and exchange,” “festivals, events, and cultural activities,” “townscape development and decoration,” “cleaning, safety, and security,” and “development projects”
(2)	Lifestyle support Businesses that make life in towns more comfortable	“Lifestyle support for the elderly,” “nursing care and welfare services,” “childcare and parenting support,” “catering and meal delivery”
(3)	Economic vitality Businesses that boost the level of activity in towns	“Startup and employment support,” “commercial incubators,” “businesses led by housewives and the elderly”
(4)	Transport and access Businesses that improve access	“Access to downtown areas,” “downtown tours”

Community businesses (or the above-described “downtown revitalization businesses”), are typically strongly associated with SMEs due to the services provided being so closely related to community needs. From the point of view that they do not seek to maximize profit, they could also be said to occupy an intervening realm where the public and private sectors overlap.

Amid the growing calls for slimmer government at both the central and local government levels in view of the expected decline of the population in the future, it will be difficult for the public sector (“big government”) to meet growing town development and welfare needs in their entirety, and this field of “private-led public” activity will likely continue to grow in the future. This survey, therefore, was designed as a municipal questionnaire on revitalization businesses with a particular focus on investigating policy on development of revitalization businesses by local government and the state of collaboration between local government and the private sector.

That the survey consequently looks at the situation principally from the point of view of municipalities therefore needs to be borne in mind when interpreting the findings.

19) Although “community business” are not definitively defined, they are described as follows in the *2004 White Paper on Small and Medium Enterprises in Japan* (pp. 108-109): “Community businesses are entities mainly formed by local residents in order to respond closely to local problems that cannot be solved within the conventional framework of public administration (the public sector) and private-sector profit-making enterprises. As well as the goal of contributing to society, a strong emphasis in community businesses is on continuation as a business, setting them apart from volunteer organizations.” Their main characteristics are: “(1) the main actors are local residents, (2) they do not have maximization of profits as their objective, (3) they provide goods and services to meet the needs of residents and problems of the community, (4) they provide places of work for local residents, (5) they are continuous businesses or entities, and (6) they are independent from local government both financially and in terms of personnel.”

1. Characteristics of four fields of revitalization business

Below we identify the characteristics of revitalization businesses in each of the four fields, and consider the state of local government involvement in each.

1) Businesses that raise appeal and attractiveness of towns

Businesses that utilize local resources to increase the attractiveness of towns and to serve and entertain visitors include the following.

- A. Tourism and exchange: Provision of information and services to tourists, such as provision of information utilizing existing local resources.
- B. Festivals, events, and cultural activities: Execution of and support for seasonal festivals, events, and routine cultural activities.
- C. Townscape development and decoration: Development of appearance of town and installation of illuminations and other decorations.
- D. Cleaning, safety, and security: Routine cleaning activities and security to ensure safety.
- E. Development projects: The above activities and other

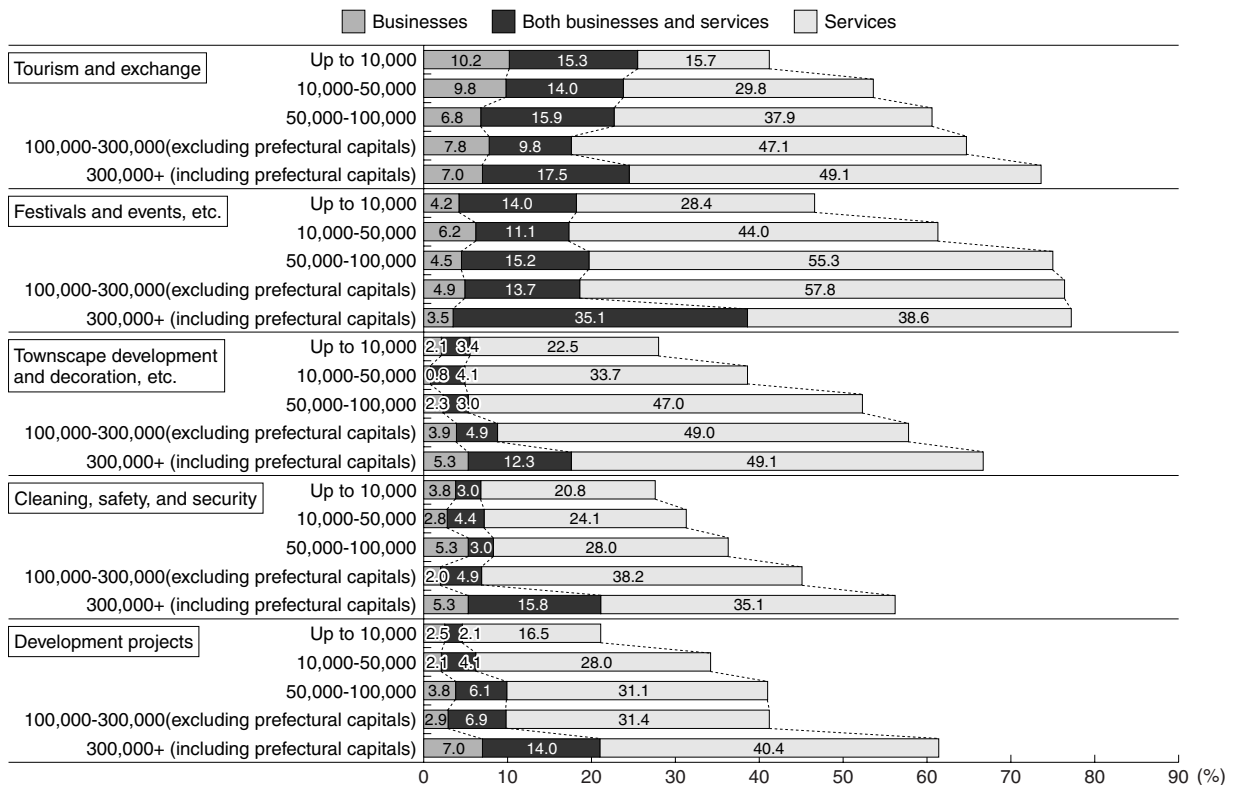
activities to improve the all-round attractiveness of towns involving also the development of local resources.

The purpose of these activities could be said to be to give town centers that extra appeal while recognizing the need to differentiate them from other cities in order to increase customer-drawing power and competitiveness.

The proportion of cities with businesses in the “town attractiveness” field tends to increase with population size (Fig. 3-4-16). This is perhaps because their purpose is not so much to satisfy residents’ lifestyle needs, but rather to create greater value added as a town as a whole, which is considered to be more of a challenge for larger cities.

A comparison of the proportion of “businesses” (defined in this survey as operations designed to generate profits) and “services” (defined in this survey as operations not designed to make a profit) in this field also reveals a greater preponderance of “services.” Making towns more appealing is by its nature an activity that is in the public interest, and is a field of activity in which there is inherently a high degree of affinity between the public and private sectors.

Fig. 3-4-16 Presence of businesses that make towns more attractive by population size
Presence is higher in cities with larger populations



Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

Note: Proportions were calculated by dividing responses regarding the presence of businesses, etc. in each field by the number of cities of each size.

Case 3-4-3

Shinmachi River Preservation Society – a NPO corporation

To promote Tokushima City as the "water capital," in 1992 a free boat cruise was introduced to circle a section of the city center named Hyotan Island due to its gourd-like shape. In 1995, the boat operation was contracted out to the Shinmachi River Preservation Society, which had engaged in activities such as cleaning up the river, so they could promote the island. The operation is run on a volunteer basis by members from the nearby shopping district that possess a shipping license. Today, there are as many as 20 volunteers and the Society has become a NPO corporation. As a rule, the boat runs five times a day, all year round. The number of people visiting the city center has increased, in part due to the introduction of the boat service, which has made a huge contribution to enlivening the area, with more than 30,000 people visiting the area each year.

These consist of activities designed to secure a certain standard of convenience for individual residents of downtown areas, rather than to differentiate one city from another.

Revitalization businesses in the "lifestyle support" field are generally located in a high proportion of all cities, and have the highest presence of any field after the "town attractiveness" field. This field is also characterized by the small difference in presence according to city size. The proportion of elderly support and catering and meal delivery operations in particular is highest in comparatively small cities with populations of 50,000-100,000 people (Fig. 3-4-17). This is probably due to the fact that, regardless of town size, the "lifestyle support" field has an essential role to play in providing certain functions that directly underpin individual residents' lives.

A further characteristic of the "lifestyle support" field is that many activities are undertaken as "businesses," which contrasts with the situation in the "town attractiveness" field where many activities are "services."

2) Businesses that make life in towns more comfortable

Next we consider businesses that make life for residents of downtown areas more comfortable by, for example, providing support for the elderly and childcare. Businesses of this type include the following.

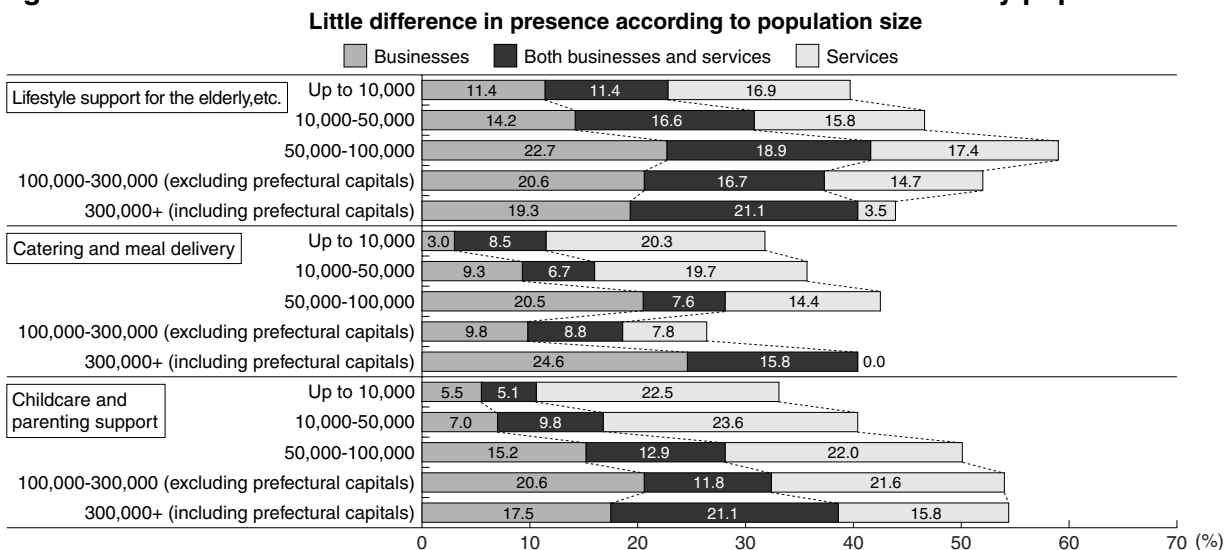
- G. Lifestyle support for the elderly: Mainly businesses to assist elderly people living in downtown areas and nursing care and welfare services.
- H. Catering and meal delivery: Services provided to downtown residents, etc.
- I. Childcare and parenting support: Provision of environment to make it easier for female residents of downtown areas to work.

Case 3-4-4

MokoMoko Meeting Plaza

Housing complexes for families have increased in the city center of Hiratsuka City in Kanagawa Prefecture. Due to growing demand for child-rearing support services and other factors, a child-rearing support center called MokoMoko Meeting Plaza was opened in September 2005 using a vacant store in the shopping district. Besides its main function of providing a place to play for infants aged zero to two, MokoMoko Meeting Plaza holds other activities, including child-rearing-

Fig. 3-4-17 Presence of businesses that make towns more comfortable by population size



Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

Note: Proportions were calculated by dividing responses regarding the presence of businesses, etc. in each field by the number of cities of each size.

related events for mothers, and cooking classes held in collaboration with a nearby TMO (food services). A total of around 3,400 people used the center in its first four months of operation. Although operation is contracted to the Shonan Social Welfare Corporation, which operates child-care centers in Hiratsuka City, it is mainly social workers and volunteers who provide the actual services. Although users must register beforehand, services are free. A distinctive feature is that use is based on mother and child participation rather than providing child-care services. Since MokoMoko Meeting Plaza opened, the town has become busier as young people, including mothers with infants, have begun gathering in the city center, which until then was visited by predominantly elderly people. The city plans to undertake various projects with the aim of providing services that meet the needs of its residents.

downtown residents and visitors.

The “economic field” has the lowest presence of the four revitalization business fields, and the presence of “startup and employment support” and “commercial incubators” in particular is markedly lower in smaller cities (Fig. 3-4-18). This is likely due to the fact that, like the “town attractiveness” field, activities to raise the future economic dynamism of towns do not directly benefit residents now, and so are more difficult to undertake in cities unless they are of at least a certain size.

Case 3-4-5

Goshogawara City Silver Human Resources Center

Goshogawara City Silver Human Resources Center in Aomori Prefecture has registrations from around 700 people aged sixty or older desiring work. Since July 2005, it has been using a vacant store in the city center to sell goods such as handcrafted items made by its members, and vegetables. Reception of this initiative has been favorable. The role of looking after the store is rotated among the 20 to 30 members who exhibit items, with the proceeds going to the exhibitors themselves. Not only is the store popular with the exhibitors as it provides the elderly with a rewarding activity, but it is also being welcomed by the shopping district because of the bustling atmosphere it has contributed.

3) Businesses that boost the level of activity in towns

Businesses that increase economic vitality in towns and increase employment in downtown areas fall into the following categories.

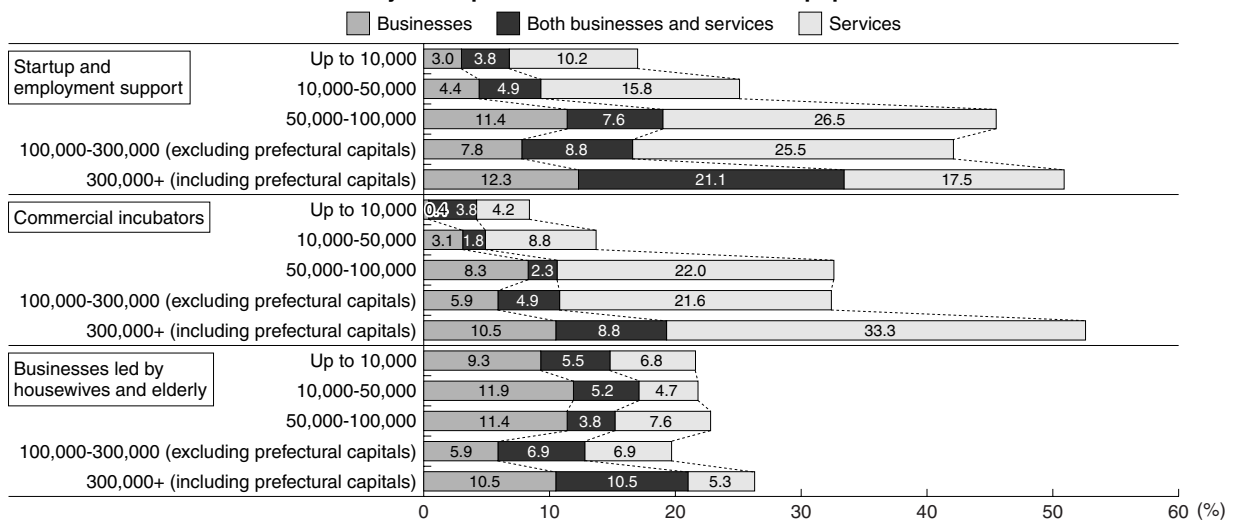
- K. Startup and employment support: IT classes, etc. to assist employment.
- L. Commercial incubators: “Challenge shops” to train entrepreneurs to play a leading role in downtown commerce.
- M. Businesses led by housewives and the elderly: Places for housewives and the elderly to work (including residents of downtown areas).

4) Businesses that improve town access

Businesses that improve access and convenience of movement around downtown areas and improve the convenience of town transport include the following.

The purpose of initiatives of this kind is more to generate future vitality in the interests of the sustainable development of towns than to meet the present needs of

Fig. 3-4-18 Presence of businesses that boost activity in towns by city size
Markedly lower presence in cities with smaller populations



Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

Note: Proportions were calculated by dividing responses regarding the presence of businesses, etc. in each field by the number of cities of each size.

- O. Access to downtown areas: Community buses and pick-up and drop-off services for the elderly (not including ordinary taxis), etc.
- P. Downtown tours: Downtown buses, rental of electric wheelchairs, means of transport targeted at tourists (rickshaws, velotaxis, etc.), rental of bicycles, etc.

These activities basically revolve around securing a certain level of convenience for downtown residents. Tour services resemble “town attractiveness” activities, however, in that they also include some tourism and customer-drawing elements.

Within the “transport and access” field, “access to downtown areas” related activities have a high presence even in comparison with the other three fields, and are characterized by the large number of activities that are profit-making “businesses.” On the other hand, “downtown tour” activities still have a comparatively low presence.

If we look at the distribution of activities according to city size, we find that “downtown access” is characterized by “lifestyle support,” such as support for the elderly and childcare, and “downtown tours” are characterized by “town attractiveness,” such as tourism and events (Fig. 3-4-19).

committee, which also has members from the Shopping District Liaison Association and a stationery shop. The committee charters a school bus from the local Gonohe branch of Nanbu Bus during the hours it is not in service. The service was originally thought up as a means of improving the convenience of the patients of these health care providers, and bus stops are situated outside the committee members' places of business. However, anyone can use the bus service, and the bus will stop when a passenger puts up his or her hand. Thus, it provides a helpful service that allows passengers to get off wherever they want. Due to the hilly terrain of the area, the bus service is particularly popular among the elderly. About 18 passengers ride the 25-passenger bus on each run.

2. Satisfaction of residents' needs in each field and municipalities' interest in development

The above analysis reveals a large split in the level of presence according to field of revitalization business. Thus while many municipalities have revitalization businesses in the “town attractiveness” field (tourism and events, etc.) and “lifestyle support” field (support for the elderly and childcare, etc.), the proportion with “economic vitality” and “transport and access” activities is low.

To what extent, then, do activities in each field of revitalization business satisfy (or are regarded by local governments as satisfying) residents' needs?

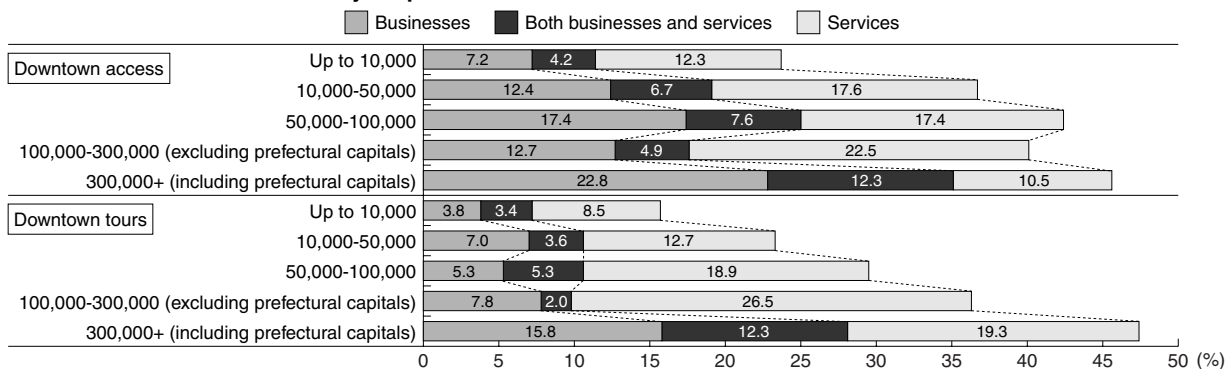
Looking at Fig. 3-4-20, it is evident that there is a large gap in satisfaction of residents' needs as regards the three main activities (festivals and events, tourism and exchange, and development projects) in the “town attractiveness” field. “Development project” related activities in particular are not undertaken in a very high proportion of municipalities, indicating that local governments do not feel that they particularly satisfy residents' needs.

Case 3-4-6

Gonohe Town circular route bus management committee

Since September 2004, there has been a free bus service operating between nine and twelve o'clock every day along a circular route covering the one kilometer or so radius from the city center to the nearby residential district. Known as the Gonohe “chinchin” bus, it is popular among residents. This bus service is managed by the Gonohe Circular Route Bus Management Committee, whose members come from local health care providers, with three physicians, two dentists, and six pharmacists serving on the

Fig. 3-4-19 Presence of businesses that improve town transport and access by city size
Tendency for presence of “access” and “tour” businesses to differ



Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

Note: Proportions were calculated by dividing responses regarding the presence of businesses, etc. in each field by the number of cities of each size.

If we look at the “lifestyle support” field, it appears that whereas elderly support satisfies residents’ needs to a certain extent, crèche and childcare related activities tend not to satisfy residents’ needs very much, and the sense that residents’ needs are not being met is especially marked in large cities.

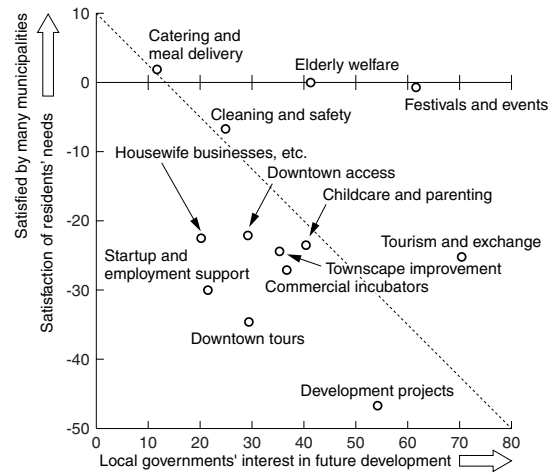
So what trends can be discerned regarding local governments’ interest in developing revitalization businesses in the future? It is generally imagined that fields that satisfy residents’ needs are judged not to require further development by local governments (i.e., interest in their development is low), but is this really so?

Fig. 3-4-21 illustrates a surprising trend. If satisfaction of residents’ needs and interest in development revitalization businesses are inversely proportionately related, each area of activity should follow the dotted line in the figure. They evidently do not, however, and in fact in many fields, there is a tendency for local government interest in development to increase with satisfaction of residents’ needs. How should this finding be interpreted?

Regarding each type of activity in the “town attractiveness” field, for example, in which there is a large difference in the proportion of cities with such activities according to population size, an examination of local government interest in development by population size reveals that, overall, interest is higher among large

Fig. 3-4-21 Satisfaction with revitalization businesses and interest in their future development

Interest in future development not decided on basis of whether needs of residents and shoppers are satisfied

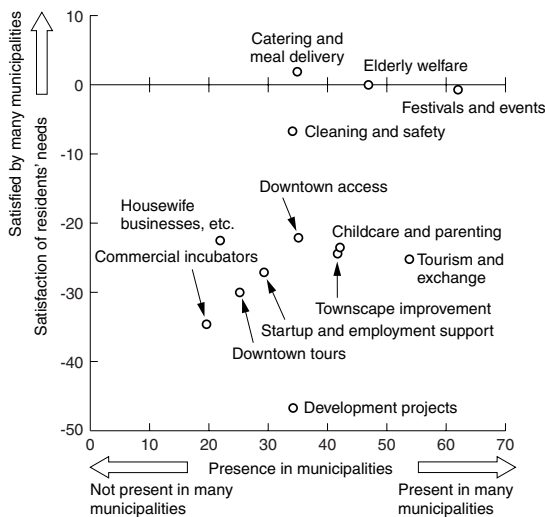


Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

Note: Satisfaction was calculated by subtracting the proportion of “insufficient” responses from “satisfied” responses. Interest in future development was calculated by converting responses to scores by assigning 2 points to “particularly want to develop,” 1 point to “want to develop,” and minus 1 point to “not specifically considering developing.”

Fig. 3-4-20 Presence of revitalization businesses and level of satisfaction

Although their presence is recognized, they generally do not meet the needs of residents and shoppers

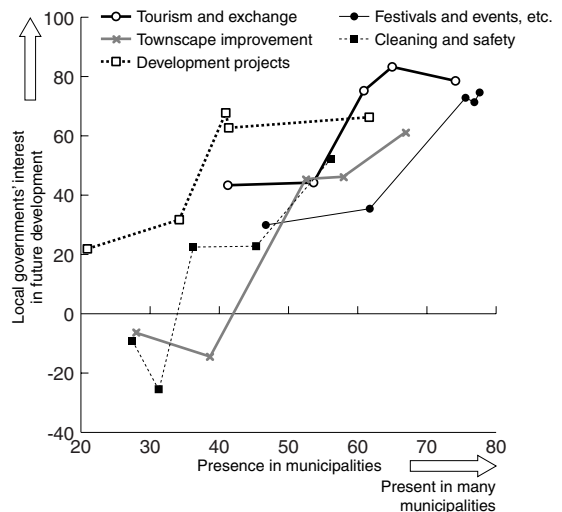


Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

Note: Responses regarding presence were converted to a score by assigning 1 point to each of “businesses,” “services,” and “both businesses and services.” Satisfaction was calculated by subtracting the proportion of “insufficient” responses from the proportion of “satisfied” responses.

Fig. 3-4-22 Presence of businesses that make towns more attractive by population size and interest in future development

Presence and interest in development tend to increase in proportion to population size



Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

Note: Responses regarding presence were converted to a score by assigning 1 point to each of “businesses,” “services,” and “both businesses and services.” Interest in future development was calculated by converting responses to scores by assigning 2 points to “particularly want to develop,” 1 point to “want to develop,” and minus 1 point to “not specifically considering developing.”

cities in which such activities have a proportionately high presence (Fig. 3-4-22). Moreover, if we look at the situation in smaller cities, we find that although, as described previously, the proportion of smaller cities with activities providing support for the elderly is also high, interest in the development of such activities is relatively higher than regarding other activities.

From this it would appear that from the local government point of view, a more important consideration when deciding whether to assist the development of revitalization businesses in the private sector is not whether or not they meet residents' needs, but rather whether activities eligible for support from the local government have already developed to a certain extent. Without such a preexisting track record, local governments appear not to be interested in assisting development.

Asked what concrete measures they were taking to support the development of revitalization businesses, the largest proportion of local governments (almost 40%) responded "subsidization of activities," followed by "provision of venues and space for activities," "support for provision of information," and "contracting out of operations."

Regarding the effects of development measures, around 80% of municipalities implementing measures of all kinds reported some impact on the generation or retention of revitalization businesses, and no marked difference in level of effect was observed according to type of measure. Nevertheless, a comparison of the "number" and effect of measures undertaken by municipalities that implemented measures of more than one type reveals that local governments that use multiple types of measure enjoy greater effects.²⁰⁾

3. State of collaboration and cooperation between municipalities and revitalization businesses

Next, we analyze the situation regarding collaboration and cooperation (partnerships) between local governments and revitalization businesses (Fig. 3-4-23).

Let us begin by examining the characteristics of the "town attractiveness" field. Starting with the state of collaboration and cooperation, it can be seen that collaboration with local governments is highest in this field (Fig. 3-4-23 1)). The commonest form of collaboration in this field is that instigated and led by the private sector (Fig. 3-4-23 2)). While, in other fields, the

greater part consists of "financial support such as subsidization and contracting out of operations," the higher proportion in this field engages in substantive joint action, such as "planning and consideration" and "joint implementation of work and operations, etc." (Fig. 3-4-23 3)). The strongest reason given by local governments for engaging in collaboration and cooperation is involvement in planning and incorporation of ideas and innovations (Fig. 3-4-23 4)).

This situation suggests that the primary objective of local governments' involvement in "town attractiveness" activities to raise the value added of towns is the incorporation of private-sector planning and ideas. Given the existence of substantive collaboration between the public and private sectors, it also appears that, out of the four fields of revitalization business, equal partnerships between the public and private sectors are strongest in this field.

What then of the situation in the "lifestyle support" field, in which the above analysis has shown that a certain level of service needs to be secured in order to ensure the convenience of residents' lives?

Looking at Fig. 3-4-23 2), it can be seen that of the four fields of revitalization business, collaboration and cooperation in the "lifestyle support" field tends to be led the most by local governments, in contrast with the situation in the "town attractiveness" field. From Fig. 3-4-23 3), it is also evident that most collaboration takes the form of financial support, such as subsidies and the contracting out of operations. Fig. 3-4-23 4) shows that again in contrast with the "town attractiveness" field, the main reasons for requiring collaboration and cooperation are "higher cost if undertaken by local government" and "want to introduce competition between businesses in the private sector."

In other words, the evidence suggests that collaboration between the public and private sectors in this field is motivated less by the need for collaboration on planning and ideas, and more by local government interest in ensuring the efficient provision of services that cannot be effectively provided by the public sector, and in outsourcing services in the public interest that cannot be provided directly by the public sector.²¹⁾

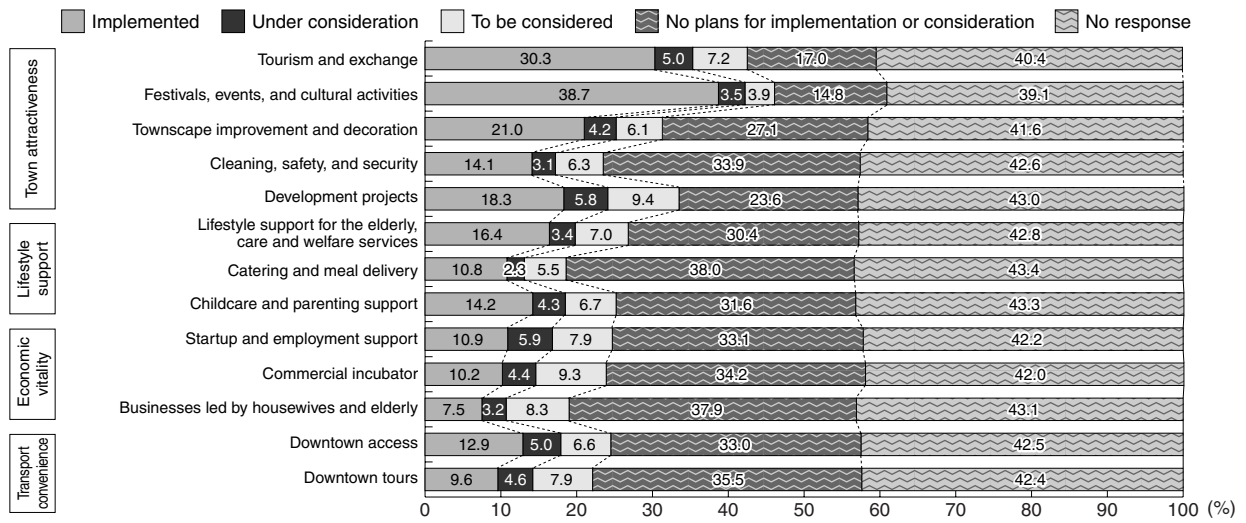
If we look at the "economic vitality" field, consisting of activities such as startup and employment support and commercial incubators, collaboration and cooperation with local governments is generally low (Fig. 3-4-23 1)),

20) See Appended Notes 3-4-7 1)-3) "Implementation of measures by local governments to develop revitalization businesses and their effect."

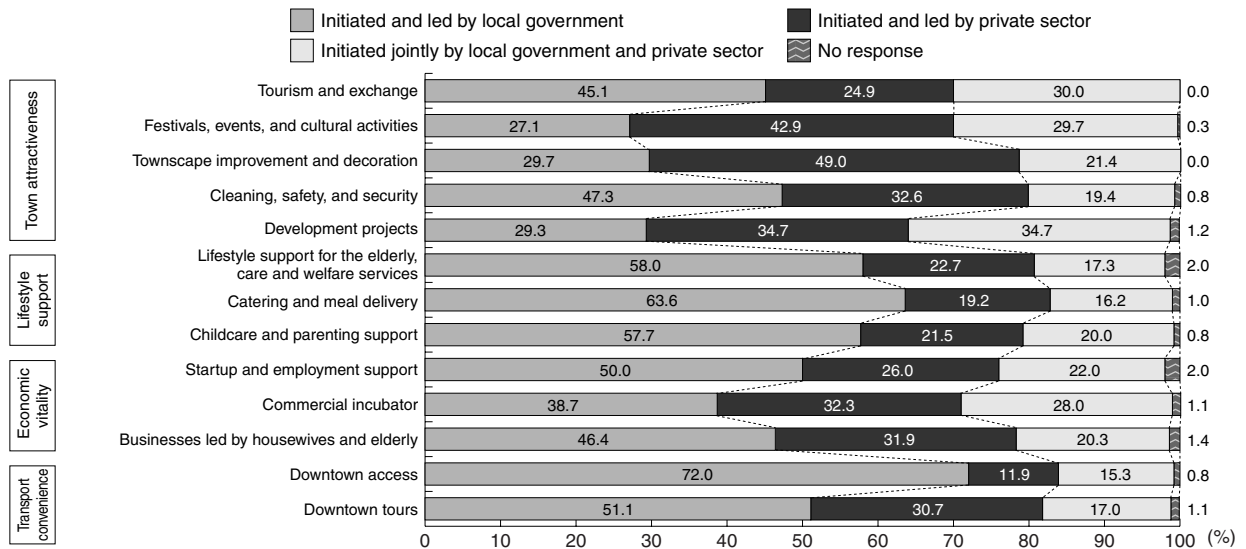
21) This is also confirmed to an extent by looking at attitudes toward local government involvement in revitalization businesses. The graph in Appended Note 3-4-8 portrays local government views on public involvement according to size of population focusing on two areas of activity in the "town attractiveness" field (tourism and development projects) and two areas of activity in the "lifestyle support" field (support for the elderly and childcare). From this it can be seen that the general trend in the "lifestyle support" field is for local governments to want to leave activities to the private sector, provided that they are commercially viable, in cities in which a higher proportion of activities exist. In the "town attractiveness" field, by contrast, the proportion of municipalities considering "implementation necessary due to residents' needs" is high overall irrespective of population size, and there appears to be less interest in reducing collaboration and cooperation from the point of view of profit and improving efficiency.

Fig. 3-4-23 State of collaboration and cooperation on revitalization businesses
Contrasting trends in “town attractiveness” and “lifestyle support” fields

1) State of collaboration and cooperation



2) Initiators in cases of collaboration and cooperation (private sector or local government led)



Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

but the proportion of collaboration instigated by the private sector is high (Fig. 3-4-23 2)). This field is similar to the “town attractiveness” field in that there is a high degree of collaboration by local governments in order to incorporate private-sector planning and know-how (Fig. 3-4-23 3)).

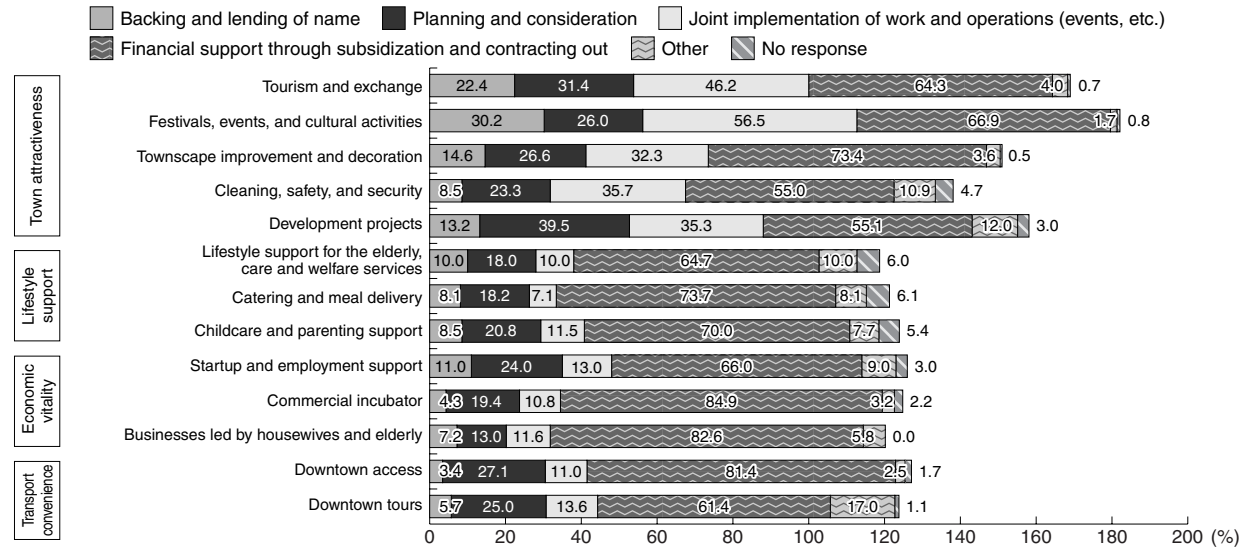
Regarding the “transport and access” field, “downtown access” activities exhibit a similar trend to “lifestyle support” in that they satisfy individual residents’ needs. “Downtown tour” activities, on the other hand, exhibit a trend somewhat between “town attractiveness” and “lifestyle support.”

Local governments were additionally asked whether any formal requirements regarding, for example, corporate status (such as limiting selection to NPO corporations and

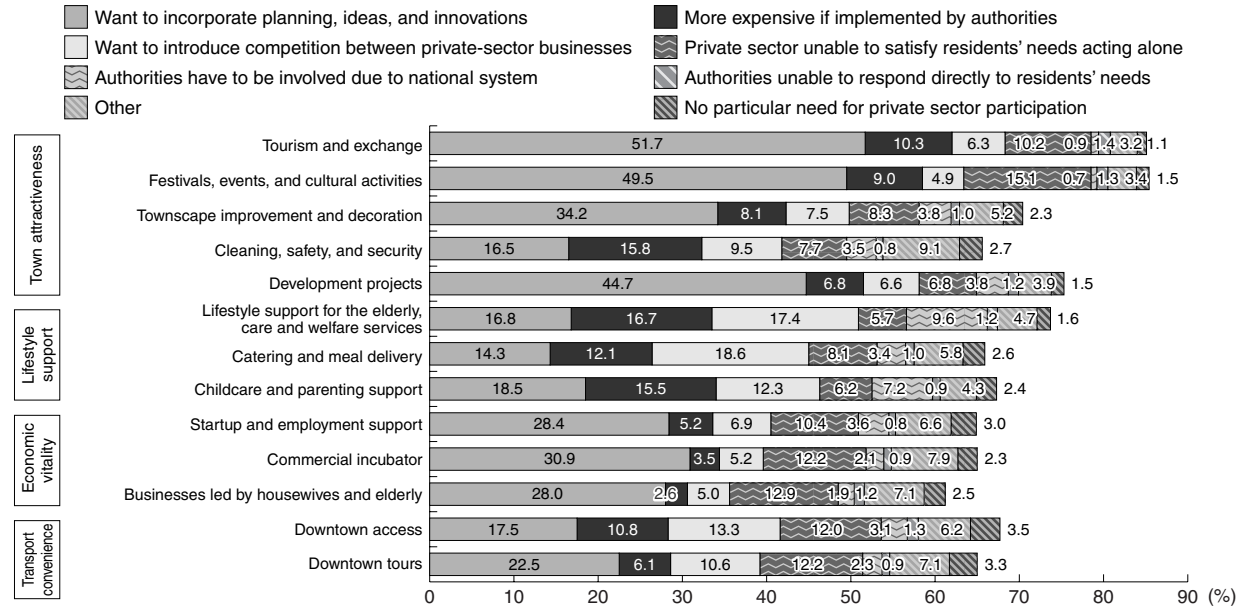
disallowing joint-stock corporations) were imposed when selecting partners for collaboration and cooperation on business and services located in this “intermediate realm between the public and private sectors.” This revealed that even if those answering “formal requirements imposed (e.g., corporate status)” and “no express provisions, but tendency for organizations of certain types to be selected” are combined, almost all local governments tend not to be concerned about formal requirements such as corporate status (Fig. 3-4-24).

Collaboration of this kind between the public and private sectors, particularly under central government programs, has often been limited to corporations. From the point of view of the local governments on the spot, however, the important thing appears to be whether or not an organization has the motivation and ability to

3) Methods of participation and involvement of local governments in cases of collaboration and cooperation



4) Reasons for revitalization businesses requiring collaboration and cooperation of local governments



Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

Note: Totals exceed 100 due to multiple responses.

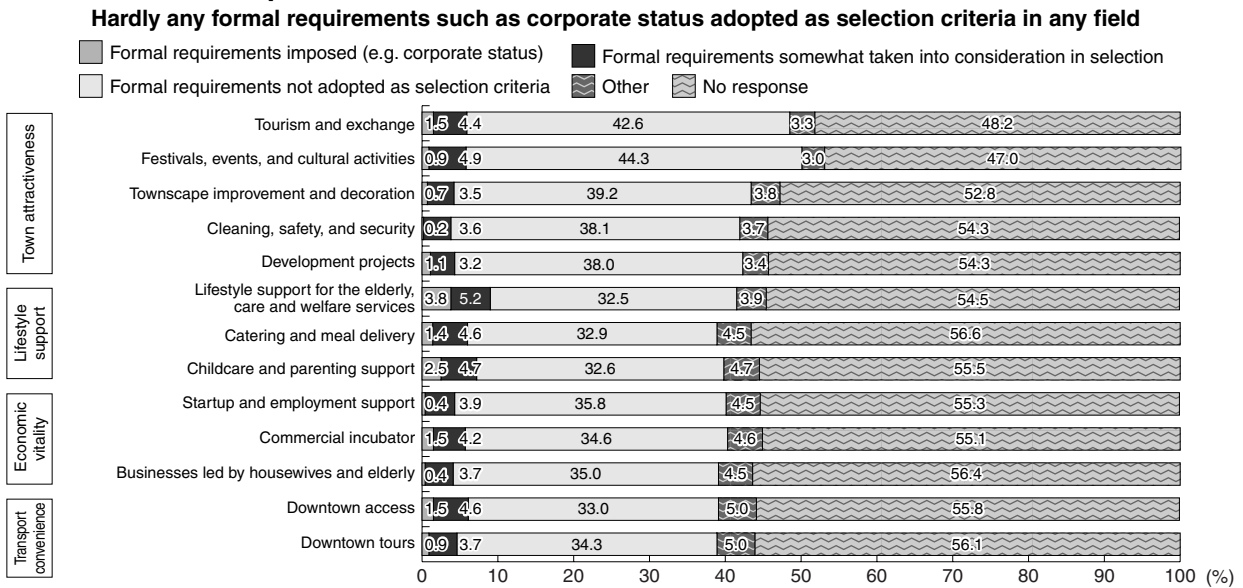
actually implement a project, indicating there is little practical benefit to being overly concerned with formalistic requirements such as whether a potential partner has corporate status. Even at the level of central government, there have recently been moves to relax and abolish corporate status requirements under various programs as part of the process of regulatory reform.²²⁾ However, in order to prevent situations in which private organizations and groups find themselves unable to participate in public-private collaboration due to not

meeting the formal requirements, despite in practice having the motivation and ability to implement a project, it is probably worth paying attention to practice in this area at the local government level.

Having thus examined the situation on the frontline of local government regarding the community businesses, or revitalization businesses, that serve to improve the attractiveness and inhabitability of towns focusing mainly on the perspective of public-private collaboration on the

22) For example, day-care centers for children have traditionally been required to be social welfare corporations in order to be licensed. This limitation was scrapped in March 2000, however, and now licensed day-care centers can be operated by other entities, including joint-stock corporations and NPOs.

Fig. 3-4-24 Formal requirements for selection of partners for collaboration and cooperation in revitalization businesses



Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

spot in municipalities, one is struck by the diversity of the public-private collaboration in municipalities that are nearest to residents. At the same time, however, we have seen that local governments tend not to become very involved in developing or collaborating in activities that have yet to become established in a locale, regardless of the scale of residents' needs. In the future, local governments facing the serious challenge of how to improve services for residents within the framework of "small government" will need to put further effort into developing and collaborating in fields in which they have not traditionally sought to become involved, and local

governments can assist each other in this process by learning from each other's best practice in such initiatives.

At the same time, organizations and groups engaging in these "public-type services" across the country will have to approach the authorities more actively in order to make their towns and neighborhoods livelier and better places to live.

Next in Section 6, we summarize these diverse initiatives by the public and private sectors and consider what kind of leadership is required to lead the "revitalization" of our towns.

Column 3-4-1 Fostering community businesses in the U.K.

Since October 2001, when the Social Enterprise Unit (SEnU) was established within the Department of Trade and Industry (DTI), to take one example, the British government has been working on measures, including corporate status, to support social enterprises (community businesses) and make them essential parts of social services.

SEnU defines a social enterprise as a "business with primarily social objectives, whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximize profit for shareholders and owners." A study conducted by SEnU in July 2005 titled "A Survey of Social Enterprises across the UK" showed there to be about 15,000 social enterprises in England, with about 500,000 employees, and revenues of about 18 billion pounds (about 3,500 billion yen).

SEnU promotes activities according to its "Social Enterprise: a strategy for success," issued in July 2002. According to a review in 2005, the environment supporting social enterprises, including availability of loans to them, has been enhanced as the result of a new legal status and introduction of social-enterprise-related measures by other ministries and agencies under the "strategy for success." Those improvements have strengthened the vitality of the businesses, and led to the establishment of more independent social enterprises.

The newly established, just mentioned legal status is that of Community Interest Company (CIC). Its effect is like a wind to the back of social enterprises wishing to make use of their profits and assets in a different manner than traditional private companies. Before this, charitable organizations registered with the government (Charity Commission), and companies limited by guarantee, had played the role

of community businesses in many cases. Charitable organizations, however, as a condition of their status, presented the problems that they were not permitted to do any profit-making not directly connected to their objectives, and their fund-raising and investment activities were limited because they had no legal status. They could, however, form separate companies to carry out those activities – but that complicated clerical work and increased handling costs. The new legal status was created out of recognition that social enterprises are important in providing social services and forming communities, and has enabled development of an environment in which they can more easily work.

CIC involves a community-interest test – that is, it must be certified that the business contributes to the community, with guaranteed public benefit, and with the community interest protected by means of an interest-and-asset lock.

A CIC enjoys no preferential tax treatment, which makes it close to an "intermediate corporation" in Japan. But the fact that it is certified and registered makes it something like a Japanese NPO as well.

While efforts are being made in the U.K. to give the sector of not-for-profit organizations more independence, and increase their competitiveness, other efforts are under way to develop Public Private Partnerships.

Japan, similarly, has enacted the Law on the Promotion of Specific Nonprofit Activities (effective from April 2000), providing the legal status of an NPO corporation, the Intermediate Corporation Law (effective from April 2002), providing the legal status of an intermediate corporation, and others. In light of a decreasing population and the need to reduce the volume of governmental services hereafter, these private organizations – with stable organizational bases – will grow from "providers of voluntary services" to "providers of reliable public services," and are expected to be powerful forces in community economies. As seen in the example of the U.K., this circumstance can be common to all developed countries.

Section 6 Collaboration and leadership by parties involved in town revitalization

Since 1998, initiatives have been pursued throughout Japan under the Law on Improvement and Vitalization of City Centers.²³⁾

As regards the current state of these activities, 682 municipalities had formulated "basic plans"²⁴⁾ as of November 2005, which means that roughly 30% of the 2,239 municipalities in Japan have formulated plans.²⁵⁾

These activities are evaluated in the "Report on the Results of Administrative Evaluation and Monitoring Regarding Revitalization of City Centers"²⁶⁾ (MIC, September 2004), which identifies the following problems with basic plans.

Insufficient ascertainment of residents' needs

In the process of formulating their basic plans, 55.1% of municipalities ascertained both the needs of local residents and businesses, and 21.0% ascertained neither at all.

Abstract objectives

10.1% of municipalities set numerical targets of one

kind or another in their basic plans (regarding, for example, population or pedestrian traffic), and the objectives of the remaining municipalities were no more than qualitative slogans or concepts.

The report also noted a number of other problems, including the fact that only 29.0% of municipalities have put in place both arrangements for collaboration between departments of local government and arrangements for collaboration with businesses in the private sector, and as much as 30.4% of municipalities do not monitor the progress of projects, allowing a situation in which city center improvement projects and commercial revitalization projects fail to be properly integrated.

Revitalization of city centers and downtown areas is difficult to achieve simply by formulating basic plans in accordance with the law. Let us then consider what measures are being taken to revitalize city centers based on the results of the *Town Center Revitalization Survey*.

We begin by identifying the attributes of the municipalities that responded to the survey. Since the

23) Law Concerning the Integrated Promotion of the Development and Improvement of City Centers and Revitalization of Commerce.

24) These are plans in which each municipality lays down basic policy and targets for city revitalization and defines city center districts in accordance with basic policy established by the competent ministry (in accordance with Article 6 of the Law on the Improvement and Vitalization of City Centers).

25) 399 small and medium retailer upgrading project initiatives ("TMO initiatives") had been approved by municipalities under the "basic plans" formulated by 682 municipalities, and 223 small and medium retailer upgrading project plans ("TMO plans") had been approved by the Minister of Economy, Trade and Industry (November 2005).

26) The survey sample consisted of 138 cities and as of towns that formulated basic plans between fiscal 1998 and fiscal 2001.

entry into effect of the revised Special Mergers Law in 1999, over 20% (22.2%) of local governments have merged and local governments have grown larger, but approximately one half (48.9%) of the responding local governments have populations of less than 30,000.

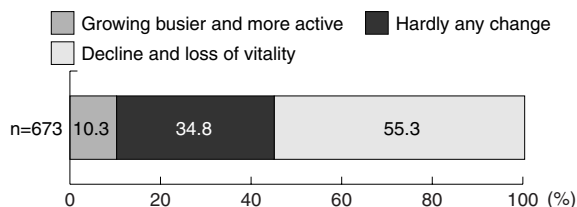
Questioned about how the level of activity in their city centers and downtown areas had changed in the preceding five years, a slightly higher proportion of local governments with larger populations answered that they were “growing busier and more active,” but the average was only around one in ten (10.3%) (Fig. 3-4-25).

Let us explore the characteristics of local governments that answered that conditions were “growing busier and more active” (which we shall call “revitalizing local governments”) amid the difficult economic situation of generally declining populations and sales.

Looking firstly at the position of city center and downtown revitalization in the general plans and urban master plans of all the municipalities that responded to the survey, over 70% (71.7%) included revitalization in their general plans, and over 50% (52.1%) included it in their master plans. Over 40% (40.6%) of local governments had also formulated basic plans under the Law on the Improvement and Vitalization of City Centers, meaning that many local governments have at least drawn up plans concerning revitalization.

If we then compare the inclusion of revitalization in these plans and their formulation with the state of revitalization, we find that although a slightly higher proportion of local governments with plans incorporating town center revitalization are “revitalizing,”²⁷⁾ overall almost 90% of local governments that have positioned or formulated plans are not revitalizing, suggesting, as noted in the aforementioned evaluation report, that simply positioning and formulating plans is unlikely in itself to have an impact on revitalization.

Fig. 3-4-25 Revitalization of city centers and downtown areas (changes compared with five years ago)
Over 50% have declined, while only around 10% are becoming busier and more active



Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

Below, then, we analyze the concrete situation regarding town revitalization measures from two perspectives: (1) collaboration within local governments, and (2) collaboration between the public and private sectors.

1. Collaboration and leadership within local governments

Regarding action to revitalize city centers, the above evaluation report suggests that “it appears that city center improvement programs and commercial revitalization programs are not being pursued in an integrated fashion,” and this may be an outcome of insufficient cooperation between the relevant departments within local governments.

In order to raise the effectiveness of city center revitalization, it is necessary to formulate project master plans ensuring inter-project consistency regarding both “city center improvement” and “commercial revitalization.” It is also important that arrangements for their implementation be put in place ensuring consistency throughout local government as a whole. We look, then, at the situation regarding this according to the *Town Center Revitalization Survey*.

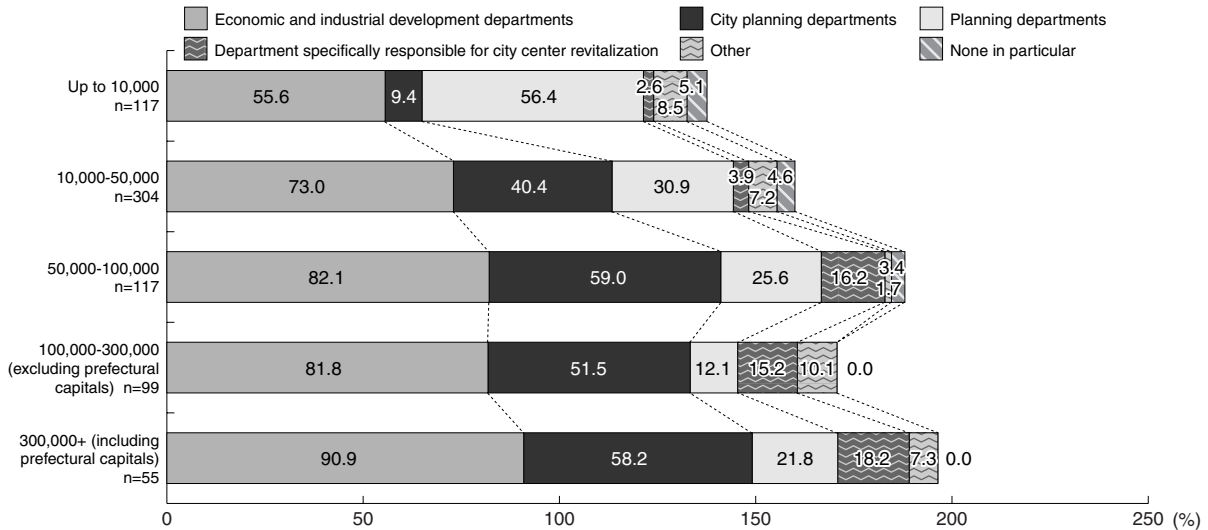
Starting with which departments are tasked with city center revitalization in each municipality, we find that planning departments and industrial development departments tend to be used more in cities with smaller populations, where the involvement of city planning departments tends to be lower. As population size increases, so too does the proportion of cities using industrial promotion departments and city planning departments, and among cities with populations of 300,000 or more, industrial promotion departments are involved in approximately 90% and city planning departments are involved in approximately 60%. Involvement by planning departments, on the other hand, decreases as population size increases, and their place is increasingly taken by dedicated departments specifically tasked with overall coordination of city center revitalization (Fig. 3-4-26).

Regarding cooperation between related departments within municipalities, a high proportion of revitalizing local governments “establish internal liaison committees” or “establish liaison officials in each department. On the other hand, while many local governments responded that there occurred “collaboration with relevant departments as necessary,” the fact that very few local governments are enjoying any effects indicates that establishing arrangements for routine liaison and information sharing is important if internal cooperation between departments of local

27) Whereas the average proportion overall of local governments reporting that their city centers are “growing busier and more active” is 10.3%, the proportions are 11.5% among local governments incorporating downtown revitalization in their general plans, 12.7% among those incorporating revitalization in their urban master plans, and 13.0% among local governments formulating basic plans under the Law on the Improvement and Vitalization of City Centers.

Fig. 3-4-26 Departments responsible for revitalization of city centers and downtown areas by population size

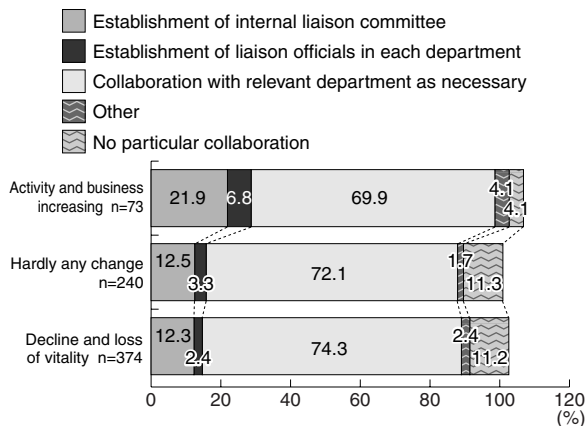
Although industrial development departments play the main role, urban planning and specialist departments are increasingly taking responsibility depending on population size



Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

Note: Totals exceed 100 due to multiple responses.

Fig. 3-4-27 Collaboration with related departments
Local governments whose city centers are growing busier and more active have arrangements for constant communication and sharing of information



Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

Note: Totals exceed 100 due to multiple responses.

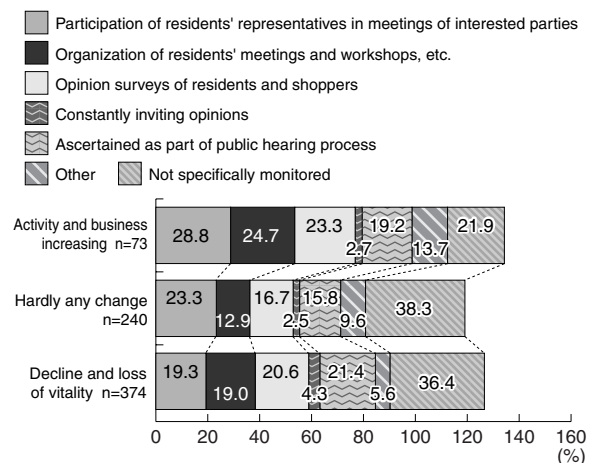
government is to function effectively (Fig. 3-4-27).

Next we examine the methods by which municipalities ascertain residents' needs and how they are associated with town revitalization.

Among local governments taking measures to regenerate and revitalize their town centers, many make concrete expressions of intent—in the form, for example, of pledges by mayors and inclusion in general plans—regarding details such as the placing of greater

Fig. 3-4-28 Methods of ascertaining views of ordinary residents and shoppers

Local governments where activity is growing take active steps to monitor the views of residents, etc.



Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

Note: Totals exceed 100 due to multiple responses.

priority on city centers. Naturally, such actions require as a prerequisite the understanding of residents and the building of a public consensus.

The results of the *Town Center Revitalization Survey* likewise indicate that a large proportion of “revitalizing local governments” actively and deliberately monitor the wishes of residents and visitors through, among other things, “participation of residents’ representatives in meetings of interested parties,” “organization of

residents' meetings and workshops," and "opinion surveys of residents and shoppers." On the other hand, although many municipalities say that residents' needs are ascertained by "constantly inviting opinions" or "as part of the public hearing process," these approaches appear not to be very effective in revitalizing towns (Fig. 3-4-28). While the trend is similar to that in the case of "collaboration with relevant departments as necessary" within local governments described above, responding "as necessary" appears not in fact to be effective.

This demonstrates that, like many initiatives in the past, town revitalization cannot be achieved simply by pursuing commercial revitalization, and that action by local government as a whole on "town revitalization" in the broader sense is necessary. During the high-growth period when both the economy and the population were continuously growing, the improvement of city centers and development of the suburbs were pursued in parallel. Now confronted by population decline, however, local governments are considering how to go about sustainable town development. However, although they have

**Case
3-4-7**

Mayor takes lead in town development after Toyama City declares its intention to be a compact city

It is anticipated that Toyama City's financial situation will become increasingly difficult. Consequently, it is envisaged that if the city's low density, dispersed urban area structure remains unchanged, it will be difficult to improve the efficiency of investment by the local administration and administrative services, and that it is possible that a larger financial burden will be placed on its residents in the future. Consequently, a study group consisting of volunteers from the prefectural government examined the issue. A study was made of the possibility of the effective utilization of existing key municipal facilities and public welfare facilities, and a quantitative analysis was made of the effects of the dispersion of the city center on city management and the lives of its residents. As a result, a scenario for "compact town development" was formulated based on 1) a city center environment where residents could walk to get where they needed to go; 2) reconstruction of the city center; 3) maturation of suburban areas centered on the formation of communities; and 4) formation of residential environments in rural areas. This became the city's official policy, and the basic plan for town development became the city's general plan. It introduced measures such as not allowing the zoning of non-commercial land to be changed for the establishment of a large shopping complex.

Every weekend, the city's mayor goes to town meetings held in various parts of the city. In addition to undertaking activities to obtain the understanding of residents, at the prefectural and city office level as well, the departments involved in town development collaborate on a daily basis, and, through shared recognition of the issues, each office has initiated specific projects aimed at achieving a compact city.

Behind the achievement of such initiatives in Toyama City lies the consistent support of the city's mayors in a leadership role, which has allowed officials under the mayor to put all their ideas and energy into the projects. Population density in the city center is the lowest among prefectural capitals, with most residents residing in the suburbs. Because most of the members of the city council are selected from new residential areas in the suburbs and farming villages, when discussions first

took place members voiced a range of opinions. For example, one suburban shop owner said "The city's commercial center should be the roadside shops in the suburbs," a city office official said, "I don't think a compact city is necessary," and a council member said, "Why should investment be made only in the city center?" Today, however, there is broader understanding among council members of these initiatives, and residents are becoming more aware of the move toward a compact city.

Main measures by the city related to town development

Toyama City is undertaking the projects shown below. They are based on a policy that states that "City projects must be implemented together with the private sector, the involvement of the administration will be kept to a minimum, and speedy and prioritized investment are of the essence."

Urban Planning Department: Project to promote residential buildings in the city center (subsidy of ¥1 million per apartment to builders of condominiums in the city center and a subsidy of ¥500,000 to the purchaser of each apartment)

Urban Development Department: Promoting of redevelopment projects in the city center, has decided to build a roofed plaza in the city center to generate a bustling environment

Parks and Green Spaces Department: Decided to renovate the entire park in Toyama Castle

Roads Department: Has decided to renovate roads in the downtown shopping district giving priority to pedestrians, designating such roads as "kurashinomichi."

Streetcar Promotion Office: Plans to take over the JR Toyama Port Line, introduce streetcars, increase frequency of services, and put back the last service each day to a later hour

City Center Revitalization Promotion Office: Providing 100% funding for resident markets for a maximum three-year period as a TMO project

In another initiative, a bus service for the elderly in the suburbs has been implemented that allows them to take a bus from anywhere in the city to the city center for a one-way charge of ¥100.

developed plans to redevelop their city centers and curb suburban sprawl, some responses from the same municipalities are in fact accelerating large stores to locate in the suburbs. As in the case of Toyama City described in Case 3-4-7, positive leadership by the head of the local government can ensure that each department and the municipality’s head are all moving in the same direction, showing how important leadership by heads of local governments is to effectively forming a consensus

within local governments.

2. Collaboration and cooperation between local governments and the private sector

Next, we examine the relationship between collaboration between local governments and players in the private sector, and town revitalization.

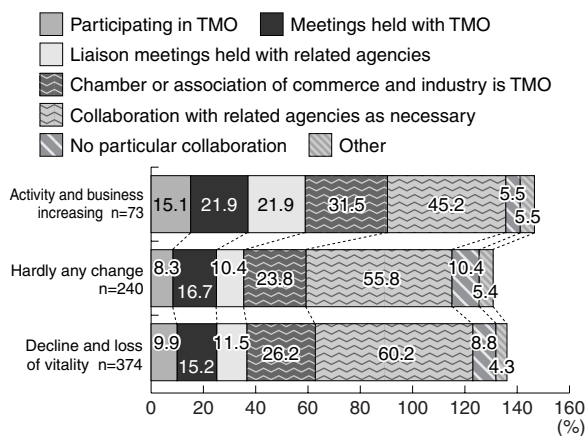
Town revitalization cannot be achieved through the efforts of local governments alone. Also important are collaboration and cooperation among a variety of other players, including local shopping districts and businesses, chambers and societies of commerce and industry, landowners and leaseholders in city centers, and the various private organizations involved in town development described in the section on revitalization businesses.

If we look then at the state of cooperation with related non-governmental entities in “revitalizing local governments,” we find that local governments of this kind tend to have arrangements in place for contact and collaboration with a wide range of related players in the private sector. These include “participation in TMOs,”²⁸⁾ “meetings with TMOs,” and “liaison meetings with related organizations” (Fig. 3-4-29).²⁹⁾

On the other hand, although as in the case of collaboration between departments within local government “collaboration with related organizations as necessary” attracted the most responses, quantitatively at least, a large proportion of these in fact reported that

Fig. 3-4-29 Collaboration with related agencies, etc. outside local government

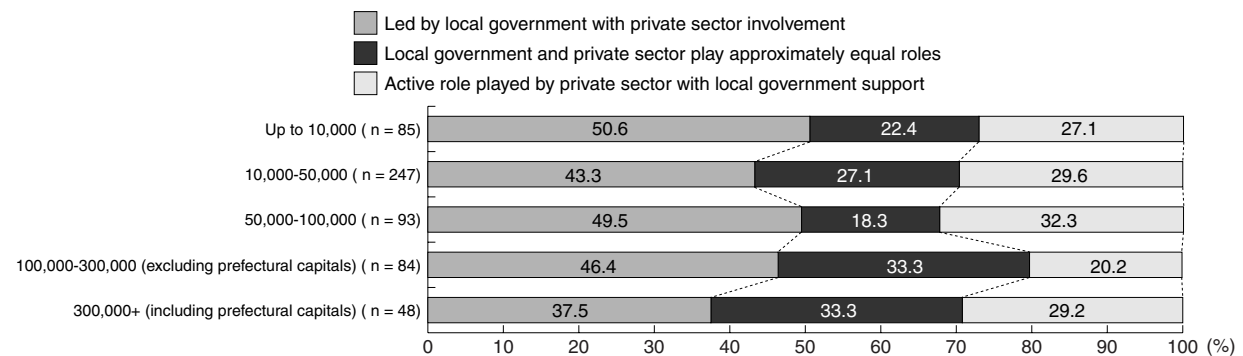
Meetings with TMOs and related agencies commonly held by local governments where activity is increasing



Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

Note: Totals exceed 100 due to multiple responses.

Fig. 3-4-30 Leadership by government and private sectors by population size
Higher proportion of local government-led action in local governments with smaller populations



Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

28) TMOs (Town Management Organizations) are organizations that integrate and comprehensively coordinate town management involving various entities, and operate and manage town development activities. Their core tasks include the formulation of concepts for commercial clusters, attraction and arrangement of tenants within an areas, management of tenant mix, area streetscaping, organization of joint events, improvement of transport access, and management of parking facilities, etc. Although the term “TMO” does not itself have any legal definition, organizations (“approved initiative promotion businesses”) that draw up “small and medium retailer upgrading project initiatives” (“TMO initiatives”) under Article 18, Paragraph 1 of the Law on Improvement and Vitalization of City Centers and are approved by municipalities under Paragraph 3 of the same article as “approved initiative promoters” are generally called “TMOs” in Japan.

29) The association of frequency of meetings with TMOs and liaison committees involving related organizations with revitalization was also investigated. Although definitive conclusions cannot be drawn due to the small sample size, a high proportion of local governments that held liaison meetings involving related organizations frequently (at least six times per year) were found to report that their towns were being “revitalized.”

their town centers are “declining.” This suggests that in the case of collaboration with related entities in the private sector, it is not action “as necessary” but rather the establishment of institutionalized arrangements for close collaboration that is the important thing.

The next question we consider is the extent to which the success of town revitalization depends on the leading role being played by the public sector or the private sector.

If we start with a breakdown by population size of which of the two plays the leading role, we find that the proportion of “local government leadership” increases as population size decreases (Fig. 3-4-30). This is a

reflection of the general tendency for the public sector to naturally assume leadership in smaller municipalities due to the insufficient clustering of “private enterprises” sufficient to lead town development.

However, a comparison of which sector—public or private—is playing the leading role in “revitalizing local governments” and other local governments reveals hardly any difference in the proportion of “led by local government” responses and “active role played by private sector responses” according to degree of revitalization (Fig. 3-4-31).

Generally speaking, then, revitalization efforts do not tend to succeed more if they are led by local governments rather than the private sector, or vice versa,

Case 3-4-8

Takamatsu City tackles redevelopment aimed at revitalizing the city center through a shopkeeper-driven initiative

In Takamatsu City there are eight shopping districts totaling 2.7 km in length. One of these is the Takamatsu Marugame-machi shopping district, with an long-established department store situated at each end – a Mitsukoshi department store and a Tenmaya department store (formerly Sogo). As such, it is a shopping district that could be said to be the “face of Takamatsu.”

Following the holding of an event in the Marugame-machi shopping district in 1989 to commemorate the 400th anniversary of the building of Takamatsu Castle, momentum grew for town development with next 100 years in view. As a result, a town development committee was established centered on the local Young Men's Association. According to a questionnaire completed by committee members in 1992, 93% believed that although at that time the shopping district was still lively enough, if nothing were done in the future the shopping district would stay the same or decline. The questionnaire also revealed that quite a few members were predicting that sales and traffic would both decline by 30%. Reasons given were that most shoppers returned home shortly after achieving their objective and that there was an over-representation of certain types of shops. Some of the opinions expressed included, “Although pretty clothes are sold there, there is nowhere in Marugame-machi worth dressing up for,” and “Although it goes without saying that individual stores need to make an effort with regard to atmosphere, service and product lineup, the district as a whole needs to create facilities and services that welcome visitors.”

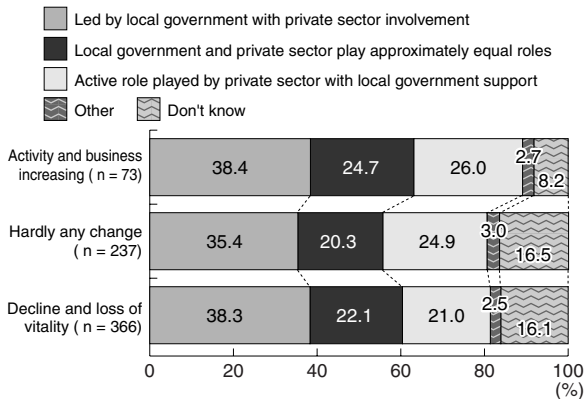
Since the late 1990s, large stores have sprung up one after another in the suburbs of Takamatsu City, and in 1998 a store was built with 40,000 square meters of floor space, the largest in western Japan. As a result, traffic in the city center in 2003 had declined significantly to 67.5% of that recorded in 1996. In response to this situation, the Takamatsu Marugame-machi shopping district put together a redevelopment concept using a “town development company.” Based on measures undertaken so far and with “developing a town where people can stay a long time in comfort and with the feeling of being on an outing,” as the central

concept, it identified the issues involved. They were: 1) Correcting the over-representation of certain types of shops within the shopping district; 2) Creating an attractive urban space; 3) Stopping the decline in resident population; 4) Promoting more rational use of land; 5) Addressing problems brought about by high, stable land prices; and 6) Doing something about the increase in shop owners going into the real estate business. As for how to undertake the project, they decided on the following: 1) The town development company established through finance provided by those holding rights in the shopping district, land, etc. will purchase reserve floor space (with the right to lease for a fixed period) from the redevelopment consortium and manage the entire facility; and 2) Right-holders will receive ground rent from the town development company; and 3) Landowners and leaseholders establishing stores will rent floor space from the town development committee and pay rent for accommodation (though it depends on store area, accommodation rent and ground rent will basically cancel each other out), while landowners and leaseholders will comply with the town development company with regard to the use of the land. In addition, they decided to proceed with the project by dividing the district into seven zones. Through a combination of not only complete rebuilding, but also rebuilding through collaboration between a small number of people, in principle, agreement by all members in the same zone was essential, and work would start from those zones which had reached agreement.

In this case, shopkeepers from a central city shopping district shared a sense of crisis from an early stage concerning the future of their cluster of shops, identified and then tackled issues requiring remedies. The formulation of the project concept came mainly from interested parties in the shopping district, and their approach was distinctive in that while skillfully incorporating the ideas of outside redevelopment consultants, they made decisions in advance on not only construction matters but also on how to manage the construction. This redevelopment project is due to be completed this autumn, and Takamatsu's residents are also looking forward to its completion.

Fig. 3-4-31 Leadership by government and private sectors according to level of revitalization

No difference in level of revitalization according to whether lead is played by government or private sector



Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

and the ideal form of leadership varies according to the circumstances of individual municipalities.

Fig. 3-4-31 does, however, show that the level of revitalization is lower in local governments that responded “don’t know” regarding which sector played the leading role, from which we may conclude that town revitalization is less likely to be occur if the locus of leadership is uncertain.

Next, we examine the case of Takamatsu City (Case 3-4-8), which in contrast with Toyama City described earlier has succeeded in revitalizing its city center through private sector rather than local government leadership.

Revitalizing towns are said to have a “key man,” whether from the side of local government or the private sector, who plays the core leadership role. These key figures are not uniform – rather, human resources suited to the projects undertaken in each town play leading roles, the public and private sectors play their respective roles, and pursue projects by assisting one another.

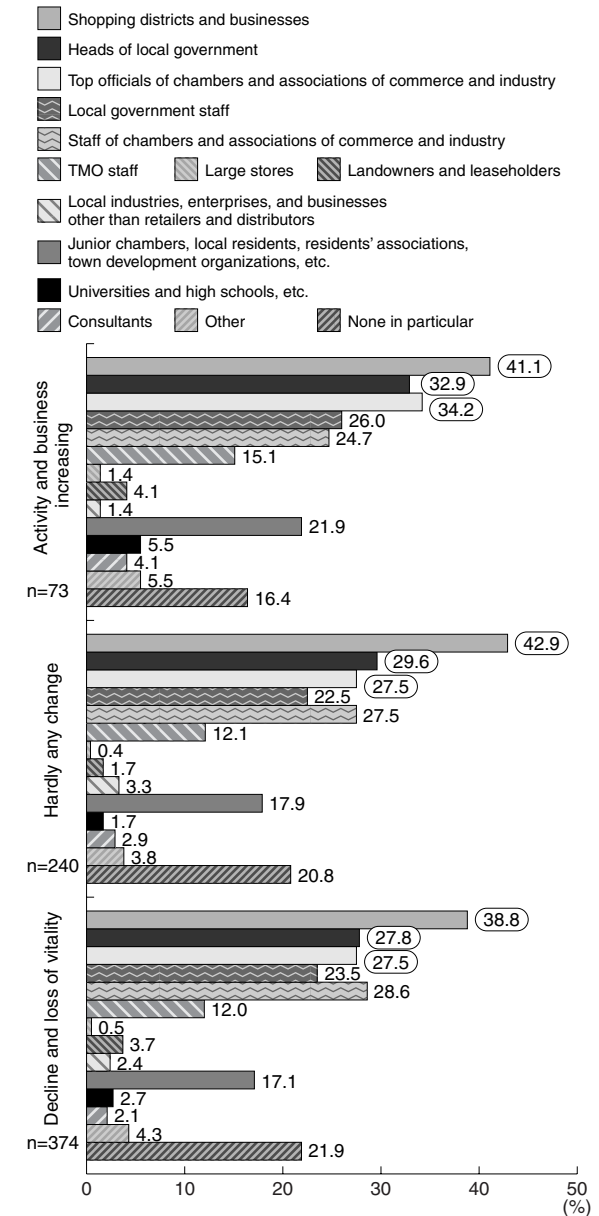
For the *Town Center Revitalization Survey*, respondents were asked about the key figures playing the leading roles in city center revitalization in each municipality. As can be seen from Fig. 3-4-32, the most commonly cited key figures were “shopping districts and businesses,” followed by “heads of local government,” and “top officials of chambers and societies of commerce and industry.”

However, who the key players are does not seem to be particularly closely correlated with the level of revitalization. This is consistent with the finding above that the form of leadership best suited to town revitalization differs according to the circumstances of each municipality.

It is also interesting to note that, although small in number, there were also some municipalities whose towns were revitalizing that identified “large stores” or

Fig. 3-4-32 Key players in revitalization of city centers and downtown areas

Leading roles tend to be played by shopping districts, businesses, local government leaders, and top officials at chambers and associations of commerce and industry



Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

“universities” as their key players. The management of large stores in particular shares many elements with the general management of shopping districts and commercial clusters, and making use of their human resources and application of their experience to town development is one option. Large stores and small and medium retailers in declining city centers now share a common interest in making town centers more active once again, and collaboration between such parties is another possible way of furthering revitalization.

Column 3-4-2 Efforts by Commercial Incubators

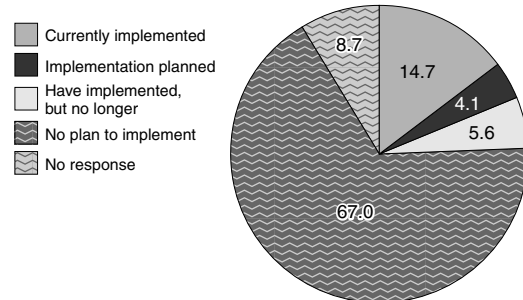
In efforts to develop "compact town," bolstering commercial vitality and enhancing the unique charms of central urban areas based on the needs of their residents and visitors are as important as the integration of civic functions.

In Kumamoto City, there is a lively shopping area called "Kaminoura-dori Shotengai," where new stores and shops engage in new kinds of businesses, and deal in new kinds of goods. In Japanese shopping areas in olden days, there was a natural turnover; when one shop went out of business it was replaced with something else, breathing new air into the area, and bringing new energy. These days, shops still go out of business, and often nothing takes their place. In such circumstances, it is critical for the sustained growth of the regional economy that new people be encouraged to step in and engage in useful commerce. To this end, efforts to establish and operate commercial "incubator facilities" making use of vacant shop spaces have appeared around the country.

Let's look at commercial incubator activities in various areas, through The *Town Center Revitalization Survey*. Among 913 municipalities responding to the survey, while a little more than 10% are still operating such facilities, more than 70% are no longer or have no plan to do so (Column Fig. 3-4-2-1). In cities that do engage in such activities, more than 90% of the facilities are located in the central urban area, with 70% of the buildings used having once been individual shops that had gone out of business. The main implementing entities include TMOs, societies of commerce and industry, chambers of commerce, shopping-district associations and municipalities.

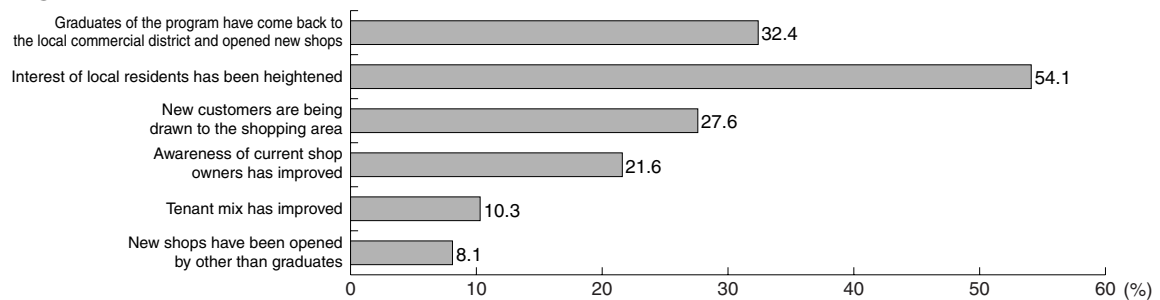
Reported effects of creating commercial incubator facilities include: "interest of local residents has been heightened," "graduates of the program have come back to the local commercial district and opened new shops," "new customers are being drawn to the shopping area" and "awareness of current shop owners has improved." It may be taken from these results that commercial incubator facilities serve the function of rejuvenation in such shopping districts – fresh air and energy – a function that existed naturally in times past (Column Fig. 3-4-2-2). Over one thousand people have graduated from commercial incubator facilities. About 20% have started their own businesses in central urban areas and continue them to date; 30% never started such businesses; and a bit less than 10% started a business but gave it up.

Fig. 3-4-2-1: Establishment and operation of incubator facilities



Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).
 Note: 913 municipalities were surveyed.

Fig. 3-4-2-2: Effects of establishment of commercial incubator facilities



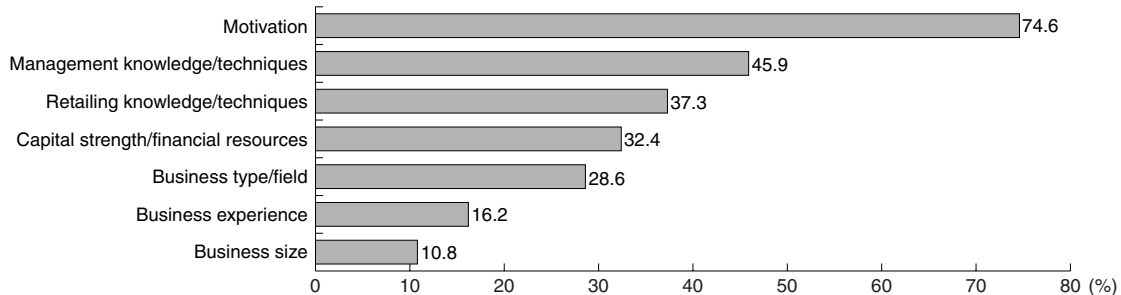
Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

Notes: 1. 185 municipalities that currently have incubator facilities or that used to were surveyed.
 2. Totals exceed 100 due to multiple responses.

Shops that opened in a central urban area and have remained are characterized by there being no other shops of the same type or otherwise directly competing, and many of them deal in imported, fashionable sundry goods, clothing, etc., or something requiring particular skill or ability – for example, handicrafts, restaurants, massage, and nail art. Success or failure depends on "motivation" as the primary factor, followed by "management knowledge/techniques," "retailing knowledge/techniques" and "capital strength/financial resources." Only slightly more than 10% referred to "business experience," suggesting again that the secret of success is enthusiasm rather than experience (Column Fig. 3-4-2-3). Among the commercial incubator facilities themselves,

however, 50% – the largest portion – pointed to "location" as the key to success, followed by "lease terms," "ready availability of advisors," and "selection of tenants" at the incubator facility, suggesting more the importance of location (Column Fig. 3-4-2-4).

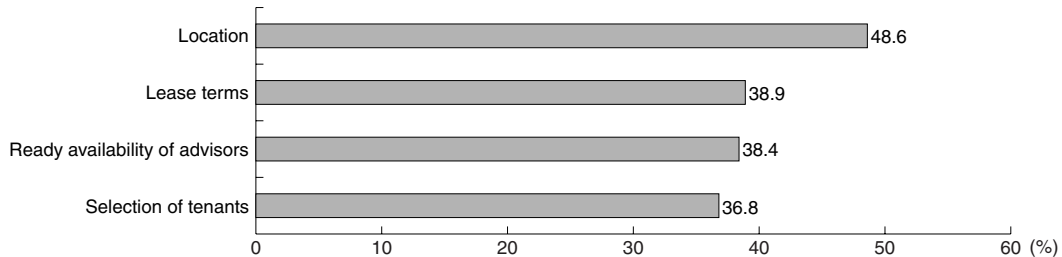
Fig. 3-4-2-3: Reasons for success or failure of new businesses started by tenants



Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

- Notes: 1. 185 municipalities that currently have incubator facilities or that used to were surveyed.
2. Totals exceed 100 due to multiple responses.

Fig. 3-4-2-4: Key points in ability of incubator facilities to lead tenants to be successful and independent

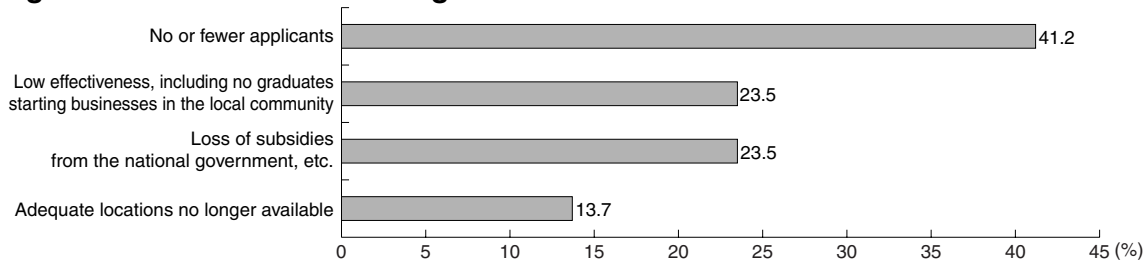


Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

- Notes: 1. 185 municipalities that currently have incubator facilities or that used to were surveyed.
2. Totals exceed 100 due to multiple responses.

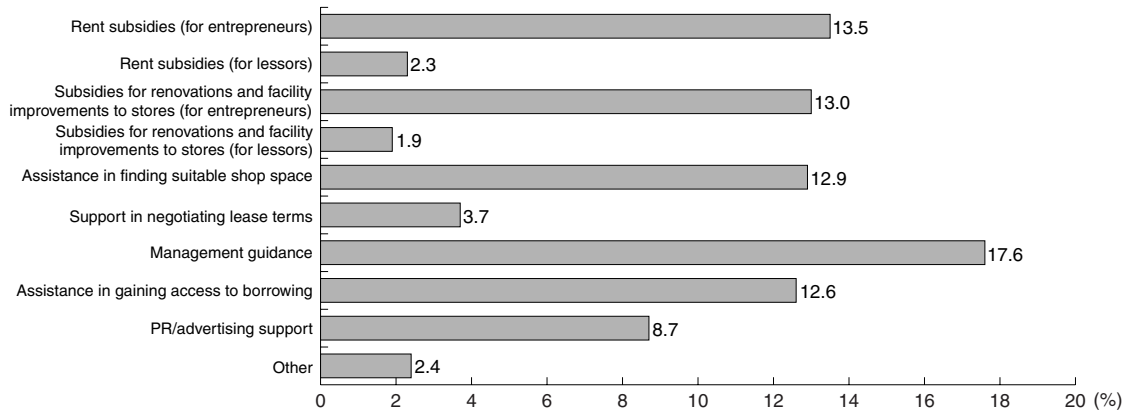
Commercial incubator facilities have borne a certain amount of fruit in that they have provided opportunities to motivated entrepreneurs and others, and have spurred creation of distinctive, competitive shops. On the same time, quite a number of facilities have experienced declining tenant applications, utilization rates and ability to attract customers. These stem from reduced interest, loss of novelty, feelings of saturation, etc. People responsible for incubator facilities that have closed cite declining tenant applications and graduates who then did not start new businesses in the communities as problems (Column Fig. 3-4-2-5). Public and private assistance to commercial entrepreneurs generally, not just tenants of incubator facilities, is in the form of management guidance, rent subsidies, subsidies for renovations and facility improvements to stores, assistance in finding suitable shop space, assistance in gaining access to borrowing, etc. It is expected that further measures tuned to local conditions will be developed (Column Fig. 3-4-2-6).

Fig. 3-4-2-5: Reasons for closing commercial incubator facilities



Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

- Notes: 1. 51 municipalities with incubator programs in the past were surveyed.
2. Totals exceed 100 due to multiple responses.

Fig. 3-4-2-6: Public and private support for entrepreneurs generally, including tenants of commercial incubator facilities

Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

Note: 913 municipalities were surveyed.

Section 7 Toward sustainable town development (summary of Chapter 4)

From the analysis in this chapter, it is clear that the “hollowing out” of city centers continues, and that underlying this trend is competition between locations in city centers on the one hand, and suburbs on the other. Conversely, there is also a strong possibility that the sales of neighboring small and medium retailers will rise when a medium or large store opens in a city center, indicating that the interests of large stores and small and medium retailers within the same commercial cluster are becoming aligned.

While the value of “compact town development” in the face of population decline, birthrate decline, and demographic aging is becoming increasingly widely recognized, the ideal direction of “town development” activities should ultimately be left for regions to decide for themselves.

In the U.K., numerous cities have successfully employed “compact city policies” to create “sustainable cities and regions.”³⁰⁾ The U.S., meanwhile, has “BIDs,”³¹⁾ which act to promote town development. In Japan, too,

the authorities, residents, organizations involved in community businesses, stores, and landowners and leaseholders need to cooperate with a shared sense of purpose.

It has been shown that the ideal form of leadership required to regenerate towns varies according to the conditions in each municipality, and that there is no single road to success. However, this chapter has also demonstrated the importance to revitalization of collaboration between interested parties, both within local government and between the public and private sectors.

Town regeneration and “sustainable town development” in an age of demographic decline are likely to increasingly depend on the public and private sectors pooling their knowledge, developing concrete action programs, and establishing effective locally-based mechanisms for their implementation, and it is hoped that local governments and the private sector throughout Japan will work together even more in the future in tackling the revitalization of our towns.

30) See *2005 White Paper on Small and Medium Enterprises in Japan*, p. 162 (“Column: Town center renewal in the U.K.”).

31) BIDs (Business Improvement Districts) are special administrative districts (a type of “local authority” operated by the private sector) established for a fixed period (e.g., five years) years in accordance with a project master plan drawn up by promoters typically drawn from among local businesses and real estate owners in city centers, and are approved by a direct ballot in the district concerned or by the city assembly. They are characterized primarily by their authority to charge special taxes within certain limits established by state law from local real estate owners, providing them with a stable source of revenue. These revenues are applied to cleaning, security, and similar services within the BID. The entities that operate these BIDs serve simultaneously as the core organizations responsible for town management in city centers, and they act as a bridge between the public and private sectors, and lead a wide range of activities to develop commerce (e.g., by attracting tenants and organizing events) and other activities relating to town development, such as street maintenance and improvements and the promotion of tourism. There are estimated to be over 1,300 such organizations in the U.S. at present. The BID system has also spread in recent years to the U.K. and Germany as a solution to the problem of ensuring that the costs of town development are borne equitably and the financial problems of organizations involved in town development. (For details of the situation regarding town management in the U.K., Germany, and France, see Appended Note 3-4-9.)

Conclusion

The reversal of long-term socioeconomic trends and SMEs

The preceding three parts provided an overview of business conditions among SMEs in fiscal 2005, and analyzed the major structural changes in the environment facing SMEs and their impact on SMEs. Let us then review the main aims of this year's analysis.

Part I examined the significance of the present recovery for SMEs from the somewhat longer perspective of the dozen or so years since the collapse of the bubble economy. Although the variation in conditions according to region and industry needs to be carefully watched, overall SMEs, too, are at last breaking free of the fetters of the "three excesses"—excess debt, excess capacity, and excess employment—and beginning to make the transition to a more aggressive approach to business.

Parts II and III showed how this turning point in trends in business presents opportunities, and summarized the significance of the structural changes in Japanese society over the next few decades for SMEs.

The radical structural changes presently confronting Japanese society are of two main kinds.

One is the deepening of ties and increasing integration of the Japanese economy with the economies of East Asia.

For decades since the end of World War II, Japan had hardly any horizontal competitive ties or divisions of labor in the economic realm with its neighbors. As seen in Part II, however, Japan's East Asian neighbors are rising meteorically, and even SMEs within Japan that generally have no contact with overseas are having to face up to market competition from abroad.

And the second major change is the long-term reversal of population trends in Japan.

For more than a century since the Meiji Restoration, Japan enjoyed uninterrupted population growth. This demographic growth did not simply mean that the size of the total population was rising – it also created a "young society" in which the next generation of young people in the prime of their lives was constantly more numerous than the elderly. Japanese systems and institutions have become entirely accustomed to this constant upward population trend, and its reversal requires major reforms throughout the nation in both the public and private sectors. And it is not only government that needs to "reform." SMEs and communities, too, need to face up to the challenge by rethinking approaches to business that may well have worked to date, but will not in the future.

What has become apparent throughout this analysis is the importance of grasping the long-term changes occurring at this great turning point and tackling new

challenges applying new and unconventional ideas.

Regarding relations with East Asia, SMEs that have plunged into local networks in China and elsewhere in the region in order to survive amid the development of divisions of labor with neighboring countries have experienced market growth and generated business innovations that have led in many cases to fresh growth within Japan.

And domestically, we have observed that among the manufacturing SMEs that underpin Japan's competitiveness, it is those that have deliberately formed broad-ranging information networks extending beyond their day-to-day customers identified their core strengths or competences, and boldly pursued the development of technologies that are growing amid the changes in the business environment resulting from the increasingly "meshed" nature of transaction patterns.

The same applies in relation to the changes in demographic structure.

The proprietors that were the young founders of enterprises during the high-growth period are now all approaching retirement. As long as they are themselves working as proprietors, however, the business succession issue is not regarded as an immediate problem, causing them to tend to procrastinate. Against this backdrop, some SMEs are succeeding in smoothly transferring their businesses to third parties by means such as M&As, which have not traditionally been associated with smaller enterprises.

The analysis of younger people revealed the importance of assessing the motivation and abilities of "freeters" and "NEETs" without any preconceptions. Symbolically, when SMEs that consider freeters "difficult to employ" before hiring them actually try hiring them as permanent employees, they are in practice almost all satisfied with how well these young people actually work.

In a society with a shrinking population, the SMEs that account for 70% of employment in Japan are considered to have an exceedingly important role in building a society that makes it easier to have and raise children. Regarding balancing work and parenting, we saw how one area that had until now had been largely ignored – namely, SMEs' flexibility in the workplace – actually has a greater than anticipated effect. The establishment of arrangements such as parental leave and shorter working hours currently being pursued by the Government remain extremely important. At the same time, however, our analysis suggests that turning our attention to the workplace at SMEs may broaden the range of measures available for building a society that makes it easier to have and raise children.

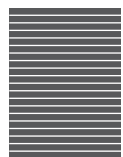
“Compact town development” is a prime example of the kind of area in which a reversal in thinking is required in keeping with the reversal in population trends. When both the population and economy were growing continuously, it made perfectly good sense to develop city centers while simultaneously developing suburban areas. As the population and tax revenues of the provinces decline and local communities become diluted, mechanisms for cooperation among interested parties and comprehensive management to enable “selection and concentration” in towns will grow further in importance.

SMEs are at last emerging from the long “night” that at one time seemed without end, and the fingers of the dawn are spreading across the eastern sky, giving enterprises the opportunity to change from the

“restrained management” followed until now to a more “aggressive management” approach. Before going on the attack, however, enterprises need to carefully assess the structural changes that mark this “turning point in time” that now confronts Japanese society and economy, ascertain the associated risks and opportunities, and grasp these opportunities to take on fresh challenges.

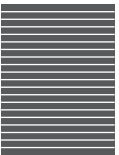
Everyone finds it difficult to shed old ways of doing things and plunge into new ways of thinking. What SMEs now need to do is to second-guess changes in the long-term structural trends in Japanese society, and to adopt new paradigms.

We conclude this white paper on small and medium enterprises with the wish that fiscal 2006 is a year of dramatic and historic progress for all SMEs with drive and motivation.



SME policies planned for fiscal 2006





**This section gives only a broad outline of program content and spending.
Details are subject to change.**

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Chapter 1 Introduction

Since the beginning of 2006, the Japanese economy has been seen to be recovering both in the industrial and household sectors. Business confidence among SMEs is also on the rebound, although there are differences according to the type of business and region.

In these economic circumstances, revitalizing SMEs, which account for the majority of Japanese industry and are a prime source of its economic vitality, is of great importance in the immediate recovery of the national economy as a whole and in enabling it to sustain its vitality hereafter. Accordingly, SME measures will be carried out in the following five areas, as “pillars” of the recovery.

First pillar: supporting manufacturing SMEs that possess high levels of technology, which in turn support the manufacturing industry in Japan.

Specifically, in order that high-tech industries (including fuel cells and home information devices) as well as other key industries that will be driving forces in the nation’s economy may develop and demonstrate the competitiveness necessary to survive in the global market, it is essential that the competitiveness of SMEs supporting the basic technologies of production (including casting, forging and pressing) be maintained and strengthened. To this end, the Draft Law concerning the Enhancement of the Fundamental Technologies for SME Creativity (hereinafter referred to as the “SME Technological Advancement Law”) will be submitted to the 164th ordinary session of the Diet, and varied measures to support SMEs, including issuance of guidance on technological development (by type of technology), promotion of information-sharing between upstream and downstream industries, and support for research and development, will be implemented.

Second pillar: securing and developing human resources for SMEs.

In order to spawn the startup of new businesses and support management rejuvenation among SMEs, people who can develop business strategies, perform marketing, etc., are essential. Efforts to match individuals with the right professional skills - including retirees - to the SMEs that need them will be carried out. And to assist those wanting to start new businesses in acquiring the necessary practical abilities, classes and seminars will be expanded and enhanced.

In addition, to support SMEs that often have difficulty appealing to young people, opportunities to promote the attractiveness of SMEs will be created, for example, by use of job cafés. Support will also be provided for education on technologies matching the needs of local businesses, coordinated with local technical colleges, etc.

Third pillar: helping SMEs tackle the challenges of new business development and reorganization.

In April 2005, the Law for Facilitating New Businesses of Small and Medium Enterprises (hereinafter referred to

as the “SME New Business Activities Promotion Law”) was enacted to make more systematic the implementation of measures to support business start-ups, SME’s seeking to innovate, etc., and to support new business activities as a result of SMEs in different fields with different technologies and experience working together (“new partnerships”). Under this law, efforts to establish support systems have made steady progress, including, in fiscal 2005, creation of local councils to support new partnerships in nine “blocs” around the country. This year, too, such efforts will be continued, making particular use of local councils to assist new partnerships and new businesses launched by SMEs at all stages of the process from issuance of business plans through commercialization of products.

SME revitalization support councils established in all prefectures, and related parties in each region, including local financial institutions, will also make concerted efforts in support of rejuvenating SMEs.

Fourth pillar: facilitating SME financing.

In fiscal 2006, in order to prevent SMEs that have the motivation and ability from being driven into bankruptcy because of difficulties in obtaining financing, safety-net measures will continue to be fully implemented in the form of loans and guarantees, a system to guarantee smooth refinancing, etc.

To facilitate borrowing without excessive reliance on security or personal guarantees, receivables-backed loans and securitization of private financial institutions’ loans to SMEs will be supported. Systems designed to eliminate, in whole or in part, the requirement of security and to exempt entrepreneurs from having to give personal guarantees for borrowings will be introduced broadly to promote smooth, diversified SME financing.

Fifth pillar: revitalizing shopping districts and city centers.

The business environments for shopping districts and urban centers have been increasingly severe of late, due to suburbanization, stagnation in retail selling, etc. Revitalization of city centers is an urgent requirement. To realize compact, vital urban centers, necessary actions will be taken so as to provide support, predominantly by selection and concentration, in areas where uniform efforts are being made to integrate urban functions in general in urban, and recover the liveliness of city centers.

Chapter 2 Support for manufacturing SMEs

Section 1 Support for the advancement of core manufacturing technologies at SMEs

It is Japanese SMEs, whose excellent technologies play key roles in production, including casting, forging and plating, to work closely on the details with downstream companies in the course of developing and manufacturing products and parts, that allows Japanese manufacturing to be internationally competitive. In order to strengthen that competitiveness in manufacturing areas including fuel cells, robots and other high-tech industries that are taking the lead in the Japanese economy, as well as to foster creation of new industries, it is important to further enhance the competitiveness of SMEs with important core technologies.

Those SMEs are, however, facing various difficulties, including changes in their business ties and connections as competition becomes more severe, greater risks in their technological development due to increased sophistication and specialization, difficulty in securing human and financial resources, etc.

The bill for the SME Technological Advancement Law will therefore be submitted to the 164th ordinary session of the Diet, and strategic, prioritized measures will be undertaken, including promotion of information-sharing between upstream and downstream industries, support for research and development on core technologies, etc.

1. Support for research and development by manufacturing SMEs

(1) Issuance of guidelines for technological advancement (guidelines specific to each technology) and recognition of R&D plans

Under the SME Technological Advancement Law, specific core technologies (casting, forging, plating, pressing, die making, etc.) will be designated, and for each, “guidelines for advancement of specific manufacturing core technologies” will be issued, to present future “visions” that individual SMEs can aim to achieve in their development of their technologies. The government will also approve specific research and development plans, etc., which SMEs will prepare based on the guidelines, and will support them.

(2) Projects to support the advancement of strategic core technologies

Efforts by SMEs to undertake innovative, highly risky research and development, research and development to realize innovation in production processes, etc., will be supported, enabling the SMEs to elevate their core technologies (casting, forging, plating, pressing, die making, etc.) in the areas that have a leading role to play in the Japanese economy. (new) (¥3,153 million budget plus SMRJ operating expense subsidy)

(3) Reduction and waiver of patent fees, etc.

Certain costs for patents on the results of research and development by SMEs, under specific research and development plans, etc., approved by the government, will be reduced or waived.

Specifically:

- 1) Fee for applying for examination → reduced by half
- 2) Patent fee → reduced by half for the initial six years

(4) Lending arrangements of JASME

Under the SME Technological Advancement Law, the Japan Finance Corporation for Small and Medium Enterprises (JASME) will provide special loans to SMEs whose specific research and development plans, etc., have been approved by the METI minister, and that meet certain requirements.

- Lending rate: special rate category 3
 Lending term: for equipment up to 20 years
 for operations in principle,
 up to 5 years

(5) Special exemptions under the Small and Medium Enterprise Credit Insurance Law

Limits for credit insurance will be expanded when SMEs borrow money from private financial institutions for approved plans, etc.

(6) Special exemptions under the Small Business Investment Company Limited Law

When SMEs increase capital to implement approved plans, etc., the Small Business Investment Company Limited will be able to underwrite shares, etc., even if the capital is more than ¥300 million.

2. Enhancement of the environment for advancement of manufacturing core technologies

(1) Support for development of networks between upstream and downstream companies

As part of efforts to reduce uncertainty in technological development by upstream SMEs and to resolve asymmetric information situations through closer communications between SMEs in the upstream, playing key roles in core technologies, and downstream companies engaged in production, for example, of fuel cells and information home appliances, support will be provided for activities to allocate personnel who can work between the upstream and downstream companies to coordinate and fine-tune their cooperation, to create opportunities for information exchanges and matching, and to create opportunities for SMEs and large businesses to interact with each other. (new) (¥200 million budget)

(2) Projects to support the advancement of strategic core technologies (re-shown, see Chapter 2, Section 1, 1. (2))

(3) Programs to develop human resources for SMEs, making use of technical colleges, etc.

In 2007, the baby boomers will begin reaching retirement age. Development of technical human resources supporting SMEs is important in respect of maintaining and strengthening the competitiveness of Japan's industries. To this end, practical training of young engineers/technicians based on the needs of local SMEs, making use of the equipment, know-how, etc., possessed by technical colleges, etc., will be supported. (new) (¥400 million budget).

(4) Objective proof of technical accuracy and reliability in measurement standards

In order to objectively establish the accuracy and reliability of processing and manufacturing by SMEs and to support the commercialization of their products in the market, a system to manage technical accuracy, etc., of SMEs using examination and inspection organizations, etc., human resources and facilities will be developed. In that way, the basis for measurement standards will be enhanced toward establishment of a traceable system essential for global business development. (new) (¥550

million budget)

(5) Facilitating continuation of core technologies

Very versatile software will be developed so that individual workers' tacit knowledge, including design and processing know-how, owned by manufacturing SMEs, can be stored digitally in a systematic way. At the same time, in order for SME manufacturers without experience in designing software to create business software (production management, quality control, shipment management, etc.) and utilize accumulated know-how, etc., in their production activities, tools to support creation of such software will be developed and provided to the SMEs. In this way, continuation of core technologies owned by SMEs will be supported. (new) (¥488 million budget)

(6) Programs to enlighten SMEs on intellectual property

Serving as "shelters" for SMEs with problems involving intellectual property, societies of commerce and industry and chambers of commerce and industry across the country will serve as one-stop access points for advice and consultation. Seminars on prevailing corporate activities focused on intellectual property will also be staged in various places around the country. (new) (¥100 million budget)

Section 2 Promotion of technological innovation by SMEs

Motivated, capable SMEs play leading roles in Japanese manufacturing, and their revitalization is essential to overall economic revitalization and the strengthening of international competitiveness. Accordingly, strong support will be provided for the development of technologies by SMEs boldly tackling new challenges and entering new business and fields, in order to foster large numbers of SMEs whose outstanding technologies will put them at the global forefront in their fields.

1. Small Business Innovation Research (SBIR)

Under the SME New Business Activities Promotion Law, the relevant ministries and agencies will cooperate in designating as "special subsidies," subsidies and contracting fees for the development of new technologies leading to the creation of new industries, and in setting targets for disbursements of grants (such as special subsidies) for SMEs in order to increase spending on SMEs. In order to then ensure that the developed technologies are successfully commercialized, support will be provided in the form of reducing or exempting SMEs from patent fees and related charges, providing special loans, and providing exemptions from credit guarantee requirements.

2. SME/venture challenge support

In order to help bring innovative but risky "seed" technologies and business ideas from SMEs and other businesses to market, subsidies will be provided to cover part of the cost of R&D for commercialization, market cultivation and similar activities undertaken by SMEs. Integrated consulting services to help give form to business plans and support for startups and new business ventures will also be provided. In particular, starting with fiscal 2006, subsidies for expenses related to acquiring rights to industrial property in other countries will be expanded. (partial modification) (¥2,416 million budget plus SMRJ operating expense subsidy)

3. Promotion of commercialization of results of business innovation by SMEs

The commercialization of technologies by SMEs using external organizations providing technological assistance will be promoted through subsidies for expenditures required when SMEs seek to resolve technological issues and commercialize their own outstanding technologies with the technological support of public research institutes and National Institute of Advanced Industrial Science and Technology (AIST), etc., so as to actively meet the needs of SMEs. (partial modification) (¥300 million budget)

Section 3 Intellectual property measures for SMEs

The following programs will be implemented in order to develop an environment to support the protection and effective use of SMEs' intellectual property.

1. Measures to protect SMEs' intellectual property rights

In order to protect the intellectual property rights of Japanese SMEs that are establishing a presence overseas, activities such as surveys of the state of infringement of intellectual property rights will be undertaken in response to individual requests by SMEs, using the overseas networks of the Japan External Trade Organization (JETRO). (continuation) (¥61 million budget)

2. Support for the intellectual property strategies of local SMEs

Support will be provided by dispatching experts in intellectual property to SMEs with unique core technologies, to assist them with the development of intellectual property strategies so that they may develop their businesses with the benefits of such intellectual property strategies in the future. Helpful information will also be provided. (continuation) (total budget for (1) and (2), ¥283 million)

(1) Support for development of intellectual property strategies

Prefectural support centers for SMEs will work in collaboration with intellectual property centers to support the development of business plans and intellectual property strategies, by dispatching specialists in intellectual property for intensive, fixed periods to local SMEs and ventures. (continuation)

(2) Models for use of intellectual property rights

Using specialists in intellectual property throughout Japan, SMRJ will identify best practices as exhibited by model SMEs making effective use of intellectual property as part of their business strategies, and will provide information on, and raise public awareness of, illustrative cases. (continuation)

3. SME/venture challenge support (re-shown, see Chapter 2, Section 2.2)

In order to help bring innovative but risky "seed" technologies and business ideas from SMEs and other businesses to market, subsidies will be provided to cover part of the cost of R&D for commercialization, market cultivation and similar activities undertaken by SMEs. Integrated consulting services to help give form to business plans and support for startups and new business ventures will also be provided. In particular, starting with fiscal 2006, subsidies for expenses related to acquiring rights to industrial property in other countries will be expanded. (partial modification) (¥2,416 million budget plus SMRJ operating expense subsidy)

4. Support for surveys of prior art for SMEs, etc.

Regarding patent applications prior to requests for examinations by SMEs and other businesses, private research institutes commissioned by the Patent Agency will perform surveys of prior art and provide information that can be used when deciding whether to request examination. (continuation) (¥481 million budget)

Section 4 Promotion of collaboration among industry, universities and government

The development and commercialization of technologies through collaboration among industry, universities and the government will be vigorously promoted through the following programs.

1. R&D by regional regeneration consortiums (SME category)

In order to promote the creation of new industries and new businesses in regions, and regional economic revitalization, strong industry-university-government consortiums led by SMEs utilizing technology "seeds" and information available at universities, etc. ("regional regeneration consortiums"), will conduct advanced R&D leading to the commercialization of technologies. (continuation) (¥2,719 million budget)

2. R&D on innovative SME technologies by the National Institute of Advanced Industrial Science and Technology

The National Institute of Advanced Industrial Science and Technology will work in collaboration with universities and public research institutes to provide comprehensive support for SMEs, including R&D to support and foster dynamic SMEs, joint research with SMEs, and technology transfers to SMEs. (continuation) (¥788 million budget)

3. Subsidizing commercial R&D by university business startups

Part of the cost of R&D undertaken jointly by enterprises and universities to commercialize the results of

research by universities will be subsidized through TLOs managing R&D, provided that SMEs contribute to the research funds and that there are clear commercialization plans. (continuation) (¥3,383 million budget)

4. University venture business support

Specialists in law, finance and management and sales will be dispatched via technology coordinators such as TLOs to university ventures, which have outstanding technologies but tend to lack business know-how. (continuation) (¥181 million budget)

Chapter 3 Securing and developing of human resources to support SMEs

As 2007 nears, when the baby boomers who have played key roles in the nation's economic growth will begin reaching retirement age, there is an increasing concern for maintaining the excellent technologies of SMEs, for whom the securing of young human resources has not been easy.

Additionally, training/educating workers mainly through conventional internal OJT will no longer be sufficient partly because of substantially reduced workforces at sites and shorter life-cycles of technologies.

Support for securing and developing human resources for SMEs will be provided through promotion of mutual understanding between SMEs and young people, development/training in local communities, with technical colleges, etc., playing the key role, matching activities utilizing the skills and know-how of retirees, etc., and more.

1. Establishing networks between young people and SMEs

Activities to promote mutual understanding between young people and SMEs in each region or community, including effectively approaching young people to present the attractions of SMEs, using private-sector know-how in the community and expanding opportunities such as internships so that young people can experience working at actual sites, in concerted efforts to build placement networks for the regions as a whole, will be carried out. Specifically, proposals on unique activities in each region will be made by job cafes, chambers of commerce and industry, etc., and promising ones will be supported as model projects. (new) (¥1,900 million budget)

2. Programs to develop human resources for SMEs making use of technical colleges, etc. (re-shown, see Chapter 2, Section 1, 2. (3))

In 2007, the baby boomers will begin reaching retirement age. Development of technical human resources supporting SMEs is important in respect of maintaining and strengthening the competitiveness of Japan's industries. To this end, practical training of young engineers/technicians based on the needs of local SMEs, making use of the equipment, know-how, etc., possessed by technical colleges,

5. Subsidizing costs of promotion of technology transfers from universities

In order to facilitate licensing of the results of university research, subsidies will be provided to TLOs with approved plans for implementation ("approved TLOs") to cover part of the cost of technology transfers under the Law Promoting Technology Transfer from Universities to Industry, which came into effect in 1998. (continuation) (¥612 million budget)

etc., will be supported. (new) (¥400 million budget)

3. Program to promote use of retirees from enterprises, etc.

In order to support matching between SMEs and venture companies seeking persons to give advice on development of new businesses, etc., and retirees, etc., with the enthusiasm to use their knowledge, experience and know-how, investigations will be undertaken through the Japan Chamber of Commerce and Industry to identify available retirees and to understand the needs of the SMEs, and activities to bring the parties together will be carried out. (continuation) (¥519 million budget)

4. Support for management in an age of fewer children (project to help SME managements cope with declining birthrates)

Investigations will be carried out on management policies compatible with a declining birthrate, together with those on the costs and benefits of such policies and various related measures, endeavoring to make the issues better known and facilitating SMEs' employing measures to cope with the declining birthrate. (new) (¥90 million budget)

5. Support for the development of human resources by the Institute for Small Business Management and Technology

The Institute for Small Business Management and Technology will provide advanced practical training on various issues faced by SMEs, such as training for people who provide support to SMEs, in addition to training on specific themes, such as finance and business strategies, for startups and SME entrepreneurs. In order to make participation in training easier, extension courses will be given in regional cities, etc., and remote training via the Internet will be provided, in addition to training at the institute itself. (continuation) (SMRJ operating expense subsidy)

6. Successor matching programs

The Central Federation of Societies of Commerce and

Industry will establish a “successor recruitment” site in order to provide a virtual plaza where entrepreneurs looking for successors and those interested in becoming successors can post information online. In this way, the efforts of entrepreneurs, playing key roles in regional economies, to continue their businesses will be supported. (partial modification) (¥10 million budget)

7. Senior adviser program

High-caliber people at associations and chambers of commerce and industry and National Federation of Small Business Associations will be appointed as senior advisers and support will be provided for the formulation of business plans, market research and similar activities leading to startups and business innovation at SMEs and similar entities. (continuation) (¥1,800 million budget)

8. Entrepreneur training promotion program

In order to cultivate a spirit of entrepreneurship among elementary, junior high and senior high school students, “hands-on” participatory education programs will be held in model municipalities. The aim will be to encourage the spread of such entrepreneurship education itself, and to foster the spread and permeation of “best practices” to surrounding regions. (continuation) (¥340 million budget)

9. “Dream Gate Project” to stimulate more entrepreneurs

In order to increase interest in all segments of society in entering business and becoming independent, and thereby expand the “challenger” base, services will be offered via websites and other channels to provide comprehensive support for entrepreneurship through, for example, transmission of e-mail newsletters useful when starting up in business, expert Internet consultations, and free interviews. Activities such as programs providing internships for university students and other participants at ventures will also be undertaken. (continuation) (¥760 million budget)

10. Program of activities to raise awareness of startups (National Forum)

In order to raise social recognition of startups and ventures, cultivate entrepreneurship among the wider public and create conditions conducive to producing large

numbers of entrepreneurs, experienced entrepreneurs and other experts will be brought together to form a “National Forum on Entrepreneurism and Venture Businesses” for a nationwide awareness-raising campaign designed to showcase and promote entrepreneurship. Locally oriented programs to stimulate entrepreneurial activity will also be undertaken by Regional Bureaus of Economy, Trade and Industry. (continuation) (¥194 million budget)

11. Startup classes and management innovation courses

Prefectural societies of commerce and industry and chambers of commerce and industry throughout the country will hold startup classes in “Business Initiation Training” (approximately 30 hours of short-term intensive classes) for those who have concrete action plans for starting new businesses, to provide training in practical skills required for startup. “Management innovation courses” will also be organized for entrepreneurs seeking to develop new businesses, young successors, etc., in order to equip them with knowledge and know-how in areas such as business strategy. (continuation) (¥1,604 million budget)

12. Establishment of one-stop service centers for the young (known as “job cafes”)

“One-stop service centers” (known as “job cafes”) providing employment-related services for young people in single, convenient locations through collaboration between local governments, industries, schools and other organizations are being developed, and finely tailored support is being provided to young people through the independent activities of the regions. Making active use of private-sector know-how, the Ministry of Economy, Trade and Industry (METI) will commission in approximately 20 model areas to provide young people with integrated service ranging from providing information to counseling and training and more. (continuation) (¥5,250 million budget)

13. Grassroots e-learning system development program

In order to provide opportunities for SME employees, young people, job-hoppers and others to gain knowledge and business skills of use in employment and work, related ministries and agencies will collaborate to develop a scheme to provide “grassroots e-learning services” through channels such as job cafes and chambers of commerce and industry. (continuation) (¥199 million budget)

Chapter 4 Vitalization of regional SME activities

Section 1 Programs to support nationwide development of new businesses by small enterprises

For the revitalization of regional economies, development of local small enterprises is essential. To this end, in collaborations among the Central Federation of

Societies of Commerce and Industry, the Japan Chamber of Commerce and Industry, their local societies of commerce and industry and chambers of commerce and

industry, and prefectural federations of societies of commerce and industry, the activities of small enterprises will be supported toward the development of products based on accurate understanding of consumers' needs and the cultivations of markets, in order to help expand business nationwide. (new) (¥2,514 million budget)

1. Development of special regional products and tourism resources and development of markets

Extensive support will be provided for cooperative activities among local small enterprises, societies of commerce and industry, etc., toward developing special products using regional resources, and markets for them.

2. Dispatch of experts to support development of markets

Experts such as buyers at department stores will be sent to societies of commerce and industry, etc., in the various regions, as advisors, to provide effective support for development of new products and markets by small enterprises.

3. Holding exhibitions and business talks

With personnel related to department stores and supermarkets invited, exhibitions of locally developed special products, etc., will be staged and opportunities for business talks will be provided so as to support small enterprises in developing markets nationally.

Section 2 “Japan Brand” Development Assistance Program

Characteristic resources abound regionally, including particular skills, know-how, traditions and culture. By using these resources, it is possible to develop products and services attractive in world markets. To do this, it is necessary to develop and boost brand strength through cooperation among regional small enterprises, developing products in light of consumers' needs, and actively disseminating information on such products.

Support will be provided with a focus on advanced activities - the initiative taken by such organizations as societies of commerce and industry and chambers of commerce and industry - to coordinate among SMEs and smaller businesses toward establishing brand strength (the “Japan brand”) in overseas markets. (partial modification) (¥1,010 million budget)

1. Programs to support establishment of brands

In order to nurture and strengthen brand power competitive in domestic and international markets, comprehensive support will be provided to projects where regional SMEs make unified efforts to develop and evaluate new products, exhibit such products in domestic and overseas venues, etc.

2. Programs to support strategy development

To foster common awareness among related parties in regions and to shine light on unified activities in regions to develop brands, support will be given to developing brand strategies, including formulating concepts and conducting market research - a stage prior providing support for establishment of brands. (new)

Section 3 Close support for startups and development of new businesses

To revitalize the economy and create new employment opportunities, it is important for the nation to actively support startups, management innovation and development of new businesses by SMEs. To this end, multi-faceted support in financing, human resources, market development, etc., will be provided for efforts to launch SMEs, bring innovation to SME management, and create new partnerships, under the SME New Business Activities Promotion Law.

1. Program to promote new partnership activities

Support will be provided to activities by SMEs in different fields (called “new partnerships”) wherein they work together in organic ways, combining their managerial resources (technology, marketing, etc.), to develop new business areas.

(1) Programs for new partnerships

- 1) Program to support establishment of new partnerships

Expenses are subsidized in support of SMEs' efforts to develop new partnerships with others (industries, research institutes, NPOs, unions, etc.), each bringing their managerial resources (technology, marketing, etc.), as an embodiment of new SME businesses.

2) Program to support commercialization and marketing

Subsidies are provided to new partnerships for expenses in carrying out activities to commercialize new businesses according plans approved as “cross-field-partnership new business development plans” under the SME New Business Activities Promotion Law. (continuation) (¥3,238 million budget)

(2) Program for local strategy councils to support new partnerships

In consultation with new partnerships among SMEs trying to obtain approval of their “cross-field-partnership new business development plans” under the SME New Business Activities Promotion Law, councils provide advice on evaluation of commercialization prospects,

market development, matching, etc. To those partnerships whose plans are approved, hands-on support, including giving appropriate advice, is provided up to the point of commercialization. (continuation) (¥875 million budget)

2. Promotion of the “Keep it up! SME Fund”

Strong support for expansion in the form of new business ventures by SMEs will be provided through the formation of the “Keep it up! SME Fund” by SMRJ, in collaboration with private-sector entities able to offer expert insights and equipped with sales networks, in order to provide funding and finely tailored support for activities such as the development of markets for SMEs encountering difficulties in undertaking new business ventures despite having outstanding technologies and ideas. (continuation)

3. Investment in venture funds

In order to promote investment in ventures and other businesses in Japan in the early stages of growth, SMRJ will invest in limited partnership unions for small and medium enterprises, operated by private venture capitalist. (continuation)

4. New startup loan program

A “new startup loan program” will be introduced to properly screen business plans and provide unsecured loans requiring no guarantor to startup entrepreneurs and would-be entrepreneurs, in order to promote startups and encourage the creation of jobs.

5. Senior adviser program (re-shown, see Chapter 3. 7)

High-caliber people at associations and chambers of commerce and industry will be appointed as senior advisers, to provide support for the formulation of business plans, market research and similar activities leading to startups and business innovation at SMEs and similar entities. (continuation) (¥1,800 million budget)

6. Coordination of market development activities

Experts in the development of markets, including former employees of trading houses, etc., will be employed by SME/venture business support centers in the large Tokyo and

Osaka markets, and the centers will introduce to trading houses and other companies, or act as agents for, new products, etc., produced by enterprises with approved business innovation plans, etc., that have been recommended by prefectural support centers and thus help them find ways to market. (continuation) (subsidization of operating expenses of the SMRJ)

7. Program of activities to support the creation of new markets (continuation) (SMRJ operating expense subsidy)

(1) General fairs for SMEs

“General fairs for SMEs” will be held where SMEs engaging in business innovation can exhibit, present, etc., their new products, technologies, etc., providing opportunities for business matching.

(2) Venture fair program

A large “Venture Fair Japan” will be staged for SMEs and ventures in Tokyo, in order to exhibit and showcase on a large scale their innovative and prototype products and services, and thus help such enterprises cultivate markets and discover business partners.

(3) Venture plaza program

“Venture plazas” serving as platforms for the announcement of business plans will be organized throughout Japan, in order to provide matching opportunities for ventures, sources of funding, potential business partners, and to help them solve financing and other problems.

8. Program to spread and promote support for development of new businesses by SMEs

In order to actively encourage startups, management innovation, activities of new partnerships, etc., by SMEs, and to support SMEs playing key roles at the foundation of Japanese manufacturing, efforts to spread systems, support measures, etc., will be made through seminars and workshops held at prefectural and other support centers. (continuation) (¥225 million budget)

9. Extension of angel tax system

Special tax treatment will be extended to support venture companies in raising funds from individual investors. (continuation)

Section 4 Support for the adoption of IT by SMEs

The adoption of information technology (IT) by SMEs will be promoted by eliminating resource-related barriers, such as shortages of human resources and funds, that hinder such adoption.

1. Promotion of IT proficiency at SMEs

(1) Dispatch of IT experts (advisers)

SMRJ will dispatch experts to advise on the introduction

of IT, at the request of SMEs. (continuation) (SMRJ operating expense subsidy)

2. Support for business innovation using IT

(1) Program to promote strategic IT introduction at SMEs

It has been pointed out that the introduction of IT at SMEs is occurring at a slower rate than at larger enterprises.

Use of EDI systems to electronically place/accept orders for parts and components, and IC tags to digitally store information, will be promoted, through which the introduction of IT and e-commerce into trading among companies will be facilitated, toward promoting introduction of advanced IT at SMEs. (partial modification) (¥700 million budget)

(2) Support for business innovation at enterprises based on the development and use of CIOs (“IT business support teams”)

To promote the use of IT at second-tier enterprises and SMEs toward business innovation, “IT Business Support Teams” (committees set up to support business innovation at SMEs through the use of IT) were established with the collaboration of experts and information service companies, including regional public entities, financial institutions, SME support organizations and IT coordinators. Local IT business support teams were also established at the level of each Regional Bureau of Economy, Trade and Industry. Examples of IT are presented so that second-tier enterprises and SMEs can see the effectiveness of it in business innovation, and training sessions on methods of actual IT use, and for the development of internal CIOs, etc., are staged. (continuation) (¥530 million budget)

(3) Fusion of manufacturing and IT (program to support succession of core technologies of SMEs)

Very versatile software will be developed so that individual workers’ tacit knowledge, including design and processing know-how, owned by manufacturing SMEs, can be stored digitally in a systematic way. At the same time, in order for SME manufacturers without experience in designing software to create business software (production management, quality control, shipment management, etc.) and utilize accumulated know-how, etc., in their production activities, tools to support creation of such software will be developed and provided to the SMEs. In this way, continuation of core technologies owned by SMEs will be supported. (new) (¥488 million budget)

3. Promotion of information dissemination using IT

(1) e-SME Agency and network project (see Chapter 15, Section 2.1)

(2) Operation of SME support portal site (J-Net21)

SMRJ will operate an Internet portal site where visitors can search for all kinds of information relating to SME support, giving SMEs and those in SME support roles ready access to necessary sources of information. (continuation) (SMRJ operating expense subsidy)

Section 5 Support for SMEs endeavoring to revitalize businesses

For SMEs who business conditions are worsening due to over-indebtedness, etc., and for whom survival is therefore at risk, but which nevertheless possess core competencies that give them the potential to again generate cash flows, it is essential that their financial affairs and activities be reviewed and their businesses revitalized, not only for the sake of regional economies but for the revitalization of the national economy. This need to revitalize SMEs will increase hereafter.

In fiscal 2006, therefore, action will be taken to revitalize SMEs by combining various measures, such as policy finance and the use of regional SME revitalization funds, centered around the SME revitalization support councils established in all prefectures.

1. Promotion of revitalization support for SMEs

(1) Support provided by SME revitalization support councils

Under the Law on Special Measures for Industrial Revitalization, support finely tailored to local conditions is being provided for the revitalization of SMEs by the SME revitalization support councils established in each prefecture. In fiscal 2006, the organization of SME revitalization support councils will be reinforced by expanding budget provisions for the use of outside experts to cope with the rise in the need for support for formulation of revitalization plans, and follow-up support after completion of formulation of revitalization plans, in order

to respond appropriately to the expected increase in demand for revitalization of SMEs in the future. At the same time, human resources to support revitalization will be developed by staging seminars to spread revitalization know-how. (continuation) (¥3,050 million budget)

(2) Revitalization support provided by regional SME revitalization funds

METI and SMRJ are providing active support for the formation of regional SME revitalization funds in order to broaden the options available to SME revitalization support councils and to provide financial support for the revitalization of local SMEs. In the future, too, actions to revitalize SMEs centered around SME revitalization support councils will be further strengthened using the revitalization support investment program of SMRJ and promoting the formation of regional SME revitalization funds. (continuation)

2. Facilitating financing for revitalization of SMEs

Active use will continue to be made of “enterprise reconstruction loans” provided to SMEs needing to take action to improve or revitalize their management, and DIP financing and DIP guarantees for SMEs that are in the process of reconstruction using legal reconstruction procedures, etc. (See Chapter 5, Section 1, “Diversifying and facilitating of SME financing,” for more on reinforcement of revitalization support through revisions to the credit insurance system.)

3. Support for formation of business roadmaps

SMRJ will provide a self-examination system for spontaneous financial analysis of an enterprise's business

situation using the CRD (Credit Risk Database for Small and Medium Enterprises), etc., enabling SMEs to quickly and objectively determine the state of their businesses at no cost, by inputting financial data through J-Net21. (SMRJ operating expense subsidy)

Section 6 Promotion of Industrial Cluster Plans

In order to further deepen and expand industrial clusters that support regional economies and give rise to a succession of new internationally competitive businesses, action will be taken to form and expand geographically broad-based personal networks among industry, universities and the government sector, pursue the commercial development of technologies at the local level, and strengthen incubation capabilities by, for example, establishing facilities to support new businesses.

1. Formation of industry-university-government networks, etc.

Exchanges and cooperation between entities such as enterprises, universities, public research institutes and specialist trading companies will be promoted, and geographically broad-based personal networks among industry, universities and the government sector will be developed by, among other things, strengthening the functions of support organizations involved in industrial cluster planning. (continuation) (¥7,400 million budget)

2. Promotion of technology development, etc., utilizing regional features

In order to generate, in chain reactions, clusters of new businesses and ventures supporting regional economies, activities such as the commercial development of technologies by second-tier enterprises and SMEs contributing to the creation of industries utilizing regional features will be pursued. (continuation) (¥43,498 million budget)

3. Development, etc., of facilities (business incubators) to support new business

In order to exploit Japan's outstanding technological capabilities and promote economic revitalization leading to the revival of the Japanese economy, business incubators will be established and incubation functions augmented by enhancing the quality of intangible support, such as by cultivating, increasing skill levels of, and raising the status of human resources to support the development of entrepreneurs, thus dynamically promoting start-ups and the development of ventures. (continuation) (¥6,674 million budget)

Section 7 Support for production centers and local industries

In order to promote the development of production centers and regions with industrial clusters throughout the country, support will be provided through "subsidies for projects to strengthen the vitality of local industries, etc.," for enthusiastic actions undertaken by local SMEs, etc., from a national point of view, including activities to start new businesses in collaboration with new distribution companies, wholesalers, etc., develop broad-area, cross-prefectural markets, develop new products based on accurate understanding of market needs, and foster human resources, in addition to efforts by the manufacturers of local products, etc., to strengthen their own sales power.

(1) Subsidizing projects undertaken by local associations,

etc., such as broad-area shows and trade fairs, exhibitions, marketing research and marketing by use of external personnel, to develop markets for local products, etc. (continuation) (¥715 million budget)

(2) Subsidizing projects undertaken by local associations, etc., such as development of products or improvement of products, based on understanding of market opportunities (continuation) (¥291 million budget)

(3) Subsidizing projects undertaken by local associations, etc., such as staging training sessions and exchange activities to nurture or secure personnel for marketing (continuation) (¥82 million budget)

Chapter 5 SME financing-related measures

Positive moves have been confirmed generally in the SME financing environment from the start of fiscal 2006. In this circumstance, in order to secure diversified SME financing means, SME financing-related measures will be continued to actively promote lending that is not dependent

on real estate for security or personal guarantees, and to facilitate the provision of funds to SMEs that have run into difficulty due, for example, to changes in the economic environment. Along with other measures, necessary budgetary steps will also be taken.

Section 1 Diversifying and facilitating SME financing

1. Enhanced support for securitization of loans to SMEs

In order to promote unsecured lending to SMEs, the Japan Finance Corporation for Small and Medium Enterprises (JASME) supports the securitization of loans by private financial institutions to SMEs.

In fiscal 2006, the scope of covered loans to SMEs will be expanded, increasing the aggregate from ¥240 billion to ¥270 billion, and the proportion of purchase-type subordinated debt held will be increased from 5% to 6%.

2. Expansion of lending not reliant on security

JASME and the Shoko Chukin Bank will continue promotion of a system that, at the option of SMEs, makes it unnecessary for them to provide security, in whole or in part, on condition that an appropriate premium is added to the interest rate corresponding to the credit risk, etc., of the SME, and that a commitment is made regarding finance and management, etc.

In fiscal 2006, JASME will increase the upper lending limit for special cases of unsecured lending from ¥50 million to ¥80 million per enterprise, and the upper lending limit for special measures of insufficient security from ¥80 million to ¥120 million (up to 75% of the lending amount) per finance system, and the scope of SMEs that can qualify as special cases for unsecured loans will be expanded.

3. Expansion of lending not dependent on guarantees

(1) Extensive introduction of a system freeing entrepreneurs from having to give personal guarantees

JASME and the Shoko Chukin Bank will continue promoting a system of exempting entrepreneurs, at the option of the SME, from the requirement that they give personal guarantees for borrowings, on the condition that an appropriate premium is added to the interest rate and a commitment is made regarding finance and management, etc.

(2) Lending not requiring third party guarantors, etc.

Having increased the upper lending limit for loans not requiring third-party guarantors, etc., the National Life Finance Corporation will continue promoting the system.

4. Actions to further expand use of the receivables-backed loan guarantee program

Regarding the receivables-backed loan guarantee

program, interested parties will be asked to cancel special agreements prohibiting the transfer of receivables, and publicity will be given through media, such as public service announcements.

5. Reviewing the credit insurance system

Based on a report on the desired attributes of a credit insurance system, issued by the Basic Policy Subcommittee of the Small and Medium Enterprise Policy Making Council's Committee on June 20, 2005, necessary revisions will be made to the system.

(1) Strengthening revitalization support by Credit Guarantee Corporations

New guarantees to parties with rights to obtain reimbursement will be expanded, DDS rights to obtain reimbursement will be commenced, and operation of the DIP guarantee system will be enhanced.

(2) Making rates flexible

The current uniform-rate system will be changed to one where business conditions are taken into consideration to a certain extent, facilitating the growth of enterprises whose situations are good, and allowing enterprises whose business situations are less good to use the system more effectively.

(3) Not requiring third-party guarantors

Given that there is an increasing social perception that security in the form of guarantees by individuals, especially those not involved in management, is not appropriate, practices not, in principle, requiring third-party guarantors will be even more fully pursued.

(4) Strengthening cooperation between Credit Guarantee Corporations and financial institutions under an appropriate system to share responsibilities

Under the current system, which essentially requires a 100% guarantee, with the effect that financial institutions bear no risk, there is no incentive for such financial institutions to provide appropriate business support, etc., to SMEs; there is also concern for the moral implications in the current system.

Therefore, financial institutions with partially secured loans, etc., and credit guarantee corporations will broadly adopt an appropriate system to share responsibilities, whereby financial institutions, as responsible lenders, will render well-thought-out support to SMEs in collaboration with credit guarantee corporations, while urging financial institutions to use the system properly.

Section 2 Providing a financial safety net

Because the economic environment facing SMEs is still severe in some categories of business and in some regions, action will continue to facilitate the provision of funds to

SMEs that have run into difficulty due to changes in the economic environment, etc., through measures such as safety-net guarantees and loans.

Budgetary steps and other measures in fiscal 2006

1. Scale of operations of government-affiliated financial institutions

(Unit: ¥100 million)

	Planned in 2005	Planned in 2006
JASME	18,300	See Note 1 16,403
(portion securitized)	1,503	1,503
National Life Finance Corporation	30,000	See Note 2 26,000
(portion under <i>Marukei</i>)	5,000	4,500

Notes: 1. If the planned amount will clearly be insufficient owing to unforeseeable changes in economic conditions or other unavoidable circumstances, the scale of borrowing and bond issuance under an FILP bond may be increased by a maximum of 50% (a flexibility clause), enabling the securing of lending up to ¥2,341.6 billion.

2. This is based on regular loans. If the entire framework effective under the aforementioned flexibility clause is allocated to regular loans, a maximum of ¥3,857 billion may be secured.

Additional data: As of fiscal 2006, the Shoko Chukin Bank is no longer an organization dealing in treasury investments and loans. Therefore, it does not guarantee commercial or industrial bonds using treasury investments or loans, but will procure funds from the market by issuing commercial and industrial bonds in order to meet the demand for funds for enterprises.

2. Strengthening the financial base of the credit insurance system

The financial bases of JASME (credit insurance division) and Credit Guarantee Corporations will be further strengthened.

(Unit: ¥100 million)

	Planned in 2005	Planned in 2006
Investment in the credit insurance division of JASME	902 (380)	365 (365)
Subsidization of the Credit Guarantee Corporation Fund	42	42

Note: Figures in parentheses indicate the portion of investment under the initial budget.

Chapter 6 Measures for SMEs in commerce

Section 1 Measures for small and medium retailers

The population is ageing, the birthrate is declining - both rapidly - and a "depopulated" society is clearly on the horizon. In such circumstances, formation of shopping districts and city centers full of vitality and inspiration will be promoted, by providing comprehensive support from the viewpoint of implementing intensive, efficient measures for those city centers endeavoring to create "compact and vigorous cities."

In addition, efforts to create shopping districts as community centers in cities will be promoted, consistent with policy positions on issues such as the ageing population and declining birthrate.

1. Revitalization support for commerce in strategic city centers

In order to realize compact cities full of energy, support is provided with a focus on activities for "selection and concentration" to revitalize commerce and services undertaken by shopping centers, retailers, etc., with extensive participation by land owners and other parties in city centers where "integration of urban functions" and "recovery of energy in city centers" are being pursued together. To this end, support will be provided to areas seeking to systematically coordinate numerous distinct considerations, including 1) trends in industry, population, transport, etc., in the regional economic zone, 2) consistency with town development plans, urban plans, etc., designed, for example, to increase the number of visitors and residents, 3) comprehensive, long-term management of city centers in general, and 4) appropriate development and operation of individual facilities, etc. (continuation) (included in ¥5,905 million budget)

2. Analyses to ensure effectiveness and support programs

Using the nine regional branches of SMRJ throughout Japan, local economic trends and town development plans, the general management situation of city centers, and the establishment and methods of operation of core facilities are comprehensively analyzed to provide advice to increase the effectiveness of city center revitalization measures. In addition, know-how, best practices, and so on will be widely propagated so as to back up the activities of TMOs (Town Management Organizations) in central urban areas across the country. (continuation) (included in SMRJ operating expense subsidy)

3. Program to dispatch advisers for city center and shopping district revitalization

In order to support activities, etc., undertaken by retailers, shopping districts, etc., contributing to the revitalization of SMEs engaged in commerce in city centers, advisers such as SME management consultants, redevelopment planners, etc., who can provide useful advice for strengthening commercial ability, will be dispatched. (continuation) (included in SMRJ operating expense subsidy)

4. Activities to promote public awareness of the revitalization of central urban areas

In order to further promote the activities of TMOs, awareness of the revitalization of central urban areas will be raised by providing and analyzing information on

know-how for revitalization in various areas, forward-thinking revitalization activities, etc., and holding symposiums in local and central areas throughout Japan. (continuation) (¥136 million budget)

5. Activities to help small and medium retailers cope with, for example, the declining birthrate and ageing population

The government will directly support commercial revitalization activities in accordance with national policy issues - including declining birthrate and ageing population, environmental preservation, safety/security and crime/disaster prevention - undertaken by shopping center promotion associations, etc., in unity, in areas other than, in principle, central urban districts, by which not only individual activities, such as development of commercial infrastructure, but also the social and public roles, etc., that the shopping centers should play in regions, will be improved. (new) (¥2,890 million budget)

6. Dispatch of advisers on commercial revitalization

In order to support activities to revitalize shopping districts, including issuance of plans, experts in fields related to commercial revitalization, such as SME management consultants and architects, will be dispatched.

In addition, to strengthen secretariat functions of shopping center promotion associations, etc., experts in, for example, planning, management, financial affairs, labor relations and tax matters, will be sent to associations, etc. (continuation) (included in SMRJ operating expense subsidy)

7. Support for collaboration on business models by small and medium retailers

Subsidies will be provided for feasibility studies on development of new business models, undertaken by small and medium retailers, etc., in collaboration with local associations and chambers of commerce and industry in each region, and efforts to spread awareness and use of the newly developed business models will be made. (continuation) (¥188 million budget)

8. Program to support activities of shopping center promotion associations

Support will be provided to the National Federation of Shopping Center Promotion Associations for its efforts in giving guidance, information, etc., to facilitate operation of activities undertaken by shopping center promotion associations, federations of shopping center promotion associations, etc. (continuation) (¥50 million budget)

Section 2 Measures to improve the logistical efficiency of SMEs

The environment faced by distributors has been changing in recent years. Physical distribution patterns are shifting, and demand is growing for more frequent deliveries of smaller quantities of merchandise and other more sophisticated distribution services. Small and medium distributors, however, have been slow to invest in improving logistical efficiency, and the steep rise in distribution costs presents a serious business problem.

Starting with support measures under the Law Concerning the Promotion of Comprehensive and Improvement of Efficiency of Distribution Operations, which came into effect in October 2005, comprehensive support will be provided for action undertaken jointly by and in collaboration among SMEs to promote the efficiency of distribution operations.

1. Dispatching expert advisers to help improve logistical efficiency

SMRJ will register experts who can provide appropriate advice when SMEs are considering improving their logistical efficiency, and will, at the request of an enterprise, dispatch the experts most suitable for solving the particular problems. (partial modification) (¥12 million budget)

2. Promoting improvements in logistical efficiency

Subsidies will be provided to associations and voluntary organizations for the development of joint logistics systems,

research and development of basic plans on, for example, the development of order and delivery information networks, and project planning and system design. Subsidies will also be provided for pilot programs undertaken by associations that have already undertaken research and systems-design activities, in order to demonstrate to still other businesses the importance of improving logistical efficiency. (continuation) (¥120 million budget)

3. Supporting SME collaboration on logistics

Collaboration among manufacturers, distributors and retailers is increasing as enterprises seek to adapt appropriately to diversifying and increasingly sophisticated consumer needs and other changes in the distribution environment. In order to support these independent efforts by SMEs, subsidies will be provided to help cover the costs of measures to strengthen the integrated physical distribution functions of manufacturers, wholesalers and retailers. (continuation) (¥32 million budget)

4. Holding seminars, etc., on improving logistical efficiency

In order to expedite activities to improve logistical efficiency, an area where SMEs are being left behind, seminars, workshops, etc., will be held across the country, based on actual case studies, etc., which may help participants solve their own problems when they are trying to improve logistical efficiency. (partial modification) (¥29 million budget)

Chapter 7 Measures for SME Globalization

As globalization proceeds, the internationalization of business, such as through the establishment of overseas operations, provides Japanese SMEs with one of the important management options. Given that SMEs are handicapped in areas such as access to information and human resources, facilitating the internationalization of their operations is a crucial issue in order to strengthen the foundations of their businesses. In recognition of this, a variety of support measures will be implemented.

In addition, bilateral and multilateral policy dialogue and others on SME measures and other related issues will be pursued with a view to adjusting and improving the business environment for Japanese SMEs overseas.

1. Support for exports

In order to promote the development of markets overseas by SMEs, JETRO will continue to support exports as it has thus far, providing support for exhibiting at overseas trade fairs and exhibitions, matching SMEs with potential partner enterprises overseas and assisting in business negotiations between the two, endeavoring to identify can-do SMEs and products with latent potential throughout Japan to help them develop overseas markets, etc. In addition, JETRO will begin providing information on procedures regarding certificates of origin, the advantages of using economic partnership agreements, etc., and will offer individual consultations.

In order to create and strengthen brand strength effective both in domestic and overseas markets, the Japan Chamber of

Commerce and Industry and the Central Federation of Societies of Commerce and Industry will provide unified, comprehensive support to projects undertaken unanimously by regional SMEs, including conducting market research, inviting experts, developing and evaluating new products, participating in domestic and overseas exhibitions, and doing publicity activities.

2. Facilitating overseas expansion

Organizations including SMRJ, the Japan Chamber of Commerce and Industry, and JETRO will conduct surveys and provide information regarding the establishment of overseas operations by SMEs, organize seminars, provide advice, and undertake similar activities.

In addition, while the Association for Overseas Technical Scholarship and Interchange Association Japan will provide training for local engineers, managers and Japanese staff and instructors posted overseas, the Japan Overseas Development Corporation will dispatch specialists to overseas subsidiaries, etc., to improve their technological and managerial ability and provide “traveling” coaching and seminars in accordance with local needs, thus facilitating the business activities of SMEs overseas.

3. International cooperation

The Government will participate in international forums such as APEC and OECD to exchange information on improving the business environment for SMEs, etc.

Chapter 8 Promotion of support for small enterprises

Small enterprises not only serve as the driving force behind the development of the Japanese economy, but also play a particularly important role at the level of local communities and economies through their community-based activities, which make use of local resources and technologies and provide local employment opportunities.

Because of their size, they also face a number of business handicaps, such as information gathering, raising funds and securing human resources - have more fragile

business bases than do SMEs in general - which leads to gaps in areas such as productivity.

Support will therefore be provided to develop competitiveness such as by facilitating access to business resources and to assist positive self-help efforts to improve management in keeping with the actual state of, for example, the business infrastructure and forms of management of small enterprises.

Section 1 Enhancement of small enterprise support programs

1. Dissemination of management improvements

The environment faced by small enterprises is changing dramatically, as exemplified by the increasing sophistication and diversity of consumer needs, advances in technology, spread of information technology, and growth of globalization. In view of this, associations and chambers of commerce and industry across the country and prefectural federations of chambers of commerce and

industry provide support for management improvements and innovations at SMEs (programs for management improvements) by, among other things, providing detailed consultations to SMEs and dispatching experts according to their needs, and promoting human resource development and regional development projects.

To ensure that these programs are implemented smoothly and effectively, support will continue to be provided through national organizations. (partial modification) (¥417 million budget)

2. Enhancement of support for startups and business innovation

(1) Organization of startup classes and management innovation classes (re-shown, see Chapter 3. 11)

(2) Senior adviser program (re-shown, see Chapter 3. 7)

3. Improvement of abilities of business advisers

In order to further enhance proposal-based guidance leading to startups and business innovation to meet the increasingly sophisticated and diverse needs of small enterprises, subsidies will be provided to the Central Federation of Societies of Commerce and Industry to assist

with the necessary costs of administering an online training system following a national curriculum for management advisers and similar staff; and training and training assessment examinations will be held. (continuation) (¥114 million budget)

4. Programs to support nationwide development of new businesses by small enterprises (re-shown, see Chapter 4, Section 1)

5. “Japan Brand” development assistance program (re-shown, see Chapter 4, Section 2)

6. Successor matching programs (re-shown, see Chapter 3. 6)

Section 2 Loans for managerial improvement funds of small enterprises, etc. (*Marukei*)

Because of the poor state of the economy, severe employment conditions and other factors, necessary funds (¥450 billion) will be provided for the National Life Finance Corporation to provide unsecured loans not backed by personal guarantees to small enterprises that have received

business advice from business advisers at associations and chambers of commerce and industry, so as to facilitate financing by those small enterprises that lack collateral and credit. Special measures regarding lending limits and loan periods will also be continued. (continuation)

Section 3 Small enterprise mutual aid projects

Small enterprise mutual aid projects will be continued under the Small Enterprise Mutual Relief Projects Law, the purpose of which is to contribute to the establishment of mutual aid programs for the discontinuation of businesses by small enterprises in a spirit of reciprocal support between them, so as to increase their mutual welfare as

well as the growth of SMEs. Activities to promote the spread of and participation in such programs will also be vigorously pursued. Subsidies will be provided to the executing entity, the SMRJ, to enable it to smoothly carry out its duties. (continuation) (included in SMRJ operating expense subsidy)

Section 4 Small enterprise equipment funding programs

In order to promote the introduction of facilities necessary to establish small enterprises and strengthen their business fundamentals, the Equipment Fund Loan Program and the Equipment Lending Program will be continued.

Specifically, the lending capital provided through loans from the national government and money transferred from the general accounts of the prefectures are managed in special accounts of the prefectures, and interest-free loans made from these special accounts to lending institutions

(foundations wholly owned by the prefectures) to provide them with the necessary funds to enable them, as implementers of the program, to provide small enterprises with interest-free loans for equipment funds and for equipment they require, under leases or installment purchase contracts. (continuation) (Scale of lending: ¥18.955 million for the Equipment Fund Loan Program, ¥32.531 million for the Equipment Lending Program)

Chapter 9 Measures to promote collaborative organizations of SMEs/SME partnerships

Section 1 Reviewing SME partnership program

In recent years cases have been witnessed where SME partnership programs run by SMEs themselves, individual businesspersons, etc., based on a spirit of mutual support, are failing as the programs' scales expand and activities become more diversified. In light of this, while discipline

in general business operations of SME partnership will be strengthened, measures to ensure sound operation of mutual aid programs (insurance programs) by SME partnerships will also be taken.

Section 2 Measures to promote collaborative organizations

1. Measures to promote collaborative organizations

In order for SMEs to develop, it is important that productivity be increased and that external negotiating capabilities be strengthened. Because one effective means of achieving this is through businesses in the same industry grouping and organizing together, further use of the SME partnership program will be promoted.

(1) Further use of the SME partnership program

Increasing use has been made of SME partnerships in recent years as a simple means for people such as retired employees of enterprises and housewives to start up a business.

Because the creation of jobs and new industries through startups is a major pillar of SME policy, a particular focus is placed on popularizing the program in order to encourage

greater use of SME partnerships in the future. (continuation)

(2) Support for partnerships through the National Federation of Small Business Associations

Support will continue to be provided through the National Federation of Small Business Associations for activities to promote, for example, improvements in productivity undertaken by SMEs using collaborative organizations such as partnerships. (continuation) (¥1,172 million budget)

(3) Support for equipment funding through upgrading loans

The SMRJ will continue to support the funding required for the development by cooperative business associations and similar organizations of facilities for joint projects in cooperation with the prefectures. (continuation)

Chapter 10 Promotion of measures for small and medium subcontractors and public demand measures, etc.

Due to factors such as increasing globalization and the service sector's growing importance to the overall economy, the business environment faced by small and medium subcontractors has changed considerably. Furthermore there are still matters of concern, including sharp increases in crude oil prices that have adversely affected profits of many SMEs. In these circumstances, in order to promote fairness in subcontracting relations and to protect the interests of the subcontractors, efforts will be made to spread awareness and

understanding of relevant laws; specifically, the Law against Delay in the Payment, etc. to Subcontracting Charges and Related Matters (hereinafter referred to as the "Subcontracting Charges Law") and the Law on the Promotion of Subcontracting Small and Medium Enterprises (hereinafter referred to as the "Subcontractor Promotion Law"). In addition, regarding public demand, measures will be steadily implemented to increase opportunities for SMEs to obtain orders.

Section 1 Measures for small and medium subcontractors

1. Fairness in subcontracting relations

(1) In order to promote fairness in subcontracting relations, in close cooperation with the Fair Trade Commission and other related organizations, written investigations of parent companies and their subcontractors and on-the-spot investigations of parent companies will be conducted, and strict measures will be taken against businesses found to be violating the Subcontracting Charges Law. (continuation)

(2) For the purpose of disseminating information on and raising public awareness of the Subcontracting Charges Law, etc., subcontracting business improvement workshops and seminars will be organized primarily for persons at commissioning companies and persons responsible for outsourcing (purchasing) at subcontractors. (partial modification) (¥84 million budget)

2. Support for the self-help efforts of small and medium subcontractors

(1) Support for development of markets through business

intermediary services and business conventions

1) Business intermediary services

Business intermediary services will be provided by introducing to small and medium subcontractors seeking new customers enterprises that meet the necessary requirements regarding, for example, present circumstances, industry, facilities and technologies of each enterprise within and outside of the prefecture. In addition, information exchanges between enterprises placing orders and those receiving orders will be promoted using the online "Transaction Matching Service" (<http://matchnet.zenkyo.or.jp/>). The existing business intermediary system will be reorganized in order to build a more efficient system. (continuation and new) (¥59 million budget)

2) Emergency wide-area business conventions

Emergency wide-area business conventions will be held to support the development of new and broader markets for subcontractors affected by, for example, major restructurings and bankruptcies of large enterprises, natural disasters, etc. (continuation) (¥18 million budget)

(2) Training human resources for SMEs seeking to cease subcontracting

Short, intensive training will be launched for entrepreneurs and managers at small and medium subcontractors seeking to cease subcontracting, in order to equip them with the know-how necessary to become independent (i.e., the necessary product development skills, marketing and business strategy, etc.). (continuation) (¥20 million budget)

3. Cooperation between parent businesses and subcontractors

The following measures will be taken to promote the

strengthening of the business bases of small and medium subcontractors in accordance with the Subcontractor Promotion Law.

(1) Guidance and advice under the Promotion Standards

General standards that should be observed by parent businesses and subcontractors (“Promotion Standards”) will be publicized. (continuation)

(2) Support regarding promotion project plans

Measures such as financial assistance will be provided for business undertaken in accordance with promotion projection plans approved by the competent minister. (continuation)

Section 2 Promotion of measures to ensure access to public demand, etc.

1. Measures to ensure access to public demand

Action will be taken to publicize as widely as possible measures to increase opportunities for SMEs to win orders relating to public demand in accordance with the “Policy on State Contracts with Small and Medium Enterprises.” (continuation)

2. Securing of fair business opportunities

In order to secure fair business opportunities for SMEs, the Law on Special Measures for Adjustment for Retail Business and the Law on Securing Business Opportunities for Small and Medium Enterprises by Adjusting the

Business Activities of Large Enterprises will be strictly enforced. (continuation)

3. Regulation of unfair business methods under the Antimonopoly Law

The Antimonopoly Law will be actively and strictly enforced, and unfair business methods regulated, in order to promote free and fair competition and to enable businesses to engage in business activities freely. Strict action will also be taken to deal with unfair methods of business that are unreasonably disadvantageous to SMEs, such as unfair price competition and the abuse of an enterprise’s superior position. (continuation)

Chapter 11 SME business stability

In order to support stability for SMEs affected economically by external factors such as changes in the

economic environment and natural disasters, necessary measures will be taken.

Section 1 SME disaster relief

1. Measures to help SMEs affected by disasters

In order to facilitate the recovery of SMEs affected by disasters such as earthquakes and typhoons, advice centers will be established and disaster recovery loans will be provided by government-affiliated financial institutions to SMEs in regions where the Disaster Relief Law has been invoked. In addition, safety-net guarantees will be provided to SMEs in regions affected by disasters whose sales fall by more than a certain amount.

In the event of a major disaster meeting certain criteria laid down by the Law Concerning Special Fiscal Aid for Coping with Disasters, disaster-stricken zones will be designated under said law, and special measures will be implemented.

2. Preliminary measures to minimize damage by disasters, etc.

Issuance and adoption of business continuation plans (BCPs) will be promoted, i.e., preliminary decisions on steps, etc., to minimize business disruptions and thus damage from causes such as natural disasters, and to facilitate early recovery of business activities. (¥25 million budget)

JASME and the National Life Finance Corporation will also lend money at low interest rates to SMEs with plans to issue BCPs and to develop disaster prevention facilities according to their BCPs.

Section 2 Measures for preventing SME bankruptcies

In order to facilitate the special business advice program under which external specialists at the “special business stability advice centers” - established by major chambers of commerce and industry and prefectural federations of societies of commerce and industry throughout Japan - provide advice on business stability to SMEs, publicity, guidance and other activities will be implemented. (continuation) (¥41 million budget)

Further, in order to stabilize the position of SMEs in financial difficulty due to the bankruptcy of customers or changes in the economic environment, funding will continue to be provided through safety-net loans by government-affiliated financial institutions and safety-net guarantees.

While a mutual aid program for preventing SMEs from going into bankruptcy, which enables an SME to borrow working capital in the event of bankruptcy of its customer, will be continued, activities to encourage SMEs to use the program and expand participation will also be pursued. To this end, smooth operation by the Organization for Small and Medium Enterprises and Regional Innovation, Japan, will be sought. (continuation) (included in SMRJ operating expense subsidy)

In addition, in order to shift rapidly from the tax-qualified pension scheme, which will be abolished at the end of March 2012 as a result of revisions to the system, to other retirement benefit schemes, seminars will be held across the country. (¥29 million budget)

Chapter 12 SME taxation

In order to support the diverse and dynamic growth and development of SMEs, which form the foundations of the

Japanese economy, finely tuned taxation support will be provided in order to, among other things, strengthen their business bases.

Section 1 SME-related taxation

As a result of the fiscal 2006 revisions to the tax system, it is advisable that the following measures be taken to strengthen the financial bases of SMEs, improve productivity, etc., given recent economic conditions and other relevant factors.

1. Fundamental revision of taxation on retained earnings in family businesses

Regarding taxation of retained earnings in family businesses, the determination of family businesses subject to the scheme will be changed, from the previous three-shareholder requirement to one shareholder, and the deductible amount of retained earnings will be substantially increased.

Also, application of measures to exempt SMEs with business innovation plans that have been approved under the SME New Business Activities Promotion Law from taxation on retained earnings, will be extended by two years.

2. Revision of taxation to promote investment in facilities and extension of application period

The taxation scheme to promote capital investment by SMEs, allowing a tax deduction of 7% or special depreciation of 30% when small or medium enterprises make capital investments in machinery, equipment, etc., will be reviewed to include certain software in assets subject to the scheme, for example, and its application period will be extended by two years.

3. Extension of special measure allowing SMEs, etc., to include the purchase cost of small-amount depreciable assets within losses

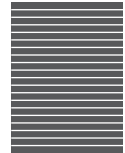
In the special measure whereby, when SMEs, etc., obtain (purchase) depreciable assets of less than ¥300,000, the entire amount may be included within losses, the upper limit allowed to be included will be changed to ¥3 million per year, and application of the measure will be extended by two years.

4. Creation of scheme of taxation to strengthen the information bases to improve industrial competitive power

Businesses investing in information systems that are protected by advanced information security programs will be allowed a tax deduction of 10% or special depreciation of 50%. In addition, measures to lower required amounts of annual investment and to make lease charges subject to a tax credit will be taken for SMEs.

5. Extension of refund measures to carry back one year tax-losses by SMEs during the first five years after their establishment

Application of measures to carry back one-year tax-losses by SMEs during the first five years after their establishment will be extended by two years.



6. Extension of special measure to include entertainment and social expenses within losses, and clarification of the scope of taxation

Regarding entertainment and social expenses that cannot in principle be included in losses, the special measure enabling SMEs to include 90% of up to ¥4 million of said proper expenses will be extended by two years.

In addition, it will be clarified that up to ¥5,000 per person for food and drinks may be included in losses, in addition to other social and entertainment expenses. (The

allowed inclusion in losses of up to ¥5,000 per person does not apply to gatherings among company officials.)

7. Revision to the scheme of taxation to strengthen technological bases of SMEs

In addition to allowing small and medium businesses, etc., undertaking experiments and research a 12% tax credit on the total relevant expenses, a further two-year measure will allow them an additional 5% tax credit on the amount of the increase in such expenses (amount exceeding the average amount for the previous three business years).

Section 2 Measures to facilitate SMEs' compliance with revision of consumption tax exemptions

In order to assist businesses in filing tax returns as they must under the revised special consumption tax exemption system for small and medium businesses (regarding the tax exemption points system and

simplified tax system), etc., close support will continue to be provided in the form of workshops, tax advice, bookkeeping guidance, etc. (continuation) (¥2,085 million budget)

Chapter 13 Promotion of employment and welfare measures

Section 1 Promotion of labor measures

1. Stabilization and promotion of employment

(1) Support for the creation of new employment opportunities utilizing the dynamism of SMEs

In order to promote the creation of good employment opportunities, active support will be provided for activities undertaken by dynamic SMEs to acquire and develop their human resources and to develop attractive workplaces, such as through startups and entering different lines of business, in accordance with the Small and Medium Enterprise Labor Force Recruitment Law.

In addition, in order to encourage the creation of new employment opportunities in new and growth fields and to facilitate the smooth movement of labor into those fields, comprehensive support, such as the provision of detailed information and advice, will be provided through various seminars and interviews with job seekers for enterprises in new and growth fields.

(2) Maintenance of employment of workers

In order to prevent unemployment due to unavoidable retrenchment arising from changes in business conditions or for other economic reasons, and to ensure the stability of employment in other areas, employment adjustment subsidies will be provided to employers trying to maintain their employment of workers by temporarily suspending (as opposed to terminating) operations or by seconding employees.

(3) Employment measures for construction workers

- 1) To promote the entry of construction employers into new fields and the movement of construction labor

within construction and into other industries. (continuation)

- 2) To secure employment and work opportunities for workers through, for example, mechanisms of adjusting supply and demand for labor (fee-based job placement services for construction work and programs to secure work opportunities for construction workers). (continuation)
- 3) To promote development and availability of skilled construction workers. (continuation)

(4) Employment of the elderly

- 1) Securing employment to age 65 by, for example, raising the mandatory retirement age and establishing programs for job continuation.
- 2) Provision of subsidies for the employment of elderly workers.

(5) Employment of the disabled

- 1) Promotion of measures to achieve statutory employment rates.
- 2) Provision of subsidies for recruitment and continued employment of disabled workers.

(6) Employment at local industries

To support creation of new employment in industries playing key roles in job-creation in their regions, subsidies for start-ups and employment by local industries will be continued to those who launch new businesses in service fields and key industries, as selected by municipalities, etc. (continuation)

2. Development of human resources

(1) Promotion of skills development programs by employers

- 1) Support will be provided for the promotion of skills development within enterprises through activities including courses for those responsible for vocational skills development, and through holding the Convention on National Vocational Ability Development Promotion.
- 2) Subsidizing the cost of development of occupational skills within enterprises under the career formation

subsidy program.

- 3) Establishing and operating local occupation training centers and providing information, advice and assistance regarding the development of occupational skills for SMEs.
- 4) Subsidizing SME entrepreneurs, etc., providing accredited vocational training.

(2) Promotion of public occupational training

Occupational training for SME workers and persons changing or leaving jobs at SMEs will be promoted.

Section 2 Promotion of welfare programs

1. Promotion of measures to reduce working hours and improve health and safety

(1) Measures seeking harmony between work and personal life through promoting improvements in working conditions, including working hours

- 1) Promotion of activities to reestablish regular conditions, including working hours. (new) (¥1,121 million budget)
- 2) Contributing momentum to the societal trend toward seeking harmony between work and personal life (new) (¥383 million budget)

- 2) Promotion of positive action (continuation) (¥228 million budget), etc.
- 3) Promotion of measures to combat sexual harassment (continuation) (¥124 million budget)

(3) Promotion of comprehensive measures to support part-time labor

Efforts will be made so that the Law Concerning the Improvement of Employment Management, etc., of Part-Time Workers ("Part-Time Labor Law") and guidance regarding measures that should be taken by employers under said law are well understood and are diligently adhered to, and the following programs will be implemented:

(2) Measures to ensure safety and health of workers

- 1) Promotion of voluntary health and safety supervision at SMEs.
- 2) Promotion of health measures at small-scale establishments.

- 1) Conventional subsidies for the improvement of employment management of part-time employees will be fundamentally revised to strengthen support for efforts by enterprises seeking to give part-time workers and permanent employees balanced treatment (partial modification) (¥446 million budget)

(3) Measures to improve other working conditions

- 1) Promotion of measures to ensure payment of wages, etc.
- 2) Promotion of payment of minimum wage.
- 3) Promotion of measures to improve wage and retirement allowance schemes.

- 2) Implementation of a program to support establishments pursuing measures to "achieve balance" by dispatching experts in various aspects of labor and human resource management to provide concrete advice to enterprises seeking to give part-time workers and permanent employees balanced treatment. In addition, a program to promote balanced treatment will be implemented wherein meetings will be staged among enterprises of the same business type in the same region, to share results. (continuation)

2. Development of conditions to enable workers to balance the demands of work and family and to enable women to make use of their abilities

(1) Promotion of support for combining the demands of work and family

- 1) Smooth enforcement of the Child Care and Family Care Leave Law and the Law for Measures to Support the Development of the Next Generation.
- 2) Developing an environment to enable workers to continue in employment while caring for children or family members. (continuation)

- 3) An on-line service will be launched, a website allowing enterprises to evaluate their own part-timer utilization rate and to check their own efforts toward balanced treatment. (new)

3. Comprehensive measures to promote employee welfare, etc.

(1) Promotion and spread of employee asset formation promotion schemes

(2) Promotion and spread of SME retirement benefit mutual aid schemes

(2) Creation of equal opportunities for and equal treatment of men and women in employment

- 1) Promotion of measures to ensure equal opportunities for and equal treatment of men and women (continuation) (¥191 million budget)

(3) **Promotion of activities of SME employee welfare service centers**

(4) **Promotion of welfare measures for young employees (¥33 million budget)**

(5) **Promotion of measures to support varied lifestyles of workers**

Infrastructure to enable workers to take part in voluntary activities will be developed.

(6) **SME welfare programs, etc.**

Subsidies provided for various activities undertaken by prefectures to improve personnel and labor management and welfare of workers. (continuation) (¥110 million budget)

4. Measures to deal with increasingly individualized and complex labor relations

Individual labor dispute resolution systems will be promoted.

Chapter 14 Special measures

Section 1 Measures for asbestos

To support smooth removal, etc., of asbestos by SMEs, JASME and the National Life Finance Corporation provide loans at low interest rates, unsecured lending without a loan premium, etc. (continuation)

In addition, SMRJ will continue emergency loans to prevent health damage, etc. as an asbestos measure in its loans for upgrades.

Section 2 Special measures for specific industries

1. Measures for the textile industry

With domestic demand for textiles in the doldrums and cheap imports from countries such as China accounting for a quantitatively large share of the market, the Japanese textile industry faces extremely severe conditions. In order to overcome these conditions, such measures as strengthening abilities to export fashions from Japan, innovation in production and distribution mechanisms to correct high-cost structures as a result of over production and losses due to disposal of unsold merchandise, will be implemented.

(1) **Strengthening ability to disseminate fashions from Japan**

In order to reinforce abilities to disseminate information on fashions to the world, making use of leading technology and an understanding of international fashion trends, support will be provided for unified efforts by fashion-related parties to, for example, hold “Japanese Fashion Week from Tokyo,” in conjunction with short-period, intensive “collection” shows and shows on materials. (continuation)

(2) **Innovation in production and distribution**

1) Implementation of self-sustainable programs by small and medium textile manufacturers

Support will be provided to activities undertaken by small and medium textile manufacturers in the supply chain that are experiencing severe conditions, but which are determined to find a way out, and have the desire and ability to make product plans, and to develop, produce and sell such products. (continuation)

2) Promotion of SCM (supply chain management)

In order to improve efficiency in production and distribution of the entire textile industry (production, wholesaling and retailing), programs such as training

and workshops where small and medium textile enterprises will obtain knowledge necessary for efficient operations and negotiating, by using information technology. (continuation) (¥40 million budget)

(3) **Others**

1) Support textiles and apparel exhibitions overseas (continuation) (¥521 million budget)

2) Strengthening of support for technological development (continuation) (¥1,775 million budget)

3) Effective development of human resources (continuation) (¥50 million budget)

2. Measures for the development of traditional crafts industries

There are throughout Japan many areas of production where traditional crafts products are manufactured using traditional skills and techniques. The development of these industries has long been promoted because of their contribution to the quality of life and distinctive character of local communities. Nevertheless, these industries now face a number of problems, such as the stagnation of demand for traditional crafts products, declining numbers of employees, and a shortage of successors.

The following measures will therefore be implemented, centered on the Law Concerning the Promotion of the Traditional Crafts Industries:

(1) **Designation of traditional crafts products in consultation with the Industrial Structure Council, upon application for such designation having been made under the above law (continuation)**

(2) Subsidization of the following activities (continuation) (¥1,026 million budget):

- 1) Activities undertaken in regions of traditional crafts production
 - a. Programs to train successors and to develop demand undertaken under development plans
 - b. Joint programs to develop demand undertaken under joint development programs
 - c. New production and regional revitalization programs undertaken under revitalization plans and cooperative revitalization programs
 - d. Local human resource training and exchange support programs and regional producer programs undertaken under support plans
- 2) Activities undertaken by the Association for the Promotion of Traditional Crafts Industries
 - a. Exhibitions of traditional crafts products
 - b. Activities to secure human resources and to ensure the survival of skills and technologies
 - c. Guidance for areas of production
 - d. Popularization activities
 - e. Demand development activities

(3) The following promotional and public information campaigns will be undertaken to raise public awareness of traditional crafts products in November each year, which will be designated "Traditional Crafts Month" (continuation):

- 1) Traditional Crafts Month national conferences and regional conferences in eight regional blocks
- 2) Traditional crafts plaza
- 3) Traditional Crafts Month art and essay contests, etc.

(4) Survey of the development of the traditional crafts industry infrastructure (continuation) (¥20 million budget)

In order to develop the production infrastructures of traditional crafts industries, a survey will be made of the equipment and materials required for the production of traditional crafts products, and studies will be made of substitute materials and new production technologies.

3. Measures for the tortoiseshell industry

Subsidies will be provided for the following activities undertaken by the Japan Bekko Association in order to ensure supplies of raw materials for small and medium tortoiseshell businesses hit hard by the prohibition imposed by the Japanese government at the end of 1992 on imports of hawksbill shells, this being such businesses' sole raw material: (continuation) (¥112million budget):

- 1) Preservation, breeding and cultivation of hawksbills in Japan
- 2) Resource protection surveys of producer countries
- 3) Visits to the Washington Convention Consultative Committee and related international organizations

4. Measures for the small and medium general merchandise industry (design preservation activities)

In order to promote the development of Japanese manufacturers of everyday necessities ("general merchandise"), the bulk of which are SMEs and small enterprises, subsidies will be provided by the National Federation of Small Business Associations to organizations undertaking design preservation programs:

(1) Collection of information and materials from Japan and overseas (continuation) (¥0.5 million)

Relevant materials such as design-related publications, magazines, catalogs and publications on industrial property rights from Japan and overseas will be collected and organized.

(2) Advisory service regarding counterfeits (continuation) (¥13.7 million)

In order to enhance the protection of designs and brands, consultation corners will be established, local consultations will be provided around the country, and market research will be conducted.

(3) Measures against the steep rise in counterfeit imported goods (continuation) (¥22.4 million)

The actual situation on counterfeits of Japanese products imported from overseas will be investigated and pamphlets toward preventing importation of counterfeits will be prepared. Seminars on countermeasures against counterfeits will be organized for domestic manufacturers, etc.

(4) Promotion of foreign registration of designs, etc. (continuation) (¥3.5 million)

Support will be provided for the acquisition of design rights and trademarks.

5. Measures for the environmental sanitation business

(1) Measures for the environmental sanitation business

As in fiscal 2005, support will continue to be given in fiscal 2006 for the advancement of environmental sanitation services suited to contemporary needs by Environmental Health Business Guidance Centers, which were established in order to maintain and raise hygiene levels and protect the interests of users and consumers by improving the soundness of management of environmental sanitation businesses. To achieve this, the following measures will be implemented:

- 1) Business base support programs involving establishment of study groups to consider issues such as business collaboration and cooperation, and modernization, rationalization, etc., of business management, and involving consumer monitoring. (partial modification) (¥4 million budget)
- 2) Urban development programs involving establishment of study groups to support the development of work and residential zones (such as shopping districts), conducting an awareness survey, and creation of sanitation mapping. (continuation) (¥8 million budget)
- 3) Programs to develop food recycling systems at establishments such as eating and drinking establishments and hotels, and programs undertaken independently by organizations such as

Environmental Health Associations for purposes such as the improvement of consumer services, promotion of community welfare, development of human resources, and improvement of sanitation levels. (continuation) (¥208 million budget)

(2) Loans for environmental sanitation-related business

The National Life Finance Corporation will make ¥200 billion available for environmental sanitation loans. In Okinawa Prefecture, the Okinawa Development Finance Corporation will provide loans worth a total of up to ¥4 billion. (continuation)

Improvement of special loans

- Special exemptions from lending requirements will be implemented for funds for equipment necessary to introduce aseismic facilities, etc. (including improvements and renovations). (new)
- Special exemptions from lending requirements will be implemented for funds for approved equipment necessary to prevent asbestos from being released and dispersed. (continuation)

6. Measures for SMEs in the agriculture, forestry and fisheries industries

(1) Modernization of SMEs in the agriculture, forestry and fisheries industries

- 1) Subsidies, etc., for enterprises in the agriculture, forestry and fisheries industries, etc.
 - a. Support will be provided for activities such as the formation of food industry clusters leading to the effective utilization of local foods, human resources, technologies and other resources undertaken as part of independent initiatives by local food industries (pursued in collaboration with ministries involved in cluster measures), and support will be provided for activities such as the development of conditions relating to the popularization and promotion of local brand-name foods, and the development of technologies and use of intellectual property by local food enterprises. (continuation) (¥609 million budget)
 - b. Support will be provided to small and medium food manufacturers, etc., by organizing human resource development workshops and providing technical information in order to further promote the improvement of control of food manufacturing processes (through hazard analysis and critical control point (HACCP) procedures). (continuation)
In addition, action will be taken to popularize and raise awareness of food safety management systems (ISO22000). (continuation) (¥136 million budget)
 - c. Support will be provided for the development of recycling facilities, etc., to regions promoting the use of biomass, including food waste. (continuation) (included in ¥13,729 million budget)
Action will be taken to drive a campaign to increase understanding of the purpose of the Law on Promoting the Use of Recycled Food Resources, primarily among the businesses that

have been slow to adopt recycling measures, etc. (partial modification) (¥28 million budget)

Action will also be taken to improve understanding of revisions to the Law for the Promotion of Sorted Collection and Recycling of Containers and Packaging (partial modification) (¥56 million budget)

- d. In order to promote the sound development of the food industry, subsidies will be provided for projects such as research and surveys by organizations such as the Food Service Industry Research Center. (continuation) (¥58 million budget)

Countermeasures will also be developed to promote the survival of businesses facing emergency conditions due, for example, to an outbreak of BSE. (continuation) (¥19 million budget)

Also, in order to promote the guidelines for labeling the place of origin in the food industry issued on July 28, 2005, activities undertaken by food service industries to disseminate and enlighten parties as to the guidelines will be promoted. (new) (¥29 million budget)

- e. In order to contribute to achieving the goals of “eating better diets,” “living better lifestyles” and “leading better lives” espoused in Biotechnology Strategy, research into the commercialization and industrialization of the results of decoding the rice genome, etc., will be pursued through collaboration between industry, universities and the government sector. (continuation) (¥962 million budget)

In order to help create new industries and businesses in the areas of agriculture, forestry and fisheries, and food industries, and to help food and other industries solve political issues confronting them, R&D undertaken by private businesses, etc., in collaboration with public research institutes, including universities and independent administrative corporations, will be promoted. (new) (¥988 million budget)

In addition, joint research undertaken by researchers in different fields using groundbreaking technologies will be promoted, and comprehensive measures will be taken to promote the establishment of ventures (enterprises developing creative or innovative businesses based on the application of new technologies) through activities such as the provision of research funds, exchanges of human resources, and individual consultations by experts. (continuation) (¥2,337 million budget)

- f. In order to promote the use of wood, action will be taken to promote development in fields such as the development of technologies, fire and earthquake resistant construction methods, development of high-quality wood preserving technologies, and development of new wood-based materials by calling for ideas from private enterprises, etc. (continuation) (¥172 million budget) (included in ¥988-million project to develop new technology to revitalize food industries, etc., through a partnership among

- industry, government and academia) (new))
- g. In order to promote business innovation in the wood industry, necessary removal costs for the disposal of facilities resulting from the rationalization of operations will be subsidized, and the development of facilities required to protect the environment and rationalize processing and distribution operations will be promoted. (continuation) (¥56 million budget)
 - h. In order to promote the use of local lumber in housing, mechanisms will be established to encourage housing construction from traceable sources through strengthened collaboration among interested parties ranging from forest owners to home builders. Among other measures, fairs and seminars will be organized and information hubs will be developed for consumers. (continuation) (¥96 million budget)
 - i. In order to reinforce a marine-product supply system so that it may be trusted by consumers, steps will be taken, including introduction of HACCP procedures at marine product processing plants, issuance of guidelines on implementation of hazard analysis and sanitation control for each item to support small marine processors in adopting HACCP systems, and evaluation of sanitation performance at marine product processing plants using the "HACCP Sanitation Performance Standards" and also giving advice based on such evaluations.
In addition, markets with controlled sanitation performance will be popularized through issuing guidelines on quality control according to the characteristics of each market in producing centers, and by approving and having public entities announce markets in producing centers with good sanitation management. (new) (¥122 million budget)
- 2) Loans for enterprises in the agriculture, forestry and fisheries industries
 - a. Funds will be loaned by institutions such as the Agriculture, Forestry and Fisheries Finance Corporation to enable specific agricultural producers affected by the liberalization of the agricultural produce market to make business improvements in accordance with the Law on Temporary Measures to Improve the Businesses of Specific Agricultural Produce Processors. (continuation)
 - b. Loans will be provided by the Agriculture, Forestry and Fisheries Finance Corporation for the development of facilities required for the upgrading of control and manufacturing processes of food enterprises in order to promote the introduction of HACCP methods in accordance with the Law on Temporary Measures on Upgrading the Control of Food Manufacturing Processes. (continuation)
 - c. Funds will be loaned by the Agriculture, Forestry and Fisheries Finance Corporation to promote the adoption of new uses for specific agricultural, forestry and marine produce and new varieties of processed raw materials. (continuation)
 - d. Food manufacturers and businesses in the agriculture, forestry and fisheries industries will build stable business relations, and the Agriculture, Forestry and Fisheries Finance Corporation will loan the funds for the development of the necessary agriculture, forestry and fisheries facilities. (continuation)
 - e. Institutions such as the Agriculture, Forestry and Fisheries Finance Corporation will provide loans to dairy farmers to improve their dairy facilities. (continuation)
 - f. In order to rationalize the production and distribution of wood, loans will be provided by the Wood Industry Upgrading Promotion Fund, and loans of the necessary funds for improving management in the forestry and wood industries will be provided under the Forestry and Wood Industry Improvement Fund Subsidization Law. (continuation)
 - g. In order to maintain and improve the use of peripheral resources and strengthen the structure of the marine produce processing industry in response to changes in conditions faced by the industry, loans will be provided from marine produce processing funds and marine product business improvement promotion funds. (continuation)
- (2) Rationalization of food and wood distribution**
- 1) Activities will be undertaken through the Organization of Food Marketing Structure Improvement to provide education and guidance in and encourage the spread of knowledge and skills required to enable small and medium food distributors to improve their management in response to the diversification of consumers' food demands. In order to enable them to fulfill their functions appropriately at the local level, support will also be provided for the development of a human resource development master evaluation system. (continuation) (¥72 million budget)
 - 2) In order to promote the revitalization of food retailing and shopping districts (city center areas) by organizations of food retailers, shopping center promotion associations, etc., in cooperation with producers and producing centers through the Organization of Food-Marketing Structure Improvement, support will be provided for measures to develop products to increase the value of local agricultural and fisheries products lineups and improve services throughout the entirety of shopping districts, etc. (partial modification) (¥41 million budget)
 - 3) Loans for the modernization of the retailing of fresh food will be provided to food distributors by the National Life Finance Corporation. Loans to improve the food distribution structure will also be provided by the Agriculture, Forestry and Fisheries Finance Corporation, the Japan Finance Corporation for Small and Medium Enterprise, and the National Life Finance Corporation. (continuation)
 - 4) Reorganization and rationalization of dairy product plants will be promoted, and subsidies provided for the

concentration of production at dairy industry facilities meeting high hygiene standards (¥500 million subsidy (use will also be made of funds allocated for the Agriculture and Livestock Industries Corporation)). In addition, comprehensive implementation of hygiene control at dairy facilities will be promoted. (continuation)

- 5) In order to promote the healthy development of the forestry industry, the establishment of distribution and processing hubs to provide low cost, stable supplies of wood products of clear quality and performance and the development of systems for supplying drying materials and the introduction of leased machinery and equipment will be promoted. The development of new distribution and processing systems to provide stable supplies of local materials to heavy users (continuation) and establishment of a model strategic system for distributing and processing lumber (new) will also be pursued. (included in ¥6,990 million subsidy for development of strong forestry and lumber industries, ¥89 million budget)

7. Measures for SMEs in the transport industry

(1) Outline of measures for SMEs in the transport industry

Support will be provided for SMEs in the transport industry by, among other things, supporting the enhancement of business fundamentals and business innovation.

(2) Measures to support business innovation

Guidance and support will be provided for the enhancement of business fundamentals and business innovation under the SME New Business Activities Promotion Law.

(3) Measures to improve logistical efficiency

Activities will be pursued to raise the efficiency of logistics operations through, for example, the development of shared delivery facilities by small and medium truck operators under the Law Concerning the Promotion of Efficient Distribution Systems in Small and Medium Enterprises.

(4) Measures for local SMEs

Support will be provided for the advancement and revitalization of shipbuilding-related industries concentrated in regions centered on shipbuilding under the Law on Temporary Measures for Activation of Specific Regional Industrial Agglomerations.

(5) Measures for specific industries

1) Warehousing industry

The modernization of facilities, upgrading of logistics functions, and development of joint warehousing operations will be promoted in order to meet more complex logistics needs created by changes in the social and economic environment.

2) Automobile wrecking and maintenance businesses

In order to facilitate the raising of funds required for the modernization of automobile wrecking and maintenance operations, loan guarantees will be provided and interest covered by making appropriate use of the

automobile maintenance modernization fund program.

3) Coastal shipping businesses

In order to promote the smooth and steady implementation of temporary coastal shipping measures, support measures will be taken through the establishment of a government guarantee facility. (¥53,000 million government guarantee budget)

In addition, as in fiscal 2005, coastal shipping will be revitalized by promoting the construction of vessels using new, environmentally friendly technologies ("super eco-ship phase I") using the joint shipbuilding operations of the Japan Railway Construction, Transport and Technology Agency. (¥400 million government investment)

4) Port transport businesses

Continuing from fiscal 2005, loans and other support measures will be implemented by the Institute for Advanced Port Transportation of Japan for the establishment of facilities such as physical distribution centers, installation of cargo-handling equipment for port transport, development and installation of logistics information systems, strengthening of the business bases of port transport providers, and terminal operator operations.

5) Small and medium shipbuilding and ship industries

In order to encourage new activities by small and medium shipbuilders and ship machinery manufacturers, financial and other necessary measures will be applied to such activities for management innovation and cultivation of new businesses in partnerships among different fields, which will be undertaken under the SME New Business Activities Promotion Law.

In conjunction with these measures, others will be taken to strengthen credit insurance measures, secure employment and establish a safety net to ensure business stability.

8. Measures for small and medium building contractors (continuation)

(1) Securing and training human resources

The Minister of Land, Infrastructure and Transport's Award for Outstanding Engineering will be awarded to outstanding construction engineers, and measures to secure and train human resources will be pursued by the Fund for Construction Industry Promotion.

(2) Organization and cooperation

Measures will be taken to promote greater organization by entities such as business cooperatives formed by small and medium building contractors, and guidance will be provided on the rational management of joint business projects.

(3) Business innovation and rationalization

- 1) The use of support measures under the SME New Business Activities Promotion Law will be promoted, and guidance and information will be provided to promote SME startups, business

innovation and new partnerships.

- 2) In order to promote the spread of expertise in the unique bookkeeping and accounting practices of the construction industry, improve accounting skills, and contribute to the rationalization and modernization of business, the official examination for accounting controllers in the construction industry will be implemented by the Fund for Construction Industry Promotion.
- 3) Measures will be taken to raise awareness of the "Guidelines on the Preparation of Business Improvement Principles in Each Industry," formulated in September 1990, and support and guidance will be provided concerning independent action to improve management, such as through subsidies by the Fund for Construction Industry Promotion.
- 4) In order to strengthen the business bases of small and medium building contractors, the Fund for Construction Industry Promotion will organize programs such as training programs for entrepreneurs in the construction industry.
- 5) In order to promote entries into new fields by small and medium building contractors, related ministries and agencies will provide coordinated support, by establishing "one-stop access centers for various services" - including information - at each prefectural association of general contractors, etc.

(4) Facilitation of finance

Steps will be taken to promote the use of loans provided by government-affiliated financial institutions and deposit loans provided by advanced guarantee providers. Measures will also be taken to promote further uptake of the subcontractor safety-net loan guarantee scheme in order to prevent the deterioration of the financial positions and domino bankruptcies of small, medium and middle-tier building contractors.

(5) Surveys and research

The Research Institute of Construction and Economy (RICE) and the Fund for Construction Industry Promotion

will undertake surveys and research on issues facing the construction industry.

(6) Rationalization of construction production systems

Action will be taken to further raise awareness of the "Principles for the Rationalization of Production Systems in the Construction Industry." At the same time, the expert basic policy committee established under the Central Construction Production System Rationalization Promotion Council will actively consider rationalization of the diverse production systems currently in existence.

(7) Modernization and revitalization of local small and medium homebuilders

In order to promote modernization and revitalization of local small and medium homebuilders, activities to promote the structural reform of the homebuilding industry will be pursued, and support will be provided to activities to train skilled workers and more.

9. Measures for small and medium realtors (continuation)

(1) Development of the real estate market

In order to promote cooperation among small and medium realtors and contribute to the development of the real estate market, the functions of the Real Estate Information Network System (REINS) will be enhanced and its use promoted.

Regarding REINS, it is necessary to raise interest among consumers as well as small and medium realtors and to increase consumer confidence in the system. Uptake of the system will therefore also be promoted.

(2) Financial measures for small and medium realtors

Loan guarantees and interest coverage will be provided for equipment loans to small and medium realtors by government-affiliated financial institutions for SMEs, and joint facility funds and funds for cooperation among business associations will be provided by the Real Estate Transaction Modernization Center Foundation.

Section 3 Response to energy and environmental issues

1. Support for rationalization of energy use by SMEs

(1) Subsidization of costs of rationalizing energy use and other technological improvements (support for new initiatives by SMEs and ventures)

In order to promote startups and new ventures created through the commercialization of the outstanding technology "seeds" of SMEs contributing to the rationalization of energy use, subsidies will be provided to cover part of the cost of commercial R&D undertaken by SMEs and other businesses,

acquisition of intellectual property necessary for commercialization activities, and development of markets. Consultations and other activities to promote the realization of business plans will also be executed in an integrated manner. (continuation) (¥720 million budget)

2. Measures to rationalize energy use and improve logistical efficiency, etc. (re-shown, see Chapter 6, Section 2)

Section 4 Promotion of human rights awareness

In order to propagate the idea of respect for human rights and to cultivate awareness of human rights among SMEs,

prefectures will be commissioned to organize activities such as lectures to raise awareness of human rights. (continuation)

Section 5 Measures for SMEs in Okinawa

With regard to measures for SMEs in Okinawa, ¥69 billion will be allocated for loans to SMEs by the Okinawa Development Finance Corporation. The special loan program will also be expanded, and the terms of loans

improved. (continuation) (¥69 billion budget)

Intensive support will be provided for ventures with outstanding business plans that aim at commercialization in Okinawa Prefecture. (continuation) (¥66 million budget)

Chapter 15 Promotion of surveys and public information activities

Section 1 Surveys

- (1) Under Article 11 of the Small and Medium Enterprise Basic Law, a “2006 White Paper on Small and Medium Enterprises” will be issued. (continuation) (included in ¥502 million budget)
- (2) Under Article 10 of the Small and Medium Enterprise Basic Law, a “Basic Survey of Small and Medium Enterprises” will be implemented to ascertain information on their management and finances, etc. (continuation) (¥341 million budget)
- (3) The reality of SME business activities will be quantitatively ascertained using the credit risk database (CRD) for SMEs, and “Financial Indicators for SMEs” will be prepared to be used in developing SME business strategies, examinations, advice, etc. (continuation)
- (4) Preparation of input-output tables by size of enterprise for industries such as manufacturing. (continuation) (included in ¥285 million budget)
- (5) Price indices by size, value of imports and exports of typical SME products, and manufacturing production, shipment and inventory indices by size will be calculated. (continuation)
- (6) The diffusion index (DI) of business sentiment, sales, operating profits, etc., in every quarter will be calculated, and a “Survey on SME Business Conditions” will be implemented to ascertain business trends directly affecting SMEs. (continuation) (included in SMRJ operating expense subsidy)

Section 2 Publicizing of measures

In order to provide effective support for SMEs, SMEs themselves must be made aware of the complex and wide-ranging menu of measures offered. Information on SME measures will therefore be provided via a variety of media, including television, newspapers, radio, the Internet and pamphlets, in order to improve access to measures and promote their use.

1. Publicizing measures via media such as television, newspapers, radio and the Internet

In order to raise knowledge and promote use of new support measures and support measures that will be most effective if taken up in a timely manner, publicity will be generated via media such as television and newspapers.

In addition, in order to help solve the problems faced by SMEs, radio programs and other productions will be produced introducing tips on management and how to succeed, in an easy to understand manner, and providing up-to-date information on measures of use to SMEs.

Furthermore, working in collaboration with SME support agencies, up-to-date information on SME measures

will be provided via an e-mail newsletter (“e-SME Net Magazine”), information on SME measures will be introduced on the SME Agency’s website, and the “e-SME Agency & Network Project” will be pursued, responding to requests for advice and views and suggestions regarding measures expressed by SMEs. (continuation)

2. Publicizing of measures via print media

In order to promote the spread and use of SME measures, publications explaining them in concise, concrete terms will be produced, and these will be widely distributed to SMEs through local governments and other organizations working with SMEs. (continuation)

3. “SME Agency for a Day” event

In order to directly determine the public’s views and wishes concerning SME measures, for incorporation into and enhancement of future measures, an “SME Agency for a Day” event will be held. (continuation)

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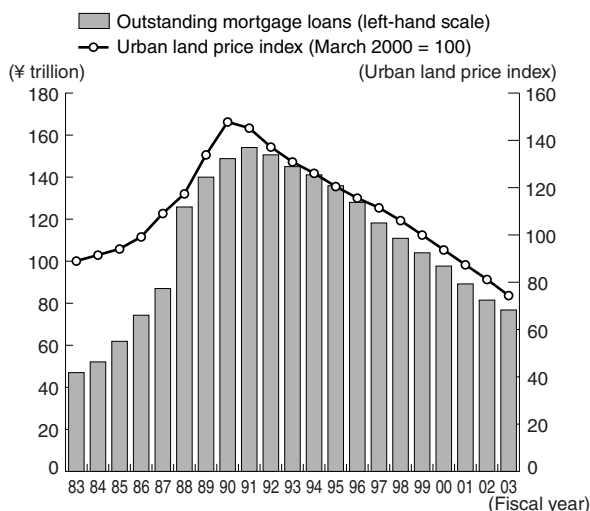
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Appended Note 1-3-1 Trends in land prices and mortgage loans

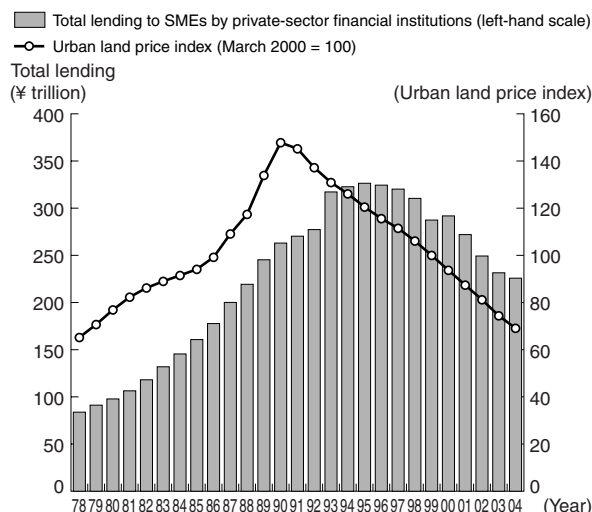
While the recovery in outstanding lending to SMEs has been assisted in part by growth in mortgage loans in some regions, outstanding mortgage loans continue to fall overall in tandem with land prices.



Source: BOJ, *Financial and Economic Statistics Monthly*, Japan Real Estate Institute, *Urban Land Price Index*.

Appended Note 1-3-2 Trends in land prices and total outstanding lending to SMEs by private-sector financial institutions

While the downward trend in outstanding lending to SMEs appears to be coming to a halt, changes in outstanding lending to SMEs by private-sector financial institutions appear to lag behind movements in land prices.



Source: Compiled by the SME Agency based BOJ, *Financial and Economic Statistics Monthly*, Japan Real Estate Institute, *Urban Land Price Index*, and other sources.

- Notes:
1. Total lending to SMEs is the amount outstanding at the end of each December. The amounts outstanding up to and including 1992 do not include overdrafts.
 2. Total private-sector lending to SMEs = bank lending to SMEs + credit association lending excluding personal loans + credit cooperative lending (not including trust accounts).

Appended Note 1-3-3 Rate of change in outstanding bank lending by prefecture (December 2005)

An examination of the rate of change in outstanding bank lending in each prefecture shows that outstanding lending has begun to increase in around two thirds.

(Unit: %)

Prefecture name	National	Hokkaido	Aomori	Iwate	Miyagi	Akita	Yamagata	Fukushima	Ibaraki	Tochigi
Rate of change	0.337574	2.898807	-3.24415	1.349611	1.505123	0.481914	2.233085	1.776852	1.703642	-2.95948
		Gunma	Saitama	Chiba	Tokyo	Kanagawa	Niigata	Toyama	Ishikawa	Fukui
		-0.78925	5.630366	2.291066	-0.01447	1.607446	0.224714	-6.89012	-0.7437	1.995579
		Yamanashi	Nagano	Gifu	Shizuoka	Aichi	Mie	Shiga	Kyoto	Osaka
		1.320071	-0.79343	1.709977	3.13814	2.020403	2.006986	1.698863	0.244478	-2.20362
		Hyogo	Nara	Wakayama	Tottori	Shimane	Okayama	Hiroshima	Yamaguchi	Tokushima
		0.696634	-0.15005	-1.97673	1.68525	1.85354	1.491194	0.502098	-0.21719	-2.27491
		Kagawa	Ehime	Kochi	Fukuoka	Saga	Nagasaki	Kumamoto	Oita	Miyazaki
		-0.14504	2.92273	-1.37799	-0.57017	-0.62511	-5.31761	1.317006	1.071668	0.532798
		Kagoshima	Okinawa							
		4.611089	0.527175							

Source: BOJ, *Outstanding Lending by Prefecture*.

- Notes:
1. Lending includes discounted notes receivable.
 2. The above figures indicate the rate of change from the same period a year earlier as of December 2005.

Appended Note 1-3-4 Short-term borrowing rates of main banks (by prefecture)

(Unit: %)

Prefecture	Hokkaido	Aomori	Iwate	Miyagi	Akita	Yamagata	Fukushima	Ibaraki	Tochigi	Gunma	Saitama	Chiba	Tokyo	Kanagawa	Niigata	Toyama
Upper 25th percentile	2.250	2.200	2.500	2.375	2.625	2.400	2.375	2.625	2.350	2.000	1.875	1.850	1.625	2.000	2.000	1.875
Median	1.875	2.100	2.375	2.000	2.163	2.225	2.000	2.000	1.850	1.863	1.563	1.750	1.375	1.875	1.875	1.875
Lower 25th percentile	1.700	1.875	2.300	2.000	2.000	1.875	1.625	1.875	1.500	1.525	1.375	1.625	1.375	1.625	1.625	1.625
(Mean)	2.115	2.236	3.057	2.356	2.362	2.118	2.178	2.203	3.000	1.885	1.676	2.912	1.648	1.961	1.995	1.938
Prefecture	Ishikawa	Fukui	Yamanashi	Nagano	Gifu	Shizuoka	Aichi	Mie	Shiga	Kyoto	Osaka	Hyogo	Nara	Wakayama	Tottori	Shimane
Upper 25th percentile	2.250	1.875	2.200	2.150	1.600	1.875	1.375	2.125	1.625	1.875	1.600	1.675	1.650	2.250	2.400	2.000
Median	1.875	1.688	1.900	1.875	1.375	1.625	1.375	1.625	1.500	1.750	1.375	1.375	1.563	1.750	2.000	2.000
Lower 25th percentile	1.625	1.500	1.625	1.750	0.800	1.375	1.050	1.375	1.375	1.625	1.375	1.375	1.375	1.375	1.875	1.875
(Mean)	2.065	1.880	1.949	2.152	1.377	1.733	1.395	1.825	1.652	1.818	1.679	1.603	1.628	1.933	2.268	2.271
Prefecture	Okayama	Hiroshima	Yamaguchi	Tokushima	Kagawa	Ehime	Kochi	Fukuoka	Saga	Nagasaki	Kumamoto	Oita	Miyazaki	Kagoshima	Okinawa	
Upper 25th percentile	1.875	2.175	1.900	2.000	1.750	2.200	1.500	1.875	1.875	2.000	2.375	1.875	2.000	1.875	2.100	
Median	1.625	1.875	1.750	1.875	1.500	2.000	1.438	1.625	1.700	1.875	1.875	1.875	1.688	1.948		
Lower 25th percentile	1.375	1.500	1.275	1.750	1.375	1.750	1.375	1.500	1.625	1.625	1.650	1.875	1.875	1.500	1.875	
(Mean)	1.684	1.843	1.574	2.095	1.563	1.995	1.438	1.829	1.858	1.930	2.139	1.991	1.971	2.167	2.233	

Source: RIETI (conducted by Tokyo Shoko Research, Ltd.) (2006), *Survey of the Financial Environment of Small and Medium Enterprises*.

Notes: 1. Short-term borrowing rates of main banks are as of the end of October 2005.

2. The latest short-term borrowing rate was used where there was no borrowing at the end of October, and the highest borrowing rate was used where there was more than one.

Appended Note 1-3-5 Trends in bond issuances by large enterprises and SMEs

(Unit: ¥ million)

	Large enterprises (capital of ¥100 million or more)	SMEs (capital of less than ¥100 million)
FY1995	55,624,290	1,083,287
FY1996	55,111,590	1,125,439
FY1997	55,529,867	740,650
FY1998	58,569,219	558,568
FY1999	57,725,220	435,214
FY2000	53,638,846	931,517
FY2001	51,292,756	1,144,967
FY2002	49,036,066	1,308,675
FY2003	48,972,021	2,453,285
FY2004	48,652,877	2,621,174

Source: MOF, *Financial Statements Statistics of Corporations by Industry (Annual)*.

Note: Large enterprises are enterprises with capital of ¥100 million or more, and SMEs are enterprises with capital of less than ¥100 million.

Appended Note 1-3-6 Content of intellectual asset management report based on an imaginary example

Content of intellectual asset management report based on an imaginary example

Main body of intellectual asset management report (example)

—Story of value generation

Intellectual asset measure supporting story(*)

Basic business philosophy

Since its establishment in ... , the Company has sought to build a corporate image that is well known among related parties (frequency of IR*) in accordance with an ethos of "creating comfortable and fulfilling urban lifestyles," and to establish this throughout the Company as a guide to action by employees (internal acceptance of business ethos*) ... In order to develop products suited to users' needs ... we will develop neighboring technologies based on technology xx developed in xxxx ... and pursue business that follows the trends of the times or stays ahead of the times.

Nature of business

The Company's core line of business is xx, and its core products are consumer products such as xx, xx, and xx. Products are supplied primarily to individual customers (x% to other businesses and x% to consumers). The main sources of supply are xx Ltd., xx Ltd., and x Ltd. for ... , xx Ltd., xx Ltd., and xx Ltd. for ..., and xx Ltd., xx Ltd., and xx Ltd. for ... Products are distributed mostly through xxx and xxx.

In recent years, the market for products such as x, x, and x has grown by an annual rate of around x%. At the same time, however, deflation has brought down unit prices, and competition with a leading competitor, x Ltd., is intensifying.

In this field, standards on x are expected to be established due to environmental protection in recent years. These standards the Company already meets as a result of environmental investment worth ¥xxx million in fiscal xxxx (environment-related investment*).

Past to present

1) Business policy: ... Against the backdrop of growing urbanization and rising demands in respect of the living environment, we anticipated a rise in demand for xx usable in comparatively restricted residential space ... Placing an emphasis on products for urban consumers characterized by their quietness and ease of maintenance, we engaged in business with the aim of developing a competitive advantage in this area.

2) Investment: ... Investment has been concentrated on design and development of soundproofing technology, weight-saving technology, and space-saving technology (¥x billion between xxxx and xxxx) (R&D concentration ratio*), ... and the materials required therefor developed in collaboration with a university (collaboration project with university xx: ¥xxx million in year xx) (outsourced R&D expenditure*). ...

3) Intellectual assets and value chain: ... A master patent was obtained in xxxx for technology xx in field xx. Rights were expanded to neighboring fields through improvement inventions based on this (xx related patents) (number of patents held*). Design rights were also acquired (xx related design rights) (number of related design rights held*) ... and development of xx materials was pursued. In order to tie these activities directly into marketing, a cross-departmental "product team" was established in the Company in xxxx, and development work and sales activities are implemented to meet needs under young leaders. More specifically, this team emerged from xxx and xxx. Accordingly, as a result of commercializing xx, which could not be produced by other companies, enhancing the product lineup by developing a variety of needs, and meeting user needs, our products now have a market share of xx% (weighted market share by product type*), ... unit product prices are being maintained despite the recent bout of deflation (change in income per customer*), and an emphasis has also been put on PR targeted at consumers since xxxx in order to raise the Company's image (business image survey*).

4) Performance: As a result, sales have grown from ¥xx in year xx to ¥xx in year xx ... and ordinary profit has gone from ¥xx in year xx to ¥xx in year xx. However, due to the impact of ... , ordinary profit declined last year.

From present to future

1) Vision: Although the business environment has grown more severe due to the emergence of competing manufacturers in Korea, we will continue to differentiate ourselves by stressing even more our ability to meet customer needs based on performance to date. In concrete terms, we will proceed with further development of products centered around our flagship xx based on basic patents so as to ensure domestic market share while sustaining unit prices. In conjunction with this, we will publicize our design capabilities and engage in PR targeted at customers, while the president in particular will undertake PR in various circles to advertise the social responsibilities being fulfilled by the Company, and rigorous action will be taken internally to improve our corporate image and further strengthen our earnings structure. In order to provide an appropriate compliance structure to maintain and improve our corporate image, we will continue to enhance compliance mechanisms (compliance manager: xx xx) (compliance structure*)

2) Investment plans: Since xxxx, we have employed and trained a total of x designers. This number will in the future be expanded to x, and training too will be expanded (from ¥x at present to ¥x in five years) (research expenditure per employee*). In addition, in order to improve our corporate image, we will focus on the ways in which our products are improving the view and on those things that are people- and environmentally-friendly in our selection of colors and materials for new products (¥xx in environment-related investment) (environment-related investment*), and make this the central pillar of external PR. In addition, development of new materials for products following on from the flagship xx is scheduled to be completed in two years (¥x in investment), following which commercialization will commence.

3) Sustainability: The master patent will expire in xxxx and neighboring patents will on average be effective until xxxx. Our products are highly regarded by our buyers, whose number is growing by the year (corporate image survey, customer satisfaction*) ... In the future, the ... system will be adopted to give an even greater incentive to "product teams." In addition, due to the expected growth in market size, including exports to certain major cities in China, which commenced last year (average growth of x% is forecast), sales are projected to grow by an annual rate of x%, and ordinary profit is expected to reach x in xxxx.

Notes: Method of calculation of metrics

• IR frequency: Frequency and time spent on external public relations' activities during the previous year by the representative director

Previous year: xx times, xx hours Year before last: xx times, xx hours

• Internal acceptance of business ethos: An anonymous survey of all staff is conducted in mm yy by the administration department.

• R&D concentration ratio: R&D investment in core business (annual) / total R&D investment (annual)

Previous year: xx% Year before last: xx%

• Weighted average share by product type: $(\text{share of product xx}) \times (\text{sales of product xx} / \text{total sales of business xx}) + (\text{share of product xx}) \times (\text{sales of product xx} / \text{total sales of business xx}) + (\text{share of product xx}) \times (\text{sales of product xx} / \text{total sales of business xx})$ Previous year: xx% Year before last: xx%

• Compliance system: number of compliance staff / total number of employees Previous year: xx% Year before last: xx%

*Number of compliance staff: Previous year: x senior staff, x holding other positions Year before last: x senior staff, x holding other positions

• Research expenditure per researcher: R&D expenditure in previous year / number of researchers (number of researchers as of mm dd including designers) Previous year: ¥xx Year before last: ¥xx

• Environment-related investment: i) Environment-related spending Previous year: ¥xx Year before last: ¥xx

ii) Trend in environment-related spending: 1998: ¥xx 1999: ¥xx 2000: ¥xx

iii) Introduction of anti-pollution equipment: ¥xx (first year, declining balance method of depreciation, useful life = x years)

• Corporate image survey: According to the results of a survey conducted by xx Ltd. in mm yy. Questionnaire survey of approximately 10,000 subscribers to a magazine published by xx Ltd.

• Customer satisfaction: x% of buyers of our products responded that they are "very satisfied" or "satisfied" (questionnaire survey based on product registration cards returned during the previous year).

Regarding the image of our products, x% responded that it is "very trustworthy" or "trustworthy" (according to the results of a questionnaire conducted by xx Ltd.: online survey conducted in mm yy, approximately xx responses to survey).

Attached: Intellectual Asset Measures

The necessary details are entered referring to Figure B. (A certain amount of comparability is ensured from the point of view of the evaluator.)

- Information conveyed outside the company by management
 - *Frequency and time spent on external public relations' activities during the previous year by the representative director
 - i) Investors: x times, x hours ii) Business partners: x times, x hours iii) Customers: x times, x hours
- Advantage in core business
 - i) Proportion of total sales accounted for by core business (xx business): x%
 - *Sales from xx business / total sales
 - ii) Proportion of operating profit accounted for by core business (xx business): x%
 - *Operating profit from xx business / total operating profit
 - iii) Operating profit ratio of core business (xx business)
 - *Operating profit from core business (xx business) / sales of core business (xx business)
- Reviews of underperforming operations
 - *Segments that achieve an operating profit ratio of not more than x% x years after commencement are reviewed. In the past five years, we have closed down operation x and pulled out of development of x products, resulting in a combined profit/loss of ¥x.
- R&D concentration ratio
 - i) Patent concentration ratio: x%
 - *x applications in top 10 categories of application by the company in the international patent classification / x applications by the company in total
 - ii) Core business R&D concentration ratio: x%
 - *R&D investment in xx business (annual) / total R&D investment (annual)
- Elasticity of cost price to changes in market price of raw materials
 - *While we are considered to be in a strong price bargaining position, this is not factored into calculations due to the difficulty of obtaining information on costs from suppliers.
- R&D expenditure to sales
 - i) Annual R&D expenditure / annual sales = x%
 - *Annual R&D expenditure: Cost of Counted as R&D expenditure
 - ii) Trend in R&D expenditure to sales
 - 1998: x% 1999: x% 2000: x%
- Employee satisfaction
 - *Ranked xxth among xx companies listed on the first section of the Tokyo Stock Exchange (according to a survey conducted in mm yy by xx Ltd., published in magazine xx)
- Compliance system
 - i) Number of outside directors / total number of directors = x%

Appended Note 2-2-1 Examination of improvement in domestic business performance of enterprises that establish operations overseas

1. Summary of analysis

An analysis was made of whether or not the establishment of operations overseas raised enterprises' performance.

2. Method of analysis

Superior enterprises would be expected to perform well regardless of whether or not they established operations overseas. A simple regression analysis to determine whether enterprises' current performance could be explained by the establishment of operations overseas without taking into account enterprises' capabilities assuming that superior enterprises find it easier to establish operations overseas would be likely to overestimate the effect of establishing operations overseas. Thus although it is exceedingly difficult to compile data regarding enterprises' capabilities (such as the ability of the president and quality of employees), a simple regression analysis that ignores the relationship between enterprise capabilities, decision-making regarding the establishment of operations overseas, and business performance also subsumes the effect of an enterprise's capabilities within the effect of establishing operations overseas, rendering it impossible to estimate the effect purely arising from establishing operations overseas.

In order to measure the pure effect of establishing operations overseas, the two-stage least squares method was used. To begin with, an equation explaining whether or not an enterprise established operations overseas was estimated using manipulated variables by the least squares method. For the manipulated variables were used variables that were considered to be unrelated to the error term of the second-stage estimation equation, but that explained whether or not an enterprise established operations overseas. Next, the equation explaining the current performance of an enterprise was estimated by the least squares method using the forecast values regarding whether or not an enterprise established operations overseas obtained at the first stage. The estimated effect of establishing operations overseas thus obtained was regarded as the pure effect of establishing operations overseas.

3. Model

Dependent variable: Ordinary profit/sales in FY2002

Explanatory variables: 1) Establishment of operations overseas dummy

(enterprises that established operations overseas in FY1995 = 1, enterprises that did not establish operations overseas between FY1995-2002 = 0)

Note: Whether or not an enterprise established operations overseas was determined according to whether or not it was an equity participant in an overseas affiliate.

- 2) Ordinary profit/sales in FY1994
- 3) Size of enterprise in FY1994 (number of employees (natural log))
- 4) Enterprise age (as of FY1994)
- 5) Tangible fixed assets/total assets (as of FY1994)

Manipulated variables in respect of established operations overseas dummy

- 1) Value of tangible fixed asset investment in FY1994 (natural log)
- 2) Industry dummies

4. Data set

METI, *Basic Survey of Japanese Business Structure and Activities*.

Manufacturing SMEs that established operations overseas in FY1995 and that did not establish operations overseas between FY1995-2002 were selected.

Sample size (number of companies)

Enterprises that established operations overseas	99
Enterprises that did not establish operations overseas	2001
Total	2100

5. Results of second-stage estimate equation (estimated by two-stage least squares method)

FP value = 0.000

	Ordinary profit/sales (FY2002)		
	Estimated coefficient	Standard error	Significance level
Established operations overseas dummy (FY1995)	0.047	0.027	*
Ordinary profit/sales (FY1994)	0.272	0.022	***
Enterprise size (FY1994)	0.000	0.002	
Enterprise age (FY1994)	-0.001	0.002	
Tangible fixed assets/total assets (FY1994)	0.019	0.006	***
Constant term	0.010	0.010	
Sample size	2,100		
FP value of first-stage estimate equation	0.000		

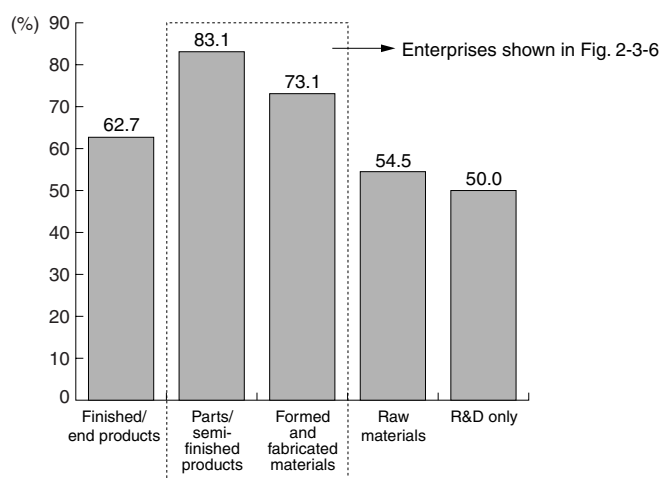
***= 1% significance level **= 5% significance level *= 10% significance level

Comparison of performances of enterprises that have and have not established operations overseas

	Estimated coefficient	Median	Enterprises that established operations overseas	Enterprises that did not establish operations overseas
Established operations overseas dummy (FY1995)	0.047	—	0.047	0.000
Ordinary profit/sales (FY1994)	0.272	0.018	0.005	0.005
Enterprise size (FY1994)	0.000	5.088	0.001	0.001
Enterprise age (FY1994)	-0.001	3.584	-0.004	-0.004
Tangible fixed assets/total assets (FY1994)	0.019	0.351	0.007	0.007
Constant term	0.010	—	0.010	0.010
Total (estimated ordinary profit/sales (FY2002))	—	—	0.065	0.019

A hypothetical enterprise was assumed described by the medians for ordinary profit/sales, enterprise size, enterprise age, and tangible fixed assets / total assets in FY1994, and ordinary profit/sales in FY2002 simulated according to whether or not an enterprise established operations overseas.

Appended Note 2-3-1 Proportion of enterprises engaging in subcontracting business (now)



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

Notes: 1. Enterprises with 300 or fewer workers.

2. "Subcontracting" is here defined as the manufacture or processing of products or parts, etc. by an enterprise as an affiliate or partner of a business larger than itself.

Appended Note 2-3-2 Change in transaction needs

1) Change in subcontracting needs from perspective of contractors

(Actual number)

	White goods	Audio-video equipment and other consumer electronics	Automobiles	IT equipment	Production facilities	Medical and welfare-related equipment and devices	Other	Total
Capital ties and business affiliations	2	1	24	8	10	4	14	63
Stability of management	4	11	119	41	62	9	48	294
Development proposal ability	6	22	112	50	60	10	47	307
Quality of products and processing	14	49	292	112	198	18	168	851
Stability of quality	17	51	357	134	222	26	182	989
High-mix small lot production capability	12	32	158	62	148	17	102	531
Cost-cutting ability	21	57	324	132	207	27	165	933
Mass-production capability	5	20	158	53	42	10	49	337
Ability to take aggregated orders involving multiple processes	5	12	97	37	81	6	63	301
Ability to cater to quick deliveries	17	37	237	117	232	21	166	827
Reliable observance of delivery deadlines	9	37	272	98	199	23	152	790
Ability to cope with new technologies and materials	5	11	86	50	37	6	35	790
Proximity to client's business establishment	2	6	51	20	35	1	39	154
Ability to establish operations overseas	3	12	43	16	9	1	7	91
Other	0	0	9	0	3	0	1	13
Total	27	77	487	196	353	44	272	1,456

(Coefficient of specialization)

	White goods	Audio-video equipment and other consumer electronics	Automobiles	IT equipment	Production facilities	Medical and welfare-related equipment and devices	Other
Capital ties and business affiliations	1.75	0.30	1.09	0.92	0.69	2.38	1.20
Stability of management	0.75	0.70	1.16	1.01	0.92	1.15	0.89
Development proposal ability	1.08	1.34	1.05	1.18	0.85	1.22	0.83
Quality of products and processing	0.90	1.08	0.98	0.95	1.01	0.79	1.07
Stability of quality	0.95	0.97	1.04	0.98	0.98	0.99	1.00
High-mix small lot production capability	1.24	1.13	0.85	0.84	1.21	1.20	1.04
Cost-cutting ability	1.24	1.15	1.00	1.02	0.96	1.08	0.96
Mass-production capability	0.82	1.11	1.35	1.13	0.54	1.11	0.79
Ability to take aggregated orders involving multiple processes	0.91	0.75	0.92	0.89	1.17	0.75	1.13
Ability to cater to quick deliveries	1.13	0.84	0.82	1.02	1.22	0.95	1.09
Reliable observance of delivery deadlines	0.63	0.88	0.99	0.90	1.09	1.09	1.04
Ability to cope with new technologies and materials	1.20	0.90	1.07	1.57	0.70	0.98	0.82
Proximity to client's business establishment	0.71	0.73	0.95	0.94	0.99	0.24	1.37
Ability to establish operations overseas	1.81	2.47	1.36	1.27	0.43	0.41	0.42
Other	0.00	0.00	1.99	0.00	1.00	0.00	0.42

2) Strengths of contractors in new transactions

(Actual number)

	White goods	Audio-video equipment and other consumer electronics	Automobiles	IT equipment	Production facilities	Medical and welfare-related equipment and devices	Other	Total
Capital ties and business affiliations	2	6	29	11	12	5	20	85
Stability of management	4	9	111	46	72	14	60	316
Development proposal ability	9	25	123	62	87	13	73	392
Quality of products and processing	12	53	280	142	232	31	191	941
Stability of quality	16	50	289	136	200	24	188	903
High-mix small lot production capability	13	37	187	89	184	23	130	663
Cost-cutting ability	12	32	139	73	66	9	83	414
Mass-production capability	7	27	165	66	56	5	77	403
Ability to take aggregated orders involving multiple processes	7	18	82	31	101	10	73	322
Ability to cater to quick deliveries	15	41	201	105	201	21	138	722
Reliable observance of delivery deadlines	12	35	206	99	173	19	142	686
Ability to cope with new technologies and materials	5	17	83	55	58	9	57	284
Proximity to client's business establishment	3	11	74	27	54	5	45	219
Ability to establish operations overseas	5	11	25	25	12	1	10	89
Other	0	1	16	5	7	0	3	32
Total	122	373	2,010	972	1,515	189	1,290	6,471

(Coefficient of specialization)

	White goods	Audio-video equipment and other consumer electronics	Automobiles	IT equipment	Production facilities	Medical and welfare-related equipment and devices	Other
Capital ties and business affiliations	1.25	1.22	1.10	0.86	0.60	2.01	1.18
Stability of management	0.67	0.49	1.13	0.97	0.97	1.52	0.95
Development proposal ability	1.22	1.11	1.01	1.05	0.95	1.14	0.93
Quality of products and processing	0.68	0.98	0.96	1.00	1.05	1.13	1.02
Stability of quality	0.94	0.96	1.03	1.00	0.95	0.91	1.04
High-mix small lot production capability	1.04	0.97	0.91	0.89	1.19	1.19	0.98
Cost-cutting ability	1.54	1.34	1.08	1.17	0.68	0.74	1.01
Mass-production capability	0.92	1.16	1.32	1.09	0.59	0.42	0.96
Ability to take aggregated orders involving multiple processes	1.15	0.97	0.82	0.64	1.34	1.06	1.14
Ability to cater to quick deliveries	1.10	0.99	0.90	0.97	1.19	1.00	0.96
Reliable observance of delivery deadlines	0.93	0.89	0.97	0.96	1.08	0.95	1.04
Ability to cope with new technologies and materials	0.93	1.04	0.94	1.29	0.87	1.09	1.01
Proximity to client's business establishment	0.73	0.87	1.09	0.82	1.05	0.78	1.03
Ability to establish operations overseas	2.98	2.14	0.90	1.87	0.58	0.38	0.56
Other	0.00	0.54	1.61	1.04	0.93	0.00	0.47

3) Features of contractors emphasized by clients when entering new business relationship

(Actual number)

	White goods	Audio-video equipment and other consumer electronics	Automobiles	IT equipment	Production facilities	Medical and welfare-related equipment and devices	Other	Total
Stability of management	23	62	414	177	366	46	493	1,581
Development proposal ability	11	25	123	70	113	12	220	574
Quality of products and processing	23	87	493	220	572	59	593	2,047
Stability of quality	31	92	536	247	587	72	727	2,292
High-mix small lot production capability	10	48	169	89	239	26	244	825
Cost-cutting ability	26	78	433	199	467	45	555	1,803
Mass-production capability	7	22	199	67	89	15	162	561
Ability to take aggregated orders involving multiple processes	1	15	61	24	78	7	61	247
Ability to cater to quick deliveries	21	73	294	165	481	47	446	1,527
Reliable observance of delivery deadlines	23	76	454	214	560	50	600	1,977
Ability to cope with new technologies and materials	6	20	98	73	114	17	163	491
Proximity to client's business establishment	6	13	105	49	120	12	113	418
Ability to establish operations overseas	3	8	23	15	13	1	20	83
Other	0	4	14	2	9	2	19	50
Total	191	623	3,416	1,611	3,808	411	4,416	14,476

(Coefficient of specialization)

	White goods	Audio-video equipment and other consumer electronics	Automobiles	IT equipment	Production facilities	Medical and welfare-related equipment and devices	Other
Stability of management	1.10	0.91	1.11	1.01	0.88	1.02	1.02
Development proposal ability	1.45	1.01	0.91	1.10	0.75	0.74	1.26
Quality of products and processing	0.85	0.99	1.02	0.97	1.06	1.02	0.95
Stability of quality	1.03	0.93	0.99	0.97	0.97	1.11	1.04
High-mix small lot production capability	0.92	1.35	0.87	0.97	1.10	1.11	0.97
Cost-cutting ability	1.09	1.01	1.02	0.99	0.98	0.88	1.01
Mass-production capability	0.95	0.91	1.50	1.07	0.60	0.94	0.95
Ability to take aggregated orders involving multiple processes	0.31	1.41	1.05	0.87	1.20	1.00	0.81
Ability to cater to quick deliveries	1.04	1.11	0.82	0.97	1.20	1.08	0.96
Reliable observance of delivery deadlines	0.88	0.89	0.97	0.97	1.08	0.89	0.99
Ability to cope with new technologies and materials	0.93	0.95	0.85	1.34	0.88	1.22	1.09
Proximity to client's business establishment	1.09	0.72	1.06	1.05	1.09	1.01	0.89
Ability to establish operations overseas	2.74	2.24	1.17	1.62	0.60	0.42	0.79
Other	0.00	1.86	1.19	0.36	0.68	1.41	1.25

4) Reasons (needs) of clients for terminating subcontracting relations

(Actual number)

	White goods	Audio-video equipment and other consumer electronics	Automobiles	IT equipment	Production facilities	Medical and welfare-related equipment and devices	Other	Total
Capital ties and business affiliations	0	1	1	0	1	0	1	4
Stability of management	1	4	36	13	31	2	31	118
Development proposal ability	2	3	6	2	8	0	10	31
Quality of products and processing	2	10	52	28	73	13	65	243
Stability of quality	3	16	108	48	120	17	92	404
High-mix small lot production capability	2	6	23	16	27	4	21	99
Cost-cutting ability	3	18	85	47	113	15	96	377
Mass-production capability	4	6	32	9	13	2	21	87
Ability to take aggregated orders involving multiple processes	2	1	7	3	11	0	8	32
Ability to cater to quick deliveries	3	12	53	30	88	8	60	254
Reliable observance of delivery deadlines	3	13	64	30	101	11	76	298
Ability to cope with new technologies and materials	2	2	11	10	24	0	13	62
Proximity to client's business establishment	0	1	3	1	8	1	10	24
Ability to establish operations overseas	0	2	1	6	1	0	1	11
Other	1	0	9	9	12	2	18	51
Total	28	95	491	252	631	75	523	2,095

(Coefficient of specialization)

	White goods	Audio-video equipment and other consumer electronics	Automobiles	IT equipment	Production facilities	Medical and welfare-related equipment and devices	Other
Capital ties and business affiliations	0.00	5.51	1.07	0.00	0.83	0.00	1.00
Stability of management	0.63	0.75	1.30	0.92	0.87	0.47	1.05
Development proposal ability	4.83	2.13	0.83	0.54	0.86	0.00	1.29
Quality of products and processing	0.62	0.91	0.91	0.96	1.00	1.49	1.07
Stability of quality	0.56	0.87	1.14	0.99	0.99	1.18	0.91
High-mix small lot production capability	1.51	1.34	0.99	1.34	0.91	1.13	0.85
Cost-cutting ability	0.60	1.05	0.96	1.04	1.00	1.11	1.02
Mass-production capability	3.44	1.52	1.57	0.86	0.50	0.64	0.97
Ability to take aggregated orders involving multiple processes	4.68	0.69	0.93	0.78	1.14	0.00	1.00
Ability to cater to quick deliveries	0.88	1.04	0.89	0.98	1.15	0.88	0.95
Reliable observance of delivery deadlines	0.75	0.96	0.92	0.84	1.13	1.03	1.02
Ability to cope with new technologies and materials	2.41	0.71	0.76	1.34	1.29	0.00	0.84
Proximity to client's business establishment	0.00	0.92	0.53	0.35	1.11	1.16	1.67
Ability to establish operations overseas	0.00	4.01	0.39	4.53	0.30	0.00	0.36
Other	1.47	0.00	0.75	1.47	0.78	1.10	1.41

Appended Note 2-3-3 Factor analysis

- Combined dispersion explained

Factor	Initial eigenvalue			Loaded sum of squares		
	Total	% of dispersion	Cumulative %	Total	% of dispersion	Cumulative %
1	4.228986	42.28986	42.28986	3.769532	37.69532	37.69532
2	1.335548	13.35548	55.64534	0.691585	6.915854	44.61118
3	0.852978	8.52978	64.17513			
4	0.832591	8.325914	72.50104			
5	0.720174	7.201742	79.70279			
6	0.638577	6.385769	86.08856			
7	0.521459	5.214591	91.30315			
8	0.384591	3.845912	95.14906			
9	0.267908	2.679083	97.82814			
10	0.217186	2.171859	100			

- Factor matrix

	Factor	
	1	2
Information from subcontractor	0.199923	0.305253
Information from regular customer	0.337203	0.544499
Information from one-off customer	0.429978	0.353017
Information from interaction with other companies in same industry	0.36962	0.23386
Information from interaction with other industries	0.622657	0.108802
Information from collaboration with university	0.757900	-0.128642
Information from collaboration with public experimental research institution	0.785726	-0.140300
Information from mass media (newspapers, magazines, etc.)	0.765829	-0.141318
Information from specialist journals and papers	0.796616	-0.215943
Information from Internet	0.702700	-0.089121

These results indicate that whereas factor 1 is strongly influenced by information from non-ordinary business channels and open sources, factor 2 is affected by information obtained via ordinary business channels, but is negatively affected by information from non-ordinary business channels and open sources. Based on this, factor 1 may be interpreted as consisting of action to develop new technologies, and factor 2 as responding to the needs of existing customers, and it may be surmised from this that the selection and use of information is affected by differences in the direction of development pursued by enterprises.

- Factor 1

Key statistical values

Cronbach's alpha	Cronbach's alpha based on standardized terms	Number of terms
0.8426	0.8412	9

Correlation matrix

	Information from regular customer	Information from one-off customer	Information from interaction with other companies in same industry	Information from interaction with other industries	Information from collaboration with university	Information from collaboration with public experimental research institution	Information from mass media (newspapers, magazines, etc.)	Information from specialist journals and papers	Information from Internet
Information from regular customer	1								
Information from one-off customer	0.3529	1							
Information from interaction with other companies in same industry	0.2263	0.2039	1						
Information from interaction with other industries	0.2028	0.3316	0.3347	1					
Information from collaboration with university	0.1699	0.2725	0.2134	0.515	1				
Information from collaboration with public experimental research institution	0.1916	0.2715	0.2459	0.4769	0.7750	1			
Information from mass media (newspapers, magazines, etc.)	0.1825	0.2837	0.2615	0.4168	0.5365	0.5638	1		
Information from specialist journals and papers	0.1716	0.2416	0.2367	0.4182	0.5771	0.6134	0.7193	1	
Information from Internet	0.1796	0.279	0.2326	0.4349	0.4510	0.5043	0.6112	0.6369	1

Combined statistical value of terms

	Mean of scale in case of deletion of term	Dispersion of scale in case of deletion of term	Corrected term combined correlation	Square of multiple correlation	Cronbach's alpha in case of deletion of term
Information from regular customer	21.5033	37.2049	0.299	0.1555	0.8511
Information from one-off customer	22.2735	35.6645	0.4046	0.2196	0.8417
Information from interaction with other companies in same industry	21.8621	36.0211	0.3515	0.1563	0.8479
Information from interaction with other industries	22.3435	33.3162	0.5884	0.3764	0.8227
Information from collaboration with university	22.7717	32.4595	0.6701	0.6419	0.8138
Information from collaboration with public experimental research institution	22.7141	32.0189	0.6979	0.654	0.8104
Information from mass media (newspapers, magazines, etc.)	22.5244	32.3956	0.6841	0.5815	0.8123
Information from specialist journals and papers	22.4989	32.1057	0.6923	0.6239	0.8111
Information from Internet	22.3136	32.7862	0.6306	0.4843	0.818

- Factor 2
Key statistical values

Cronbach's alpha	Cronbach's alpha based on standardized terms	Number of terms
0.5226	0.5288	3

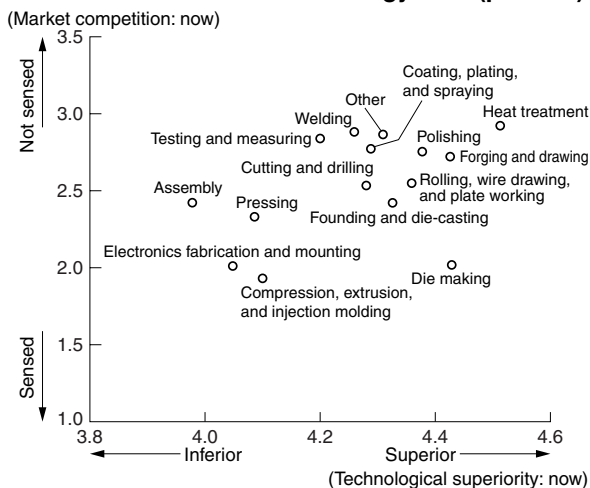
Correlation matrix

	Subcontractor	Regular customers	One-off customers
Subcontractor	1		
Regular customers	0.2714	1	
One-off customers	0.1780	0.3672	1

Combined statistical value of terms

	Mean of scale in case of deletion of term	Dispersion of scale in case of deletion of term	Corrected term combined correlation	Square of multiple correlation	Cronbach's alpha in case of deletion of term
Information from regular customer	6.4164	2.9612	0.2704	0.0808	0.5367
Information from one-off customer	6.2616	2.8905	0.4136	0.1787	0.3016
Information from interaction with other companies in same industry	7.0042	2.9805	0.3343	0.1415	0.4244

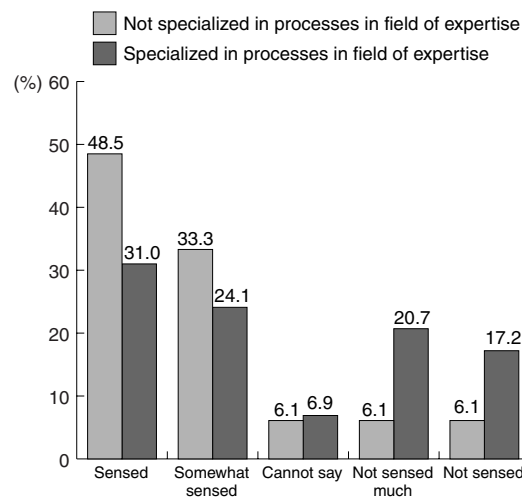
Appended Note 2-3-4 Extent of technological superiority and market competition in each core technology field (present)



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

- Notes:
- Manufacturers and processors of parts, semi-finished products, and formed and fabricated materials with 300 or fewer workers.
 - Regarding their core field of technology, enterprises were asked whether they presently sensed market competition due to the influx of East Asian products in the domestic market (5. No, 4. Not much, 3. Neither, 2. Somewhat, 1. Yes) and whether they were technologically superior to East Asian enterprises (5. Superior, 4. Somewhat superior, 3. Neither, 2. Somewhat inferior, 1. Inferior).

Appended Note 2-3-5 Market competition among die manufacturers in automobile group (now)



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

- Notes:
- Manufacturers and processors of automobile and production facility-related parts, semi-finished products, and formed and fabricated materials with 300 or fewer workers.
 - Enterprises were categorized according to whether they specialized in processes in fields of expertise based on their responses regarding their implementation of business policy in the past 10 years.

Appended Note 2-3-6 Technological superiority and sources of strengths

1. Model

- Dependent variables:
- Technological superiority (5 years ago) (superior = 5, somewhat superior = 4, cannot say = 3, somewhat inferior = 2, inferior = 1)
 - Technological superiority (now) (superior = 5, somewhat superior = 4, cannot say = 3, somewhat inferior = 2, inferior = 1)
 - Technological superiority (5 years hence) (superior = 5, somewhat superior = 4, cannot say = 3, somewhat inferior = 2, inferior = 1)

- Explanatory variables: 1) Number of workers (natural log)
 2) Related end products dummy (reference category: automobiles)
 3) Core technology field (reference category: pressing)
 4) Level of market competition (corresponding time: not felt = 5, not felt much = 4, neither = 3, somewhat felt = 2, felt = 1)
 5) Source of technological superiority (reference category: manufacturing equipment (commercial products including custom-made))

2. Data set

Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

3. Results of estimates (estimated by least squares method)

Adjusted RSQ = 0.0211 Adjusted RSQ = 0.0677 Adjusted RSQ = 0.1190

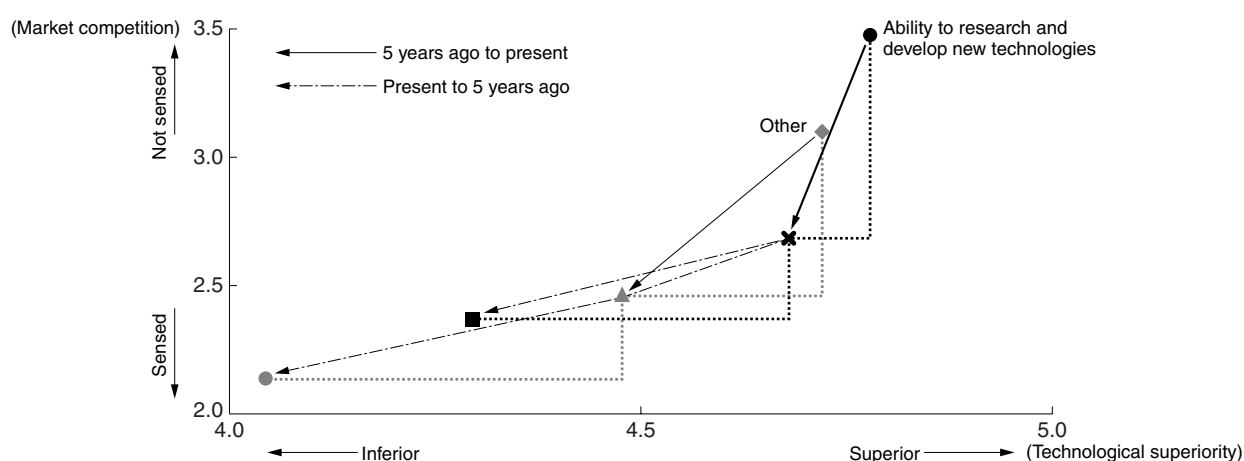
	Technological superiority (5 years ago)			Technological superiority (now)			Technological superiority (5 years hence)		
	Estimated coefficient	Standard error	Significance level	Estimated coefficient	Standard error	Significance level	Estimated coefficient	Standard error	Significance level
Number of workers	0.113	0.009		0.021	0.146		0.027	0.022	
White goods dummy	-0.157	0.102		0.067	0.100		-0.076	0.153	
Audio-video equipment and other consumer electronics dummy	0.813	0.612		0.650	0.617		-0.059	0.095	
IT equipment dummy	0.140	0.435	***	0.096	0.043	**	0.007	0.067	
Production facilities dummy	0.181	0.373		-0.007	0.037		-0.050	0.057	
Medical and welfare-related equipment and devices dummy	0.177	0.892	**	0.110	0.089		0.036	0.138	
Other products dummy	0.012	0.384		0.043	0.038		-0.044	0.059	
Founding and die-casting dummy	0.108	0.702		0.155	0.070	**	0.264	0.108	**
Forging and drawing dummy	0.178	0.812	**	0.188	0.081	**	0.086	0.124	
Welding dummy	0.119	0.676	*	0.140	0.068	**	0.108	0.103	
Compression, extrusion, and injection dummy	0.056	0.604		-0.014	0.061		0.014	0.093	
Coating, plating, and spraying dummy	0.141	0.649	**	0.038	0.065		0.056	0.100	
Rolling, wire drawing, and plate working dummy	0.123	0.950		0.112	0.095		0.182	0.146	
Cutting and drilling dummy	0.961	0.961	*	0.111	0.052	**	0.153	0.080	*
Polishing dummy	0.162	0.847	*	0.144	0.085	*	0.144	0.129	
Assembly dummy	0.026	0.609		0.021	0.061		0.035	0.093	
Electronics fabrication and mounting dummy	1.000	0.736		-0.125	0.074	*	-0.080	0.113	
Heat treatment dummy	0.221	0.908	**	0.221	0.091	**	0.268	0.139	*
Die-making dummy	0.153	0.660	**	0.274	0.066	***	0.291	0.101	***
Testing and measuring dummy	0.138	0.112		0.145	0.112		-0.133	0.171	
Other technologies dummy	0.112	0.606	*	0.108	0.061	*	0.169	0.093	*
Level of market competition	0.024	0.009	***	0.064	0.009	***	0.181	0.015	***
Manufacturing equipment (developed by own company) dummy	0.176	0.536	***	0.143	0.054	***	0.128	0.082	
Workers' skills dummy	0.597	0.404		0.0612	0.040		0.096	0.062	
R&D on new technologies dummy	0.108	0.502	**	0.143	0.536	***	0.285	0.077	***
Other sources dummy	0.038	0.639		0.054	0.064		0.062	0.098	
Constant term	4.431	0.810	***	4.089	0.080	***	3.402	0.122	***
Sample size	1,389			1,392			1,382		

***= 1% significance level **= 5% significance level *= 10% significance level

Appended Note 2-3-7 Supplementation regarding sources of superiority to East Asian enterprises and trends in technological superiority and market competition

Fig. 2-3-29 showed that the proportion of enterprises responding that their superiority derived from “ability to research and develop new technologies” increases with enterprise size, and conversely that the proportion of enterprises responding “skills of employees” increases as enterprise size declines. In order to test for the possibility that the results of Fig. 2-3-23 were affected by “enterprise size bias” (i.e., both technological superiority and market competitiveness are both on the high side due to the large number of comparatively large enterprises among enterprises with an edge in “ability to research and develop new technologies”), therefore, the following figure was plotted.

This shows that even if considering only small-sized enterprises with 50 or fewer employees, enterprises whose superiority derived from “ability to research and develop new technologies” exhibit both higher technological superiority and greater market competitiveness.



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey of Recent Changes in Business Relations in Manufacturing* (November 2005).

- Notes:
1. Enterprises with 50 or fewer workers that manufacture or process parts/semi-finished products or formed and fabricated materials and responded that they were currently technologically "superior" or "somewhat superior" to East Asian enterprises.
 2. Comparison of trends in technological superiority and market competition according to source of technological superiority to East Asian enterprises.
 3. "Other" is the combined total of enterprises that responded that their technological superiority to East Asian enterprises derived from "performance of manufacturing equipment and machine tools (developed or modified by own company)," "performance of manufacturing equipment and machine tools (commercial products including custom-made)," and "employees' skills."

Appended Note 2-4-1 Actual value of shipments of manufactured goods

(Unit: ¥ million)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Hiroshima	3,345,146	3,158,906	2,842,031	2,639,824	2,456,599	2,566,427	2,523,073	2,263,192	2,082,481	2,062,363	1,909,942	1,807,693	1,911,360
Kitakyushu	2,723,918	2,586,868	2,375,152	2,261,350	2,282,599	2,304,812	2,409,847	2,155,096	1,941,564	1,958,631	1,843,385	1,560,533	1,580,028
Sabae	730,982	689,074	643,479	630,241	642,750	644,048	676,290	631,121	620,803	663,532	564,805	530,129	547,400
Tsubame-Sanjo	472,854	459,738	430,970	408,030	425,439	448,682	450,170	396,790	357,900	362,786	351,257	335,389	331,306
Ota	2,120,869	2,036,762	2,004,912	2,029,637	2,096,680	2,265,777	2,424,147	2,334,520	2,415,164	2,301,010	2,304,537	2,078,119	2,077,628
Suwa	634,424	582,296	518,462	465,510	484,029	456,837	471,424	447,097	419,004	449,840	409,841	355,622	343,738
Hamamatsu	2,173,520	2,120,579	1,998,642	1,919,940	1,965,927	1,933,968	2,115,018	2,064,133	2,048,075	2,016,425	1,975,244	1,931,381	1,925,124
Higashiosaka	2,025,553	1,898,061	1,706,248	1,567,216	1,567,317	1,563,056	1,594,828	1,466,918	1,280,425	1,280,642	1,219,376	1,113,609	1,114,812
Kitakami	621,629	605,754	607,715	687,705	760,121	742,332	799,648	746,527	823,056	926,296	877,741	811,784	861,439
Kofu	792,818	690,202	626,724	624,689	677,012	689,349	697,933	642,008	632,263	679,611	585,173	534,024	556,227
National total	340,834,634	329,520,639	311,199,479	299,027,369	306,029,559	313,068,385	323,071,831	305,839,992	291,449,554	300,477,604	286,667,406	269,361,805	273,734,436

Source: Recompiled from METI, *Census of Manufactures*.

Appended Note 2-4-2 Trends in number of workers in manufacturing by cluster region

(Unit: persons)

	1986	1991	1994	1996	1999	2001	2004
Hiroshima	101,022	102,836	102,993	89,458	81,843	75,695	69,309
Kitakyushu	96,157	86,056	83,294	81,272	69,119	65,186	55,887
Sabae	38,074	40,837	37,778	35,044	34,038	32,719	29,184
Tsubame-Sanjo	32,487	32,368	31,234	30,662	27,612	26,280	24,158
Ota	53,270	55,466	51,414	55,363	54,299	53,827	46,972
Suwa	33,530	31,923	28,804	26,904	24,936	25,817	22,531
Hamamatsu	111,432	100,201	94,777	88,873	84,304	82,798	77,536
Higashiosaka	105,726	106,154	96,101	97,316	84,494	78,755	74,207
Kitakami	27,761	31,977	31,756	32,451	31,895	32,911	31,693
Kofu	25,853	27,236	26,322	27,156	23,269	23,232	21,732
National total	13,176,051	13,904,019	13,123,945	12,744,465	11,280,992	10,956,750	9,940,449

Source: Recompiled from MIC, *Establishment and Enterprise Census of Japan*.

Appended Note 2-4-3 Manufacturing industry (medium group) abbreviations

Industry		Abbreviation	Industry		Abbreviation
09	Food	Food	22	Ceramic, stone, and clay products	Ceramics, etc.
10	Drinks, tobacco, and animal feed		23	Iron and steel	Iron and steel
11	Textiles	Textiles	24	Non-ferrous metals and products	Nonferrous metals
12	Apparel and other textile products	Apparel	25	Fabricated metal products	Metals
13	Wood and wood products	Wood	26	General machinery	General machinery
14	Furniture and fixtures	Furniture	27	Electrical machinery and equipment	Telecoms
15	Pulp, paper, and paper products	Paper and pulp			
16	Printing and allied industries	Printing	28	Information and communications machinery and equipment	
17	Chemicals	Chemicals			
18	Petroleum and coal products	Petroleum	29	Electric components and devices	Electronics
19	Plastic products	Plastics	30	Transportation equipment	Transport
20	Rubber products	Rubber	31	Precision instruments and machinery	Precision instruments
21	Leather tanning, leather products, and fur skins	Leather	32	Other manufacturing industries	Other

Appended Note 3-1-1 Trends in total fertility rates of major countries

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Japan	1.50	1.42	1.43	1.39	1.38	1.34	1.36	1.33	1.32	1.29
U.K.	1.75	1.71	1.73	1.72	1.71	1.69	1.64	1.63	1.64	1.71
Germany	1.24	1.25	1.31	1.36	1.36	1.36	1.38	1.35	1.31	1.34
Italy	1.22	1.19	1.19	1.18	1.20	1.23	1.24	1.23	1.26	1.29
France	1.65	1.71	1.72	1.71	1.76	1.79	1.88	1.84	1.89	1.89
U.S.	2.04	2.02	1.98	2.04	2.06	2.01	2.13	2.03	2.01	2.04

Source: United Nations Department of Economic and Social Affairs, *Demographic Yearbook 2005 (Revised)*; TFR for Japan only calculated by the National Institute of Population and Social Security Research.

Appended Note 3-1-2 Trends in total populations of major countries

(Unit: 1,000 persons)

	1980	1985	1990	1995	2000	2005	2010	2015	2020	2025
Japan	116,807	120,837	123,537	125,472	126,843	127,914	127,998	127,224	125,617	123,444
U.K.	55,530	56,008	56,761	58,612	59,756	59,598	60,392	61,275	62,274	63,287
Germany	78,289	77,685	79,433	81,661	82,183	82,560	82,575	82,497	82,294	81,959
Italy	56,434	56,593	56,719	57,301	57,762	57,253	56,560	55,507	54,264	52,939
France	53,880	55,284	56,735	57,844	58,893	60,711	61,889	62,841	63,597	64,165
U.S.	231,428	243,484	255,712	263,044	275,265	300,038	314,921	329,669	344,276	358,030

Source: United Nations Department of Economic and Social Affairs, *Demographic Yearbook 2005 (Revised)*.

Notes: Figures for 2005 onward are "middle estimates" of the demographic changes in each country.

Appended Note 3-1-3 Method of calculation of contribution to annual average rate of growth in number of employed persons

$$L_t = \sum_{i=1}^2 P_{i,t} \times r_{i,t}$$

$$\frac{dL_t}{L_t} = \sum_{i=1}^2 \omega_i \left(\frac{dP_{i,t}}{P_{i,t}} + \frac{dr_{i,t}}{r_{i,t}} \right)$$

This is discretely approximated thus.

$$\frac{\Delta L_t}{L_t} = \sum_{i=1}^2 \frac{1}{2} (\omega_{i,t} + \omega_{i,t+1}) \left(\frac{\Delta P_{i,t}}{P_{i,t}} + \frac{\Delta r_{i,t}}{r_{i,t}} \right)$$

$$\omega_i = \frac{P_{i,t} \times r_{i,t}}{L_t}, \Delta L_t = L_{t+1} - L_t, \Delta P_{i,t} = P_{i,t+1} - P_{i,t}, \Delta r_{i,t} = r_{i,t+1} - r_{i,t}$$

where

L_t : total number of employed persons at time t

$P_{i,t}$: population of males ($i=1$) and females ($i=2$) at time t

$r_{i,t}$: labor force participation rate of males and females at time t

Appended Note 3-1-4 Labor force participation rates used to calculate future number of employed persons in case of change in labor force participation rate

(1) In case of gradual recovery in labor force participation rate to level in 1992 by 2015

1) Males

	15–19 years	20–29 years	30–39 years	40–49 years	50–59 years	60–64 years	65 years and over
2002	0.167	0.784	0.936	0.943	0.911	0.658	0.336
2005	0.167	0.784	0.936	0.943	0.911	0.658	0.336
2010	0.171	0.797	0.945	0.951	0.921	0.674	0.354
2015	0.176	0.810	0.954	0.959	0.931	0.691	0.372
2020	0.180	0.823	0.962	0.966	0.941	0.707	0.390
2025	0.185	0.836	0.971	0.974	0.951	0.723	0.408

2) Females

	15–19 years	20–29 years	30–39 years	40–49 years	50–59 years	60–64 years	65 years and over
2002	0.173	0.680	0.588	0.705	0.630	0.395	0.148
2005	0.173	0.680	0.588	0.705	0.630	0.395	0.148
2010	0.173	0.680	0.587	0.708	0.630	0.399	0.154
2015	0.173	0.681	0.587	0.712	0.629	0.403	0.161
2020	0.173	0.681	0.586	0.715	0.629	0.407	0.168
2025	0.173	0.681	0.586	0.718	0.628	0.411	0.175

(2) In case of increase in labor force participation rate of females aged 20-39 and elderly aged 60-64 by 0.5% each year

1) Males

	15–19 years	20–29 years	30–39 years	40–49 years	50–59 years	60–64 years	65 years and over
2002	0.167	0.784	0.936	0.943	0.911	0.658	0.336
2005	0.167	0.784	0.936	0.943	0.911	0.658	0.336
2010	0.167	0.784	0.936	0.943	0.911	0.683	0.336
2015	0.167	0.784	0.936	0.943	0.911	0.708	0.336
2020	0.167	0.784	0.936	0.943	0.911	0.733	0.336
2025	0.167	0.784	0.936	0.943	0.911	0.758	0.336

2) Females

	15–19 years	20–29 years	30–39 years	40–49 years	50–59 years	60–64 years	65 years and over
2002	0.173	0.680	0.588	0.705	0.630	0.395	0.148
2005	0.173	0.680	0.588	0.705	0.630	0.395	0.148
2010	0.173	0.705	0.613	0.705	0.630	0.420	0.148
2015	0.173	0.730	0.638	0.705	0.630	0.445	0.148
2020	0.173	0.755	0.663	0.705	0.630	0.470	0.148
2025	0.173	0.780	0.688	0.705	0.630	0.495	0.148

Appended Note 3-1-5 Data used to calculate future labor force population in case of change in total fertility rate

(1) TFR simulated according to the National Institute of Population and Social Security Research's "Population Estimates Database"

	2005	2010	2015	2020	2025	2030	2035	2040	2045	2050
Decline to 1.29	1.33	1.32	1.32	1.31	1.31	1.31	1.30	1.30	1.29	1.29
Recovery to 1.39	1.34	1.34	1.35	1.35	1.36	1.37	1.37	1.38	1.38	1.39
Recovery to 2.08	1.40	1.48	1.55	1.63	1.70	1.78	1.85	1.93	2.01	2.08
Recovery to 2.5	1.45	1.56	1.68	1.80	1.91	2.03	2.15	2.27	2.38	2.50

(2) Total population simulated according to the National Institute of Population and Social Security Research's "Population Estimates Database"

(Unit: 1,000 persons)

	2005	2010	2015	2020	2025	2030	2035	2040	2045	2050
Decline to 1.29	127,363	126,501	124,152	120,561	116,125	111,083	105,605	100,088	94,531	88,784
Recovery to 1.39	127,384	126,585	124,323	120,849	116,550	111,669	106,390	101,103	95,802	90,327
Recovery to 2.08	127,535	127,157	125,523	122,830	119,475	115,747	111,885	108,305	104,958	101,656
Recovery to 2.5	127,627	127,505	126,251	124,036	121,258	118,245	115,295	112,856	110,870	109,145

Appended Note 3-1-6 Trends in average age of representative director by amount of capital

(Unit: year, month)

	1985	1990	1995	2000	2001	2002	2003	2004
Average for all presidents	53.01	54.00	56.01	57.06	57.09	57.11	58.02	58.06
Under ¥10 million	52.07	53.06	55.06	56.02	56.06	56.08	56.11	57.04
Under ¥50 million	54.10	54.11	56.01	57.06	57.09	58.00	58.03	58.06
Under ¥100 million	57.01	57.00	58.03	58.08	58.08	58.09	58.09	58.11
Under ¥500 million	59.04	59.00	59.12	60.00	59.08	59.06	59.06	59.08
Under ¥1 billion	61.06	61.02	62.05	62.00	61.09	61.10	62.00	62.03
¥1 billion and over	62.02	62.00	62.11	63.02	62.11	62.10	62.11	63.00

Source: Teikoku Databank, Ltd., *Survey of the Proportion of Presidents Changed*.

Note: The decimal numbers represent the number of months.

Appended Note 3-1-7 Total fertility rate by prefecture in 2004

1st-10th		11th-20th		21st-30th		31st-40th		41st-47th	
Okinawa	1.72	Fukui	1.45	Yamanashi	1.36	Ehime	1.33	Osaka	1.20
Miyazaki	1.52	Kagawa	1.43	Yamaguchi	1.36	Tokushima	1.31	Kanagawa	1.20
Fukushima	1.51	Iwate	1.43	Ishikawa	1.35	Gifu	1.31	Saitama	1.20
Tottori	1.50	Nagano	1.42	Aomori	1.35	Akita	1.30	Hokkaido	1.19
Saga	1.49	Shiga	1.41	Gunma	1.35	Kochi	1.30	Nara	1.16
Shimane	1.48	Oita	1.40	Niigata	1.34	Wakayama	1.28	Kyoto	1.14
Yamagata	1.47	Okayama	1.38	Mie	1.34	Fukuoka	1.25	Tokyo	1.01
Kumamoto	1.47	Toyama	1.37	Aichi	1.34	Hyogo	1.24		
Nagasaki	1.46	Tochigi	1.37	Hiroshima	1.33	Miyagi	1.24		
Kagoshima	1.46	Shizuoka	1.37	Ibaraki	1.33	Chiba	1.22		

Source: Compiled based on MHLW, *Vital Statistics*.

Appended Note 3-1-8 Economic ripple effect of “lifestyle support service industry” on other industries based on Industry Statistics by Size 2003

(Unit: ¥ million)

	Large enterprises	SMEs	Total
Manufacturing	627,002	1,105,399	1,732,401
Commerce	337,181	214,419	551,601
Business services	262,720	601,323	864,043
Personal services	21,351	139,798	161,149
Other	—	—	1,853,222
Total ripple effect on other industries	—	—	5,162,416

Note: As the ripple effect on industries other than manufacturing, commerce, and services cannot be broken down into the effect on large enterprises and the effect on SMEs, the total effect is shown under “other” in the table.

Appended Note 3-2-1 Method of estimation of jobs lost due to exits caused by absence of successor

The annual number of exits and annual number of regular employees of exiting enterprises broken down into SMEs and large enterprises based on the results of MIC’s *Establishment and Enterprise Census of Japan (2004)* (Fig. 1) worked out as follows.

Fig. 1) Annual number of exits and annual number of regular employees of exiting enterprises (private, non-primary industry)

		01 (0 employees)	02 1-4 employees	03 5-9 employees	04 10-19 employees	05 20-29 employees	06 30-49 employees	07 50-99 employees	08 100-199 employees	09 200-299 employees	10 300-499 employees	11 500-999 employees	12 1,000+ employees	Total
SMEs	Number of exits	139,971	116,832	29,729	15,566	4,968	3,616	2,508	987	303	165	81	40	174,794
	Number of regular employees of exiting enterprises	0	229,868	192,174	207,455	117,172	135,918	171,198	133,942	73,128	61,292	54,269	77,208	1,453,623
Large enterprises	Number of exits	0	0	0	0	0	0	93	267	113	165	162	140	938
	Number of regular employees of exiting enterprises	0	0	0	0	0	0	6,453	37,712	27,521	62,995	113,922	548,170	796,773
Total	Number of exits	139,971	116,832	29,729	15,566	4,968	3,616	2,600	1,254	416	329	243	180	175,732
	Number of regular employees of exiting enterprises	0	229,868	192,174	207,455	117,172	135,918	177,652	171,654	100,649	124,287	168,191	625,377	2,250,396

Source: Recompiled from MIC, *Establishment and Enterprise Census of Japan (2004)*.

Notes: 1. Totals exclude enterprises with zero workers.

2. The number of workers is as of October 2001, and is not necessarily the same as when an enterprise actually exits.

3. As these statistics cover a 32-month period, the above figures were obtained as follows: (aggregate for 2001-04) / (32 months) × (12 months)

The number of regular jobs lost as a result of the above exits due to the absence of a successor was estimated based on the following two hypotheses.

Hypothesis 1

Two scenarios were hypothesized regarding “exits due to retirement of proprietor”:

- 1) The “minimum scenario,” which assumed that such exits occurred only at small enterprises with 50 or fewer employees.
- 2) The “maximum scenario,” which assumed that such exits occurred at all SMEs, though not at large enterprises.

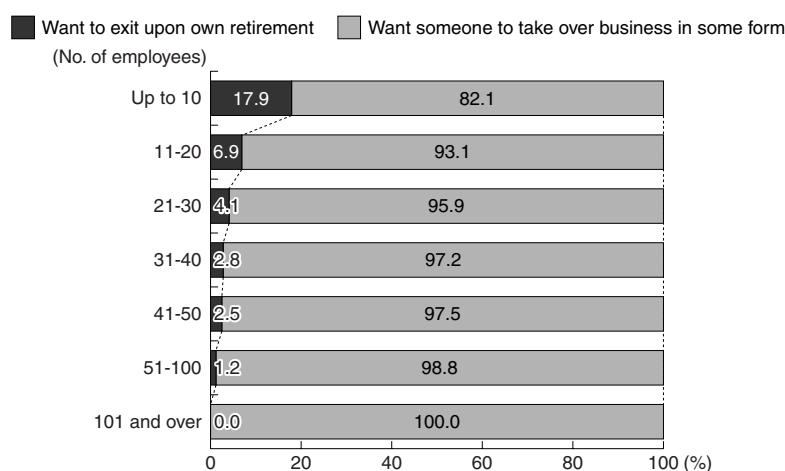
Hypothesis 2

It was hypothesized that 24.4% of enterprises of all sizes that “exit due to retirement of proprietor” do so due to having “no successor.”

Regarding hypothesis 1

According to the *Succession Questionnaire*, the proportion of proprietors who, given the choice of exiting upon their own retirement or having someone take over their business, said that they would choose the former declines as the number of employees increases, and is almost zero among enterprises with 50-100 employees.

Fig. 2) Proportion of enterprises considering exiting upon own retirement (by number of employees)



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey Regarding Business Successions and Transfer of Vocational Skills* (December 2005).

This appears to be a reflection of the fact that as enterprises grow, exits of enterprises due to the retirement of a single person, i.e., the proprietor, generally cease to occur.

The “minimum scenario” was therefore hypothesized on the assumption that exits due to the retirement of the proprietor would occur only at small enterprises with fewer than 50 employees.

In reality, however, it is conceivable that somewhat larger enterprises might be forced to exit when their proprietors retire, despite not initially intending to do so, due to business going downhill in the confusion following succession.

To account for this, then, the “maximum scenario” was designed assuming that exits due to the retirement of the proprietor could occur at all SMEs.

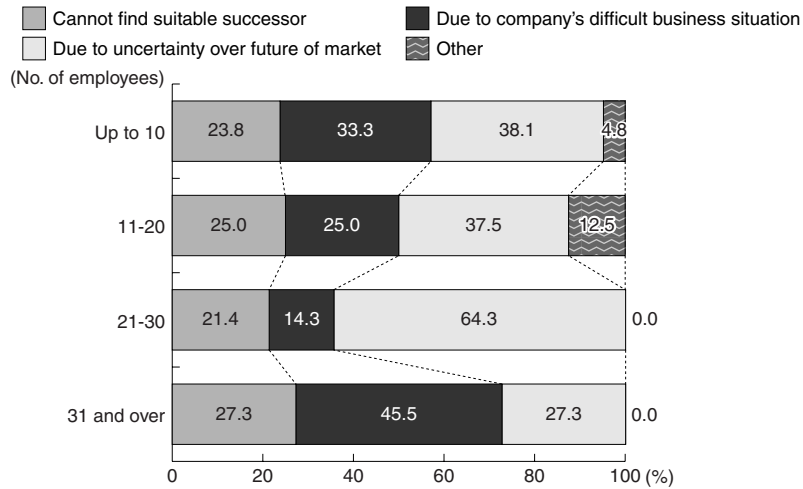
Large enterprises were excluded from the above estimates because their stakeholders are more dispersed, making it unlikely that an enterprise’s business would go downhill simple due to inheritance of ownership.

Regarding hypothesis 2

According to the results of the *Succession Questionnaire*, the proportion of enterprises responding “want to exit upon own retirement” that give as their reason “cannot find a suitable proprietor” is generally constant regardless of enterprise size (though allowance has to be made for the size of the sample).

Accordingly, estimates were calculated assuming the proportion of exits due to “absence of successor” to be 24.4% regardless of enterprise size.

Fig. 3) Reasons for considering exiting upon own retirement (by number of employees)



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey Regarding Business Successions and Transfer of Vocational Skills* (December 2005).

Based on the above hypotheses 1 and 2, the annual number of regular employee jobs lost due to exits caused by the absence of a successor works out as follows.

- (1) Minimum scenario
 $882,587$ (total number of regular employees at exiting enterprises with fewer than 50 employees) \times 24.4%
 (Fig. 3-2-2) = 215,351 Approximately 200,000

- (2) Maximum scenario
 $1,453,623$ (total number of regular employees at exiting enterprises) \times 24.4% (Fig. 3-2-2) = 354,684
Approximately 350,000

Appended Note 3-2-2 Number of sons, daughters, and sons-in-law, and criteria for selection of successor

Regardless of the number of sons, daughters, and sons-in-law (if any), “management ability” tends to outweigh “relationship by blood or marriage” as a principal determinant of successor among SME entrepreneurs.

Fig. 1) Presence of sons, daughters, and sons-in-law, and determinants of successor

	Related by blood or marriage	Compatibility with present proprietor	Management ability	Trusted by directors and employees	Trusted by financial institutions	Trusted by customers and suppliers
Overall	39.3	15.6	56.3	46.3	8.6	24.6
Has son(s)	41.2	14.8	51.0	43.2	8.2	22.8
Has daughter(s)	37.1	15.4	53.8	41.4	8.7	22.1
Has son(s)-in-law	37.9	15.5	56.9	48.3	10.3	26.7

- Notes:
1. Only enterprises wanting someone to take over their business in some form that responded “candidate available but successor not yet chosen” are included.
 2. Totals exceed 100 due to multiple responses.

Fig. 2) Total number of sons, daughters, and sons-in-law, and determinants of successor

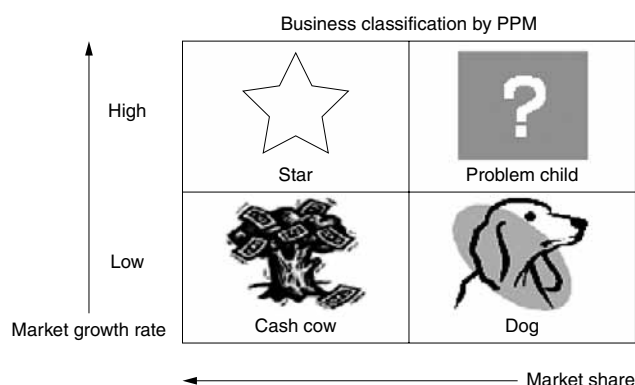
	Related by blood or marriage	Management ability
1	34.8	48.5
2	38.3	56.4
3	46.4	56.6
4 and over	46.5	52.3

Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey Regarding Business Successions and Transfer of Vocational Skills* (December 2005).

Appended Note 3-2-3 Classification of businesses according to PPM (Product Portfolio Management) by the Boston Consulting Group

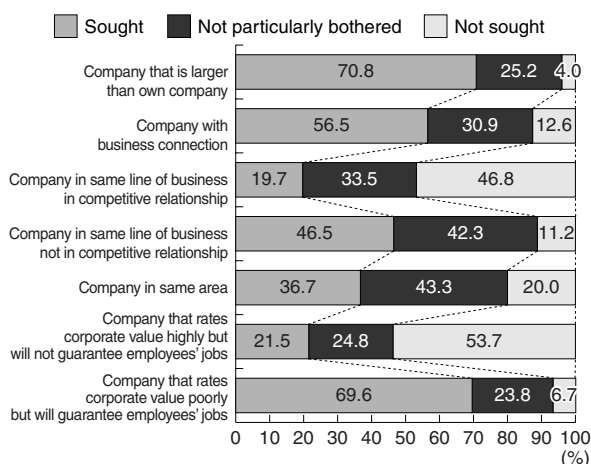
This is a method classifying one's own operations developed by the Boston Consulting Group in the 1960s. Operations are classified into the following four categories according to the market growth rate and the company's market share in each business.

- (1) Star: Business with both high market growth and high market share that will generate profit but requires injection of funds.
- (2) Cash cow: Business that will generate funds due to high market share despite low market growth.
- (3) Problem child: High market growth but low market share. Injection of considerable funds required to grow business, but uncertainty over whether this would yield returns in the future.
- (4) Dog: Business with lower market growth and low market share from which the company should withdraw.



Appended Note 3-2-4 Desired buyers in case of business sell-off

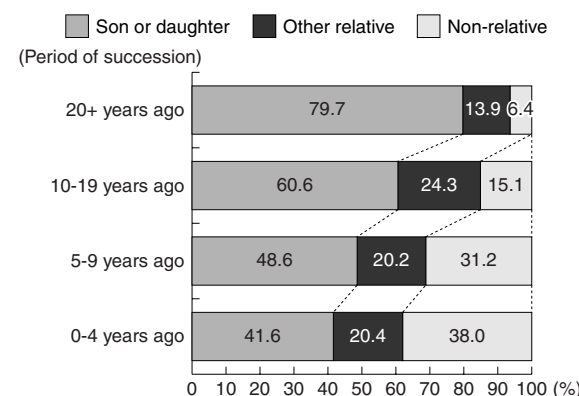
There is a marked preference for larger enterprises and enterprises that will guarantee employees' jobs



Source: Mitsubishi UFJ Research and Consulting Co., Ltd., *A Questionnaire Survey Regarding Business Successions and Transfer of Vocational Skills* (December 2005).
 Note: "Sought" is the combined total of "sought" and "somewhat sought," and "not sought" is the combined total of "not sought much" and "not sought."

Appended Note 3-2-5 Change in relationship with previous proprietor

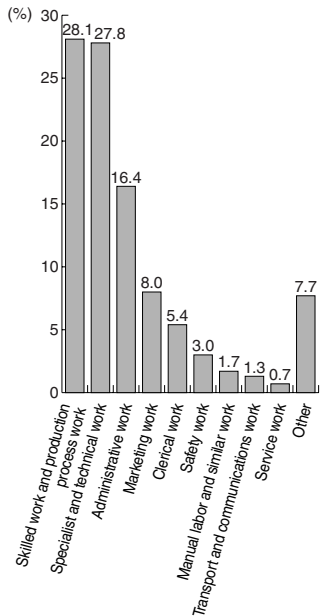
An examination of the relationship of successors to previous proprietors reveals that whereas over 20 years ago more than 90% were sons, daughters or other relatives, the proportion of non-relatives has now grown to almost 40%.



Source: Tokyo Shoko Research, Ltd., *Fact-finding Survey on the Education of Successors* (2003).

Appended Note 3-2-6 Job categories in which skills transfer is a particular concern

Fig. 1) Specific job categories
Need to transfer skills not limited to specific job category



Source: Japan Institute for Labour Policy and Training, *A Survey of Personnel Strategies and Job Consciousness at a Time of Population Decline* (December 2004).
Note: Non-responses are excluded from the above.

Fig. 2) Job categories in which skills transfer is a particular concern (by occupation)

(Unit: %)

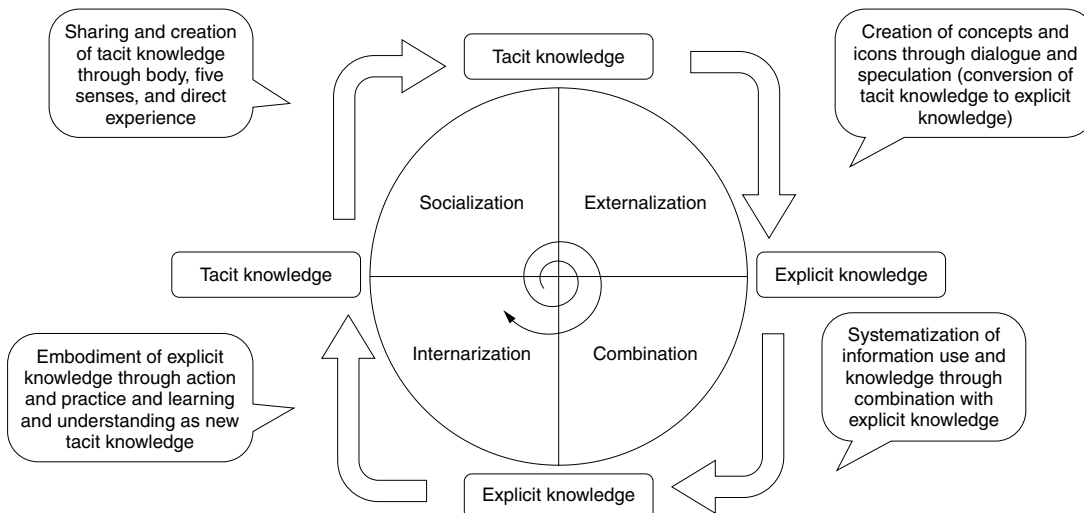
	Specialist and technical work	Administrative work	Clerical work	Marketing work	Service work	Safety work	Transport and communications work	Skilled work and production process work	Manual labor and similar work	Other
Overall	27.8	16.4	5.4	8.0	0.7	3.0	1.3	28.1	1.7	7.7
Construction	38.8	22.4	4.1	8.2	0.0	0.0	0.0	18.4	4.1	4.1
Manufacturing ³	28.0	5.9	4.2	2.5	0.0	1.7	0.0	49.2	0.0	8.5
Electricity, gas, heat supply, and water service	33.3	0.0	0.0	0.0	0.0	0.0	0.0	33.3	0.0	33.3
Information and communications	60.0	0.0	0.0	0.0	0.0	0.0	0.0	40.0	0.0	0.0
Transport	10.0	23.3	13.3	6.7	0.0	3.3	13.3	13.3	6.7	10.0
Wholesale and retail trades	6.1	24.2	6.1	33.3	6.1	6.1	0.0	9.1	0.0	9.1
Finance and insurance	28.6	42.9	7.1	7.1	0.0	0.0	0.0	0.0	0.0	14.3
Real estate	100.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Eating and drinking places, accommodations	50.0	0.0	0.0	0.0	0.0	0.0	0.0	50.0	0.0	0.0
Other services	39.5	23.7	5.3	5.3	0.0	10.5	0.0	13.2	0.0	2.6
Other	16.7	16.7	0.0	16.7	0.0	0.0	0.0	16.7	16.7	16.7

Source: Japan Institute for Labour Policy and Training, *A Survey of Personnel Strategies and Job Consciousness at a Time of Population Decline* (December 2004).

- Notes:
1. Non-responses are excluded from the totals in each category.
 2. "Medical, health care, and welfare" and "education and learning support" are not shown as there were no responses in these categories.
 3. Manufacturing is the combined total for "consumption related," "materials related," "machinery related," and "other manufacturing."

Appended Note 3-2-7 Knowledge creation process (SECI)

1. Process of conversion of personal tacit knowledge to organizational tacit knowledge (socialization)
2. Process of conversion of tacit knowledge to explicit knowledge using language and manuals (externalization)
3. Combination of explicit knowledge and explicit knowledge (combination)
4. Process of conversion of explicit knowledge to tacit knowledge (internalization)



Source: Nonaka and Konno, *The Advancement of Knowledge Management* (1999).

Appended Note 3-3-1 Process of development of flowchart for younger people

- (1) The proportion of each form of employment of new graduates was calculated by retabulating the results of MIC's *Employment Status Survey* (2002).
- (2) Based on the proportions of responses regarding "form of employment after graduation" and "form of employment" at present" of 30-34 year olds according to the Cabinet Office's *Opinion Survey of Young People* (2003), the forms of employment of 30-34 years olds were allocated proportionately to "non-employed," "non-permanent employee," and "permanent employee."
- (3) The proportion of 35-39 year olds with spouses and children was calculated by proportionately allocating "non-employed," "non-permanent employees," and "permanent employees" aged 30-34 based on the proportion of persons aged 35-39 with spouses and children calculated by retabulating the results of MIC's *Employment Status Survey* (2002).
- (4) The proportion of persons aged 35-39 with spouses and children was calculated by using as a basis the proportions of forms of employment of 30-34 year olds assuming there to be almost no change in form of employment upon entering one's thirties.

Appended Note 3-3-2 Comparison of forms of employment after graduation and at present

(Unit : %)

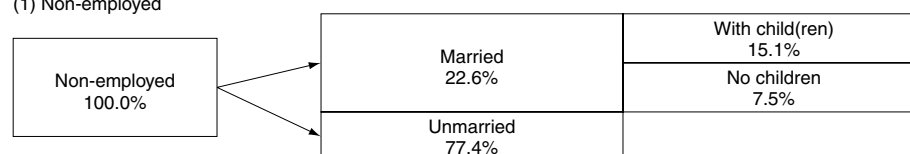
		Form of employment at present			
		Permanent employees	Non-permanent employees	Non-employed	Total
Form of employment after graduation	Permanent employees	77.7	19.0	3.3	100.0
	Non-permanent employees	57.4	31.9	10.6	100.0
	Non-employed	33.3	16.7	50.0	100.0

Source: Cabinet Office, *Survey of Opinion among Young People* (2003).

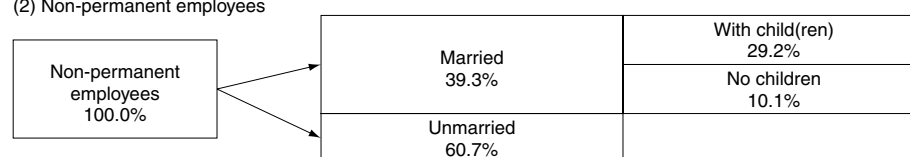
- Notes:
1. Persons aged 30-34 at the time of the survey.
 2. "Non-permanent employees" here refers to part-time and *arubaito* workers, and does not include dispatched workers provided by temporary employment agencies.
 3. "Non-employed" here does not include students or full-time homemakers.

Appended Note 3-3-3 Proportion of people with spouses and children by form of employment (35-39 year olds)

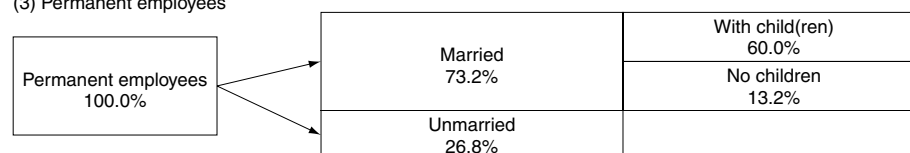
(1) Non-employed



(2) Non-permanent employees



(3) Permanent employees



Source: Recompiled from MIC, *Employment Status Survey* (2002).

- Notes:
1. "Non-employed" here excludes persons "engaged in housework" and persons "commuting to school, college or university" from "persons who are not working."
 2. "Non-permanent employees" here consists of persons who are "mainly working," excluding "employed persons" who are "permanent staff or employees."
 3. "Permanent employees" here refers to persons who are "mainly working" and are "employed persons" who are "permanent staff or employees."

Appended Note 3-3-4 Process of development of flowchart for women

- (1) The flow chart was produced based on MHLW, *Statistics on Employment Changes Before and After Having a Child*,

MHLW, *First Longitudinal Survey of Babies in the 21st Century*, and MHLW, *Third Longitudinal Survey of Babies in the 21st Century*.

- (2) In MHLW's *Statistics on Employment Changes Before and After Having a Child*, changes in the employment and withdrawal from employment one and a half years after birth of women with jobs one year before birth are categorized into the following five types: "continued employment," "temporary withdrawal," "withdrawal before birth," "withdrawal after birth," and "other." Below, the proportions of "continued employment" (31.0%), "temporary withdrawal" (17.8%), and "withdrawal before birth" (43.5%) were calculated excluding "other" from the overall total (100%).
- (3) The "withdrawal after birth" group (7.7%) was further divided into two. Hence, only those who were employed at the time of birth and who were not employed six months after birth were classed as "withdrawal after birth" (4.3%), and those who were employed six months after birth but not employed 18 months after birth were classed as "withdrawal after parental leave" (3.4%) (Fig. 1). Note that although women still on parental leave 18 months after birth are classified in the "continued employment" group, they do not necessarily actually return to the workforce after taking parental leave.

Fig. 1) Breakdown into the five types of employment and withdrawal from the workforce

12 months before birth: employed	100.0%
Continued employment	31.0%
Temporary withdrawal	17.8%
Withdrawal before birth	43.5%
Withdrawal after birth	4.3%
Withdrawal after parental leave	3.4%

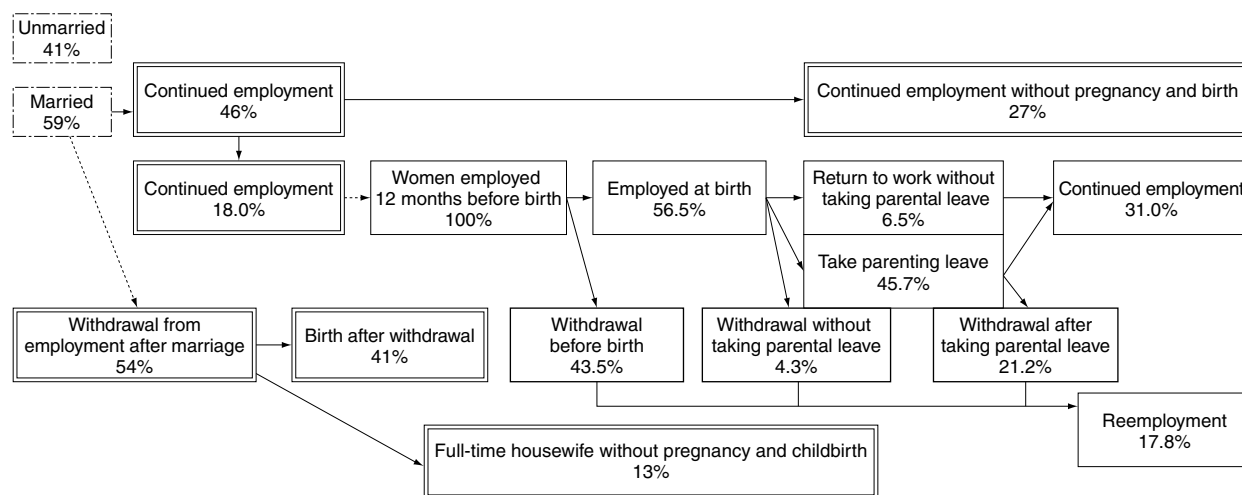
Source: Compiled by the Fujitsu Research Institute based on MHLW, *Statistics on Employment Changes Before and After Having a Child*.

- (4) The "proportion of women in employment at time of birth" was calculated by deducting the pre-birth withdrawal rate from the total ($100\% - 43.5\% = 56.5\%$).
- (5) According to MHLW's *First Longitudinal Survey of Babies in the 21st Century* (2001), the proportion of "women who took parental leave" among "women in employment at time of birth" was 80.8%. By then multiplying the proportion of "women in employment at time of birth" by the parental leave rate, the proportion of "women who took parental leave after birth" was calculated ($56.5\% \times 0.808 = 45.7\%$).
- (6) By deducting the proportion of "women who withdrew from employment after birth" and the proportion of "women who took parental leave after birth" from the proportion of "women in employment at time of birth," the proportion of "women who remained in employment after birth" was calculated ($56.5\% - 4.3\% - 45.7\% = 6.5\%$).
- (7) The proportion of women in employment six months after birth according to MHLW's *First Longitudinal Survey of Babies in the 21st Century* (2001) who were not in employment 30 months after birth according to the *Third Longitudinal Survey of Babies in the 21st Century* (2003) is 11.3%. The proportion of "women withdrawing from employment after parental leave" 30 months after birth was then corrected by combining the aforementioned "proportion of women continuing in employment after birth" and proportion of "women who took parental leave after birth, and multiplying them by the "non-employment rate 30 months after birth" ($6.5\% + 45.7\% = 52.2\%$, $52.2\% \times 0.113 = 5.9\%$).
- (8) The proportion of "women returning to employment after parental leave" was calculated by deducting the proportion of "women who withdrew from employment after birth" from the proportion of "women who took parental leave after birth" ($45.7\% - 5.9\% = 39.8\%$).
- (9) The proportion of "women who continued in employment after parental leave" was calculated by subtracting the proportion of "women who continued in employment after birth" from the proportion of "women who continued in employment" ($31.0\% - 6.5\% = 24.5\%$).
- (10) The proportion of "women who withdrew from employment after returning to employment" was calculated by subtracting the proportion of "women who continued in employment after parental leave" from the proportion of "women who returned to employment after parental leave" ($39.8\% - 24.5\% = 15.3\%$).

12 months before birth	► Birth	► After birth	► After parental leave	► After taking parental leave
100% in employment 12 months before birth	43.5% withdrew from employment before birth			
	56.5% in employment at birth	4.3% withdrew from employment after birth		
		6.5% continued in employment after birth		
		45.7% took parental leave after birth	5.9% withdrew from employment after parental leave	
			39.8% returned to employment after parental leave	15.3% withdrew from employment after returning to employment
				24.5% continued in employment after returning to employment

Additional data: Employment patterns of employed women with marriage, birth, and parenting

Fig. 3-3-1 2) shows the estimated changes in employment patterns after birth of women who were employed 12 months before giving birth. Below, however, we estimate the routes typically taken by women in employment as they marry, have children, and raise them.



Additional data: 1. Estimated marriage and non-marriage rates (enclosed by -----, estimated so as to sum to 100%)

- 1) Distribution calculated by age of mother (in employment) in fiscal 2000 based on *Fiscal 2003 Vital Statistics Survey Special Report* (Fig. 1A).
- 2) Non-marriage rates were calculated for women by age group based on the *Fiscal 2000 Population Census* (Fig. 1B).
- 3) Calculating the “non-marriage rate of females of the same age as mothers who gave birth” by multiplying A by B yields 41.4% (Fig. 1C).
- 4) Assuming that all mothers who gave birth are married,¹⁾ $100 - 41.4 = 58.6\%$ is the “marriage rate of women of the same age as mothers that gave birth.”

Fig. 1) Non-marriage rate of women of the same as mothers who gave birth

Age	15-19	20-24	25-29	30-34	35-39	40-44	45-49	Total
Proportion of distribution by age of mother (A)	0.4%	9.8%	38.6%	36.0%	13.4%	1.7%	0.1%	—
Female non-marriage rate by age (B)	99.1%	87.9%	54.0%	26.6%	13.8%	8.6%	8.6%	—
Non-marriage rate corresponding to proportion of distribution by age of mother at birth	0.4%	8.6%	20.9%	9.6%	1.8%	0.1%	0.0%	41.4%

Source: Compiled by the Fujitsu Research Institute based on MHLW, *Fiscal 2003 Vital Statistics Survey Special Report* and MIC, *Fiscal 2000 Population Census*.

Additional data: 2. Estimates of continuation and withdrawal from employment after marriage (enclosed by —, estimated to sum to 100%)

- 1) The *12th Basic Survey of Trends in Births* (2002) investigated the relationship between the present employment status of wives employed before marriage and whether or not they had children. Among women married less than five years, 45% were employed and 54% were full-time housewives, and only 18.1% of the total were employed and had children. In addition, the proportion of employed persons who had children (40%) was markedly lower than the proportion of full-time housewives with children (76%), suggesting that many employed women become full-time housewives rather than remaining in employment when they have children.
- 2) The “proportion remaining in employment without becoming pregnant or giving birth” after marriage was assumed to equal the proportion of “employed persons without children” (18.1%). The “proportion remaining in employment despite becoming pregnant” after marriage was considered to be the proportion of “employed persons with children” (26.6%), and the “proportion withdrawing from employment after marriage” was assumed to be the proportion of “full-time housewives” (54.3%).²⁾

1. As the proportion of children born outside marriage is currently only around 2%, they were excluded from these estimates.
 2. Strictly speaking, a better option would be to use the proportion determined by calculating the weighted average of the “probability of parenthood by period of marriage” and “employment and child status by period of marriage (including five years or more after marriage).” However, the above figures were used as an approximation on the basis that women married for less than five years included wives who, though they might not presently have children, would become pregnant and have children in the future.

Fig. 2) Employment status and children of women married less than five years

Employed		Full-time housewives	
Child (ren)	No children	Child (ren)	No children
26.6%	18.1%	13.0%	41.3%
44.7%		54.3%	

Source: Natinal Institute of Population and Social Security Research, *the 12th Basic Survey of Trends in Birth (2002)*.

Appended Note 3-3-5 Are permanent employees and “freeters” perceived differently (by item)?

(Unit: %)

	Freeters are much better	Freeters are somewhat better	No perceptible difference	Fresh graduates are somewhat better	Fresh graduates are much better	Total
Approach to work	1.8	13.7	55.1	24.2	5.3	100.0
Motivation and sense of responsibility	2.6	10.6	61.7	20.3	4.8	100.0
Skills and knowledge	1.3	18.8	67.4	8.5	4.0	100.0
Attitude to self-improvement	0.0	9.3	65.8	21.3	3.6	100.0
Communication ability	1.3	19.9	65.9	11.5	1.3	100.0
Business etiquette	1.8	15.0	63.9	16.7	2.6	100.0
Relations with other employees	0.4	17.2	70.0	11.0	1.3	100.0
Overall assessment	0.4	11.0	68.7	18.5	1.3	100.0

Source: Nomura Research Institute, Ltd., *A Survey of Employment of Young Workers (November 2005)*.

Note: Only enterprises that hired freeters as permanent employees are included.

Appended Note 3-3-6 Information communicated at time of recruitment

(Unit: %)

	Strongly emphasized	Somewhat emphasized	Emphasized little	Not emphasized at all	Total
Management philosophy and policy	23.8	50.4	23.2	2.7	100.0
Business performance and potential	19.7	59.4	19.0	1.9	100.0
Type of person sought	30.7	55.4	12.1	1.8	100.0
Company's line of business	38.2	53.5	7.3	1.0	100.0
Duties after hiring	27.1	59.7	12.0	1.2	100.0
Working hours after hiring	14.8	59.6	23.4	2.2	100.0
Pay after hiring	14.6	63.7	19.9	1.7	100.0
Leave and fringe benefits, etc.	9.8	52.5	34.5	3.2	100.0
Policy on training after hiring	18.8	54.1	24.1	3.1	100.0

Source: Nomura Research Institute, Ltd., *A Survey of Employment of Young Workers (November 2005)*.

Appended Note 3-3-7 Impression before and after joining company

(Unit: %)

	Better than imagined	As imagined	Not as good as imagined	Total
Leave and fringe benefits, etc.	11.7	42.8	45.5	100.0
Policy on training after hiring	4.7	40.0	55.3	100.0
Business philosophy and policy	6.9	46.7	46.5	100.0
Working hours after hiring	10.1	48.9	41.0	100.0
Pay after hiring	7.2	41.1	51.7	100.0
Business performance and potential	8.8	40.0	51.2	100.0
Type of person sought	5.7	48.9	45.4	100.0
Duties after hiring	10.1	55.0	34.9	100.0
Company's line of business	9.2	55.4	35.4	100.0

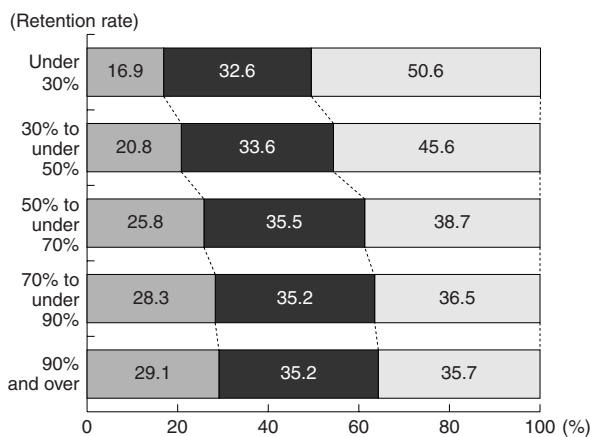
Source: Nomura Research Institute, Ltd., *Questionnaire of Young Workers (November 2005)*.

Note: 20-29 year olds employed as permanent employees.

Appended Note 3-3-8 Correlation between retention rate of young workers (after three years and after one year) and performance

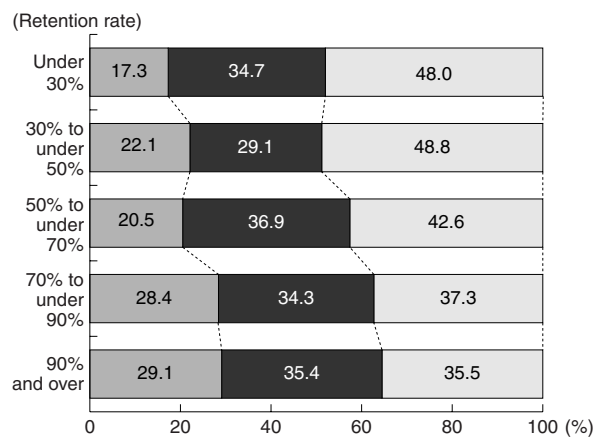
1) Relationship between retention rate after three years and ordinary profit

■ Upward trend in earnings ■ Unchanged □ Downward trend in earnings



2) Relationship between retention rate after one year and ordinary profit

■ Upward trend in earnings ■ Unchanged □ Downward trend in earnings

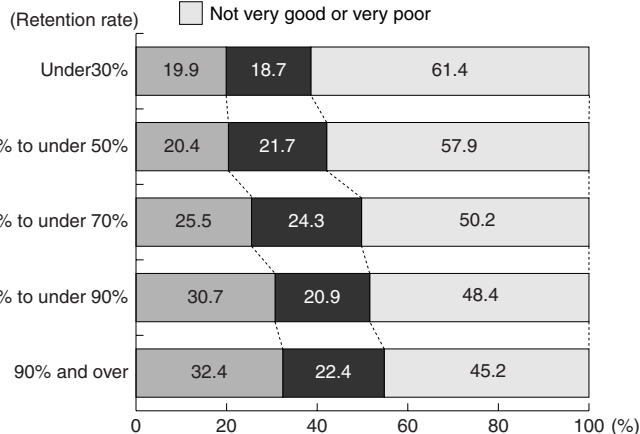


Source: Nomura Research Institute, Ltd., *A Survey of Employment of Young Workers* (November 2005).

Note: The retention rate of young workers here means the rate of retention of 16-34 year olds employed as permanent employees.

Appended Note 3-3-9 Correlation between retention rate of young workers and business confidence

■ Very good or quite good ■ Neither good nor bad □ Not very good or very poor



Source: Nomura Research Institute, Ltd., *A Survey of Employment of Young Workers* (November 2005).

Note: The retention rate of young workers here means the retention rate after 5 years of 16-34 year olds employed as permanent employees.

Appended Note 3-3-10 Analysis of correlation between retention rate of young workers and performance

1. Summary of analysis

An analysis was performed to determine whether the performance of SMEs improved as the retention rate of permanent young employees increased.

2. Model

- Dependent variable: 1) Trend in ordinary profit in past three years (downward trend = 1, no change = 2, upward trend = 3)
- Explanatory variables: 1) Retention rate from 30% to under 50% dummy (rate of retention after five years of young workers employed as permanent employees is 30% to under 50% = 1, other = 0)
- 2) Retention rate from 50% to under 70% dummy (rate of retention after five years of young workers employed as permanent employees is 50% to under 70% = 1, other = 0)
- 3) Retention rate from 70% to under 90% dummy (rate of retention after five years of young workers employed as permanent employees is 70% to under 90% = 1, other = 0)
- 4) Retention rate is 90% or over dummy (rate of retention after five years of young workers as permanent employees is 90% or over = 1, other = 0)
- 5) Enterprise size (number of employees at last year-end (natural log))
- 6) Enterprise age (2005 - year of startup + 1 (natural log))
- 7) Industry dummies (omitted)

3. Data set

Nomura Research Institute, Ltd., *A Survey of Employment of Young Workers* (November 2005).

4. Results of estimates (estimated by ordered probit model)

Log likelihood = -1,475.901, χ^2 P value = 0.000

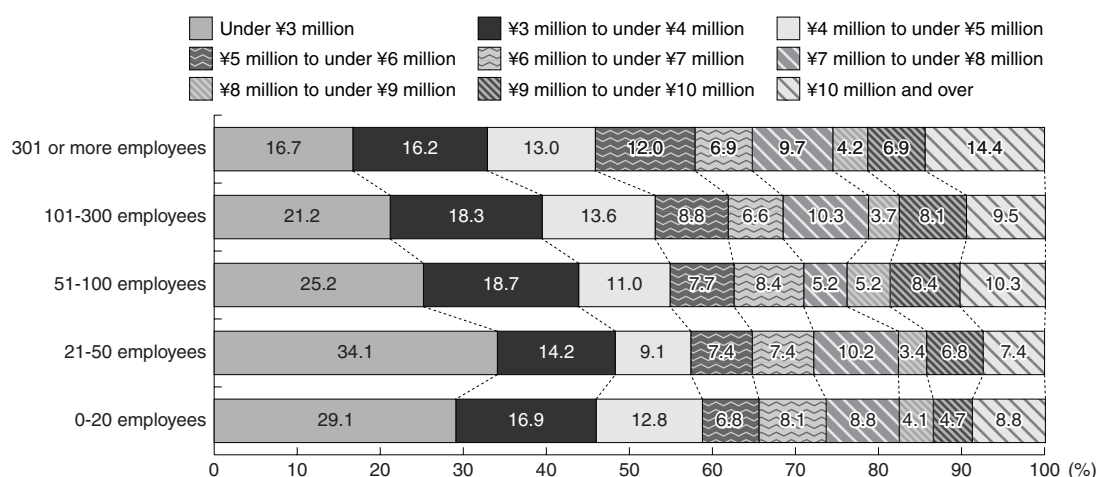
	Trend in ordinary profit		
	Estimated coefficient	Standard error	Significance level
1) Retention rate 30% to under 50%	0.136	0.135	
2) Retention rate 50% to under 70%	0.149	0.120	
3) Retention rate 70% to under 90%	0.267	0.112	**
4) Retention rate 90% or over	0.321	0.107	***
5) Enterprise size	0.133	0.032	***
6) Enterprise age	-0.213	0.050	***
7) Industry dummies (omitted)	—	—	—

***= 1% significance level **= 5% significance level += 10% significance level

5. Conclusions

See main text.

Appended Note 3-3-11 Annual household income of female permanent employees by size of employer



Source: Fujitsu Research Institute, *Survey Regarding Work and Parenting at Small Businesses* (December 2005).

Appended Note 3-3-12 Calculation of effect

- (1) Calculated from Fujitsu Research Institute, *Business Survey Regarding Small Business Support for Balancing Work and Family* (December 2005).
- (2) Results were tabulated concerning the implementation in the past three years of 12 types of organizational and operational adjustment, such as concentration and dispersal of decision-making powers, and establishment of more flexible working-hour arrangements, such as parental leave, shorter of working hours, and flextime.
- (3) Establishment of more flexible working-hour arrangements, such as parental leave, shorter working hours, and flextime, was weighted by assigning values to each of the following categories: “system established and used,” “no system but flexible response,” “system established but little used,” and “no system and no flexible response.”
- (4) Use of each type of organizational or operational adjustment was calculated by weighting according to the state of implementation.
- (5) Implementation of each type of organizational or operational adjustment is plotted on the horizontal axis and use on the vertical axis to produce an approximation line. The slope of the line was defined as the effect on the state of use of the system in the case of implementation of an organizational or operational adjustment.

1) Parental leave system

		Arrangements established and actually used	No arrangements but flexible response	Arrangements established but little used	No arrangements and no flexible response	Total	Degree of use
Weight		100	75	50	25	—	
Concentration of decision-making powers	Drastic change pursued	25.6	32.8	28.1	13.4	100	0.676
	Minor adjustments pursued	20.1	30.4	33.7	15.8	100	0.637
	No particular adjustments made	10.4	38.2	21.9	29.5	100	0.57375
Dispersion of decision-making powers (delegation to subordinate positions)	Drastic change pursued	26.6	34.3	29.9	9.2	100	0.69575
	Minor adjustments pursued	20.5	31.6	30.8	17.2	100	0.639
	No particular adjustments made	9.9	37.8	22.2	30.1	100	0.56875
Revision of powers of executives and managerial staff	Drastic change pursued	29.2	33.9	27.2	9.6	100	0.70625
	Minor adjustments pursued	19.3	32.0	32.3	16.4	100	0.6355
	No particular adjustments made	9.9	37.6	22.2	30.3	100	0.56775
Revision of duties of managerial staff and ordinary employees	Drastic change pursued	23.7	36.2	30.1	10.0	100	0.684
	Minor adjustments pursued	18.4	32.8	31.6	17.2	100	0.631
	No particular adjustments made	11.0	37.1	21.6	30.3	100	0.572
Integration and elimination of departments, etc.	Drastic change pursued	32.5	22.1	36.2	9.2	100	0.69475
	Minor adjustments pursued	22.0	27.1	36.5	14.5	100	0.642
	No particular adjustments made	6.9	42.5	18.4	32.2	100	0.56025
Flattening of organizational hierarchy	Drastic change pursued	30.6	25.2	33.1	11.2	100	0.6885
	Minor adjustments pursued	19.8	32.5	32.5	15.1	100	0.642
	No particular adjustments made	10.7	38.2	22.1	29.0	100	0.5765
Adoption of intranet and other IT	Drastic change pursued	24.2	30.3	30.7	14.8	100	0.65975
	Minor adjustments pursued	15.2	36.0	29.2	19.6	100	0.617
	No particular adjustments made	7.4	39.4	18.6	34.6	100	0.549
Replacement of paper with electronic media	Drastic change pursued	24.5	29.6	29.6	16.3	100	0.65575
	Minor adjustments pursued	17.7	35.9	30.0	16.4	100	0.63725
	No particular adjustments made	9.2	37.9	20.9	32.0	100	0.56075
Rationalization of departmental overlap, etc.	Drastic change pursued	29.1	31.8	30.8	8.4	100	0.7045
	Minor adjustments pursued	21.9	30.8	32.2	15.1	100	0.64875
	No particular adjustments made	8.2	38.9	20.9	32.0	100	0.55825
Improvement of operational efficiency and reduction of costs	Drastic change pursued	19.9	35.1	28.6	16.4	100	0.64625
	Minor adjustments pursued	17.1	33.4	29.5	20.1	100	0.61925
	No particular adjustments made	7.0	38.9	18.1	35.9	100	0.542
Development of new business	Drastic change pursued	16.7	37.4	27.0	18.9	100	0.62975
	Minor adjustments pursued	19.1	35.6	27.3	18.0	100	0.6395
	No particular adjustments made	9.9	35.4	22.6	32.0	100	0.5575
Outsourcing of operations	Drastic change pursued	27.3	27.0	28.8	16.9	100	0.66175
	Minor adjustments pursued	22.4	30.6	29.2	17.7	100	0.64375
	No particular adjustments made	9.3	39.2	23.0	28.5	100	0.57325

2) Shortening of working hours

		Arrangements established and actually used	No arrangements but flexible response	Arrangements established but little used	No arrangements and no flexible response	Total	Degree of use
Weight		100	75	50	25	—	
Concentration of decision-making powers	Drastic change pursued	18.4	42.2	21.6	17.8	100	0.653
	Minor adjustments pursued	12.0	44.6	21.7	21.7	100	0.61725
	No particular adjustments made	7.8	48.2	12.3	31.7	100	0.58025
Dispersion of decision-making powers (delegation to subordinate positions)	Drastic change pursued	19.6	43.9	21.8	14.8	100	0.67125
	Minor adjustments pursued	12.9	45.0	20.1	21.9	100	0.62175
	No particular adjustments made	7.3	47.8	12.5	32.3	100	0.57475
Revision of powers of executives and managerial staff	Drastic change pursued	20.3	47.2	18.9	13.6	100	0.6855
	Minor adjustments pursued	13.0	44.8	20.9	21.3	100	0.62375
	No particular adjustments made	7.1	47.3	12.8	32.8	100	0.57175
Revision of duties of managerial staff and ordinary employees	Drastic change pursued	20.4	49.8	16.8	12.9	100	0.69375
	Minor adjustments pursued	13.4	44.1	20.5	22.0	100	0.62225
	No particular adjustments made	6.8	47.2	13.1	32.9	100	0.56975
Integration and elimination of departments, etc.	Drastic change pursued	21.1	35.9	25.0	18.0	100	0.65025
	Minor adjustments pursued	12.2	40.8	23.5	23.5	100	0.60425
	No particular adjustments made	6.4	51.5	10.1	32.0	100	0.58075
Flattening of organizational hierarchy	Drastic change pursued	23.1	37.2	21.1	18.6	100	0.662
	Minor adjustments pursued	12.1	43.8	23.7	20.5	100	0.61925
	No particular adjustments made	7.7	48.7	12.5	31.1	100	0.5825
Adoption of intranet and other IT	Drastic change pursued	16.8	42.4	19.3	21.5	100	0.63625
	Minor adjustments pursued	10.0	49.0	18.3	22.7	100	0.61575
	No particular adjustments made	5.8	47.7	10.8	35.7	100	0.559
Replacement of paper with electronic media	Drastic change pursued	18.0	40.1	20.2	21.6	100	0.63575
	Minor adjustments pursued	10.4	48.6	19.3	21.7	100	0.61925
	No particular adjustments made	7.3	47.7	11.7	33.4	100	0.57275
Rationalization of departmental overlap, etc.	Drastic change pursued	23.1	43.1	20.7	13.0	100	0.69025
	Minor adjustments pursued	13.0	44.0	21.3	21.7	100	0.62075
	No particular adjustments made	6.2	48.5	11.8	33.4	100	0.56825
Improvement of operational efficiency and reduction of costs	Drastic change pursued	15.7	48.6	18.1	17.6	100	0.656
	Minor adjustments pursued	10.0	46.7	17.6	25.8	100	0.60275
	No particular adjustments made	5.3	45.2	11.1	38.5	100	0.54375
Development of new business	Drastic change pursued	12.7	51.2	15.6	20.5	100	0.64025
	Minor adjustments pursued	13.6	45.5	18.4	22.5	100	0.6255
	No particular adjustments made	6.3	45.1	13.3	35.2	100	0.55575
Outsourcing of operations	Drastic change pursued	21.2	39.2	16.9	22.7	100	0.64725
	Minor adjustments pursued	13.3	41.7	23.3	21.7	100	0.6165
	No particular adjustments made	7.0	49.6	12.4	30.9	100	0.58125

3) Introduction of flextime or other flexible working-hour arrangements

		Arrangements established and actually used	No arrangements but flexible response	Arrangements established but little used	No arrangements and no flexible response	Total	Degree of use
Weight		100	75	50	25	—	
Concentration of decision-making powers	Drastic change pursued	19.4	40.3	20.9	19.4	100	0.64925
	Minor adjustments pursued	12.0	41.4	17.8	28.8	100	0.5915
	No particular adjustments made	9.2	45.2	9.5	36.1	100	0.56875
Dispersion of decision-making powers (delegation to subordinate positions)	Drastic change pursued	23.6	40.6	17.0	18.8	100	0.6725
	Minor adjustments pursued	12.3	44.7	16.4	26.7	100	0.607
	No particular adjustments made	8.5	44.0	10.5	37.0	100	0.56
Revision of powers of executives and managerial staff	Drastic change pursued	21.3	42.5	17.6	18.6	100	0.66625
	Minor adjustments pursued	13.6	43.2	16.4	26.8	100	0.609
	No particular adjustments made	8.4	44.2	10.4	37.0	100	0.56
Revision of duties of managerial staff and ordinary employees	Drastic change pursued	21.5	44.8	15.1	18.6	100	0.673
	Minor adjustments pursued	13.0	42.3	17.5	27.2	100	0.60275
	No particular adjustments made	8.5	44.2	10.2	37.1	100	0.56025
Integration and elimination of departments, etc.	Drastic change pursued	22.1	34.5	18.0	25.5	100	0.6335
	Minor adjustments pursued	12.4	39.5	19.9	28.2	100	0.59025
	No particular adjustments made	7.8	47.7	8.8	35.8	100	0.56925
Flattening of organizational hierarchy	Drastic change pursued	27.7	35.1	15.3	21.9	100	0.6715
	Minor adjustments pursued	12.9	40.9	21.3	24.8	100	0.60425
	No particular adjustments made	8.4	45.7	10.0	35.9	100	0.5665
Adoption of intranet and other IT	Drastic change pursued	18.2	40.5	16.5	24.8	100	0.63025
	Minor adjustments pursued	10.2	45.8	14.5	29.5	100	0.59175
	No particular adjustments made	7.2	44.4	8.8	39.6	100	0.548
Replacement of paper with electronic media	Drastic change pursued	21.6	36.3	16.6	25.5	100	0.635
	Minor adjustments pursued	11.6	45.0	16.2	27.1	100	0.60225
	No particular adjustments made	7.5	45.4	9.3	37.7	100	0.55625
Rationalization of departmental overlap, etc.	Drastic change pursued	25.8	42.1	14.4	17.7	100	0.69
	Minor adjustments pursued	12.9	41.6	18.4	27.1	100	0.60075
	No particular adjustments made	7.5	45.1	9.8	37.7	100	0.5565
Improvement of operational efficiency and reduction of costs	Drastic change pursued	17.2	45.4	13.9	23.5	100	0.64075
	Minor adjustments pursued	9.7	44.2	14.6	31.5	100	0.58025
	No particular adjustments made	7.2	42.2	9.7	41.0	100	0.5395
Development of new business	Drastic change pursued	15.9	46.1	13.4	24.6	100	0.63325
	Minor adjustments pursued	12.6	43.7	15.8	27.9	100	0.6025
	No particular adjustments made	7.5	42.7	10.2	39.6	100	0.54525
Outsourcing of operations	Drastic change pursued	24.1	38.5	14.7	22.7	100	0.66
	Minor adjustments pursued	14.2	39.4	19.6	26.8	100	0.6025
	No particular adjustments made	7.9	46.2	9.9	36.1	100	0.56525

Appended Note 3-4-1 Categorization and definition of characteristics of locations

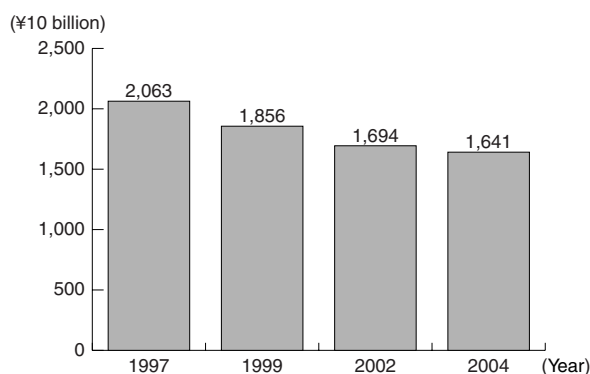
Census of Commerce Appendix 1

Characteristic no. and category	Definitions
Commercial district subcategory	
1 Commercial districts	Mostly commercial districts and neighborhood commercial districts, as defined according to the zone definitions given in Article 8 of the City Planning Law, in which shopping districts have formed. In general, a single shopping district is regarded as constituting one commercial cluster, where a “single shopping district” is a cluster of 30 or more neighboring retailers, eating and drinking places, and service providers. Shopping centers and buildings containing multiple businesses (station buildings and department stores, etc.) meeting the preceding definition are also as a rule classified as comprising a single commercial district.
Around-station-type commercial districts	Commercial clusters located around JR and private railway stations. As a rule, however, clusters around subway and tramway stations are excluded from this category.
City-area-type commercial districts	Commercial clusters located in downtown and office districts in central urban areas (excluding those around stations).
Residential-background-type commercial districts	Commercial clusters located next to residential districts and housing estates whose shoppers consist mainly of local residents.
Roadside-type commercial districts	Commercial clusters located along a national highway or equivalent road (excluding those in central urban areas).
Other types of commercial district	Commercial clusters that do not fall into any of the above categories. They include shopping districts in tourist spots and near shrines and temples.
2 Office building districts	Mostly commercial districts and neighborhood commercial districts, as defined according to the zone definitions described in Article 8 of the City Planning Law, that do not fall under “1. Commercial cluster” above.
3 Residential districts	Class 1 and class 2 exclusive districts for low-rise residential buildings, class 1 and class 2 exclusive districts for medium-rise and high-rise buildings, class 1 and class 2 residential districts, and quasi-residential districts, as defined according to the zone definitions described in Article 8 of the City planning Law.
4 Industrial districts	Land classified under Article 8 of the City Planning Law as exclusively industrial districts, quasi-industrial districts, and industrial districts.
5 Other districts	Districts that are not classified as urbanization promotion areas under Article 7 of the City Planning Law or falling under “1. Commercial districts” to “4 Industrial districts” above.

Source: METI, *Census of Commerce*.

Note: If a district's actual situation does not match its classification under the City Planning Law (e.g., if it has hardly any residences despite being classified as a residential district) or it has not been designated as a particular type of land under the City Planning Law, it may be classified according to its actual situation.

Appended Note 3-4-2 Trends in sales of department stores and general merchandise stores

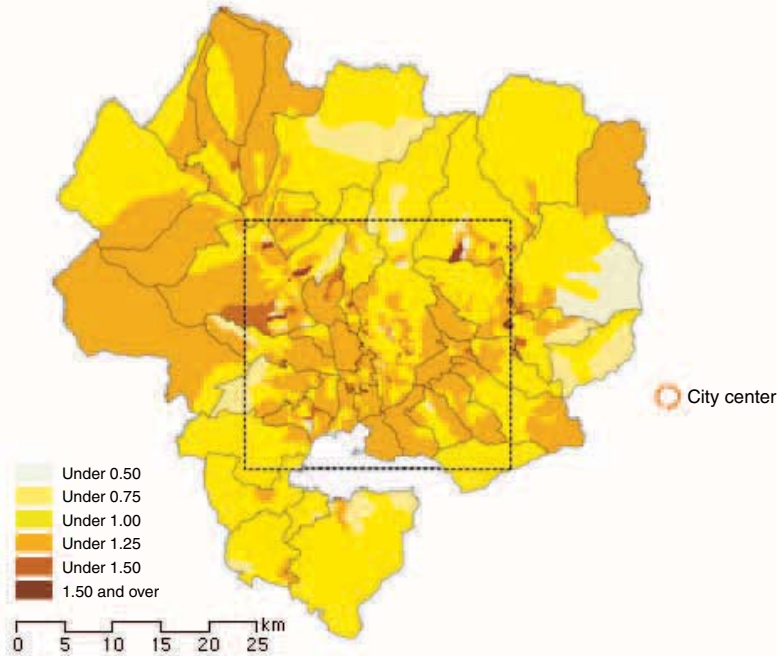


Source: Recompiled from METI, *Census of Commerce*.

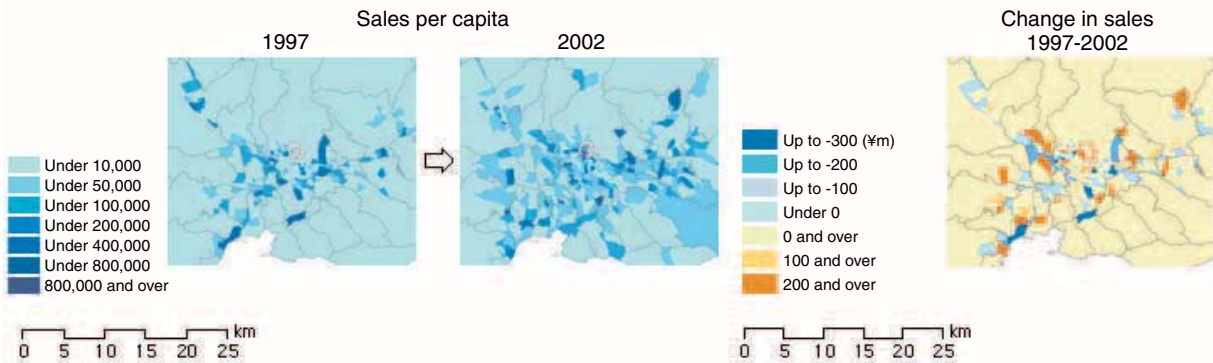
Appended Note 3-4-3 Trends in population and retail sales by district in and around (1) Kofu City and (2) Akita City

(1) Kofu City

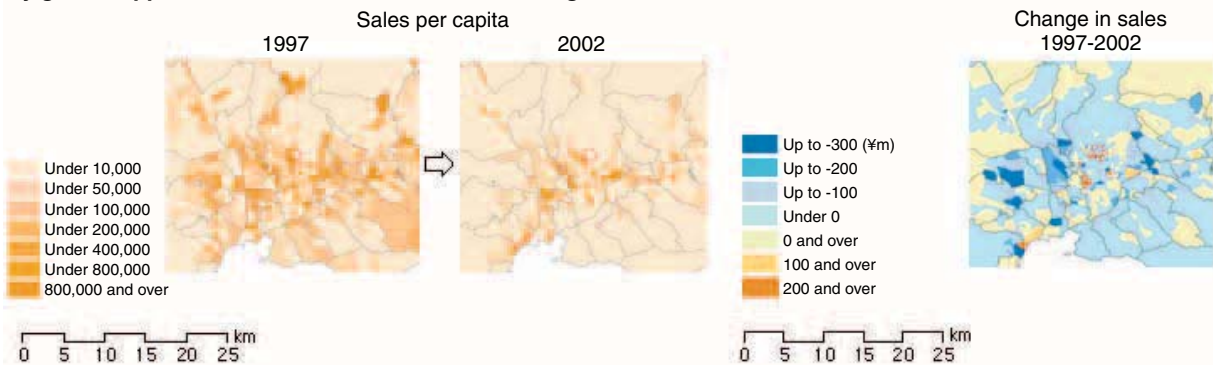
Population growth according to Population Census (1995-2000)



Food and drink retailing



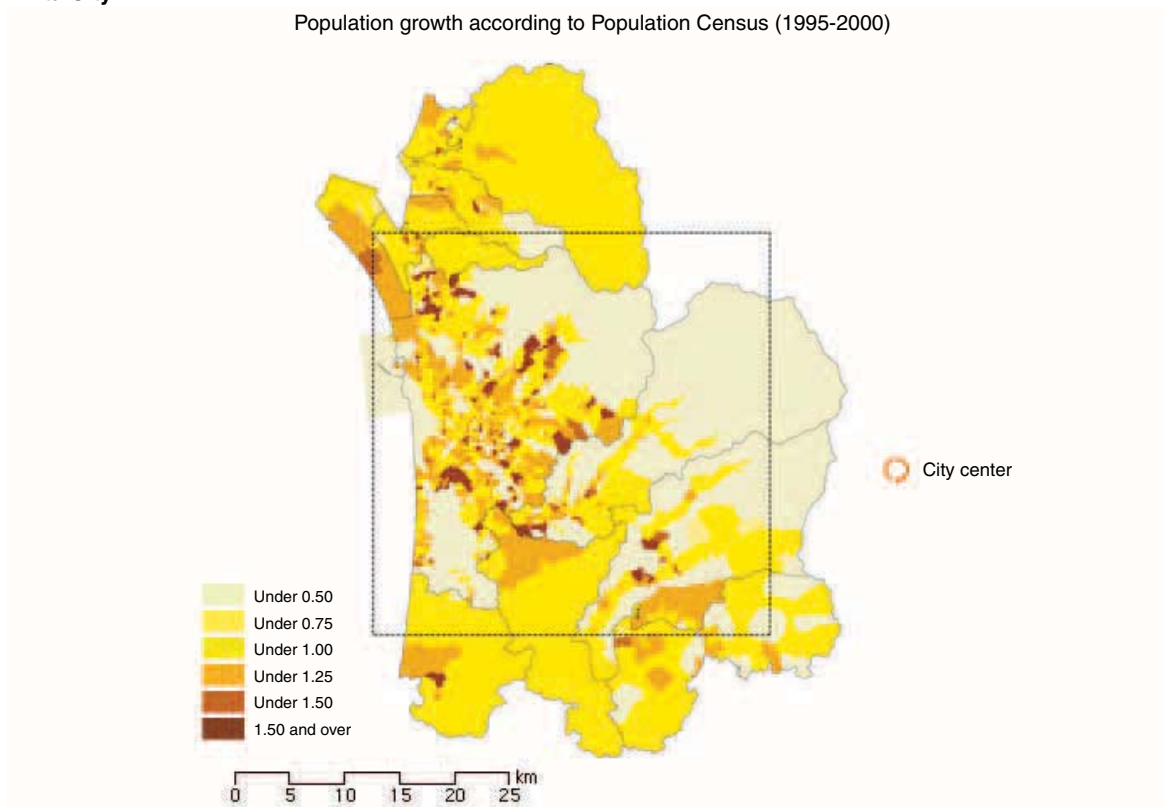
Dry goods, apparel, furniture, and automobile retailing



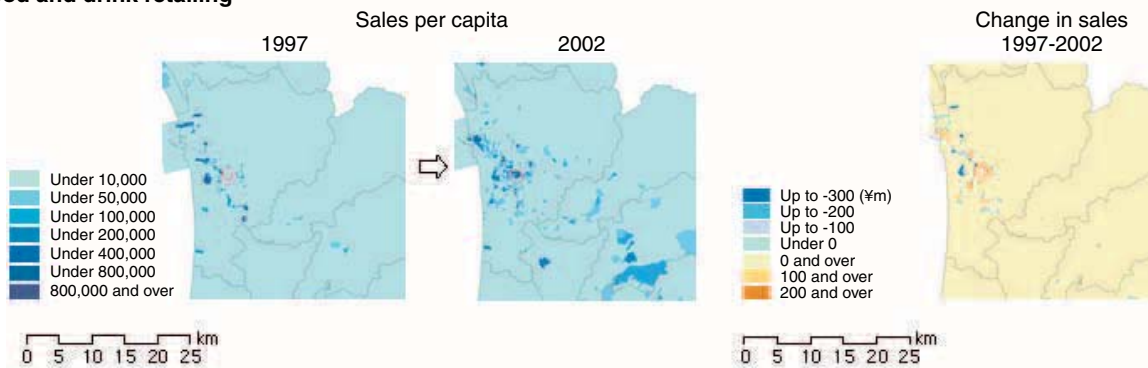
Sources: MIC, *Population Census*; METI, *Census of Commerce*.

(2) Akita City

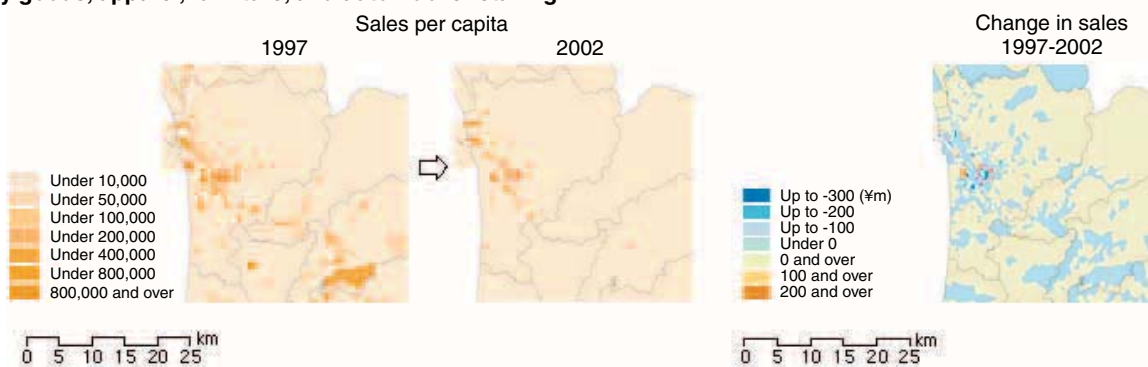
Population growth according to Population Census (1995-2000)



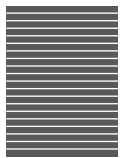
Food and drink retailing



Dry goods, apparel, furniture, and automobile retailing

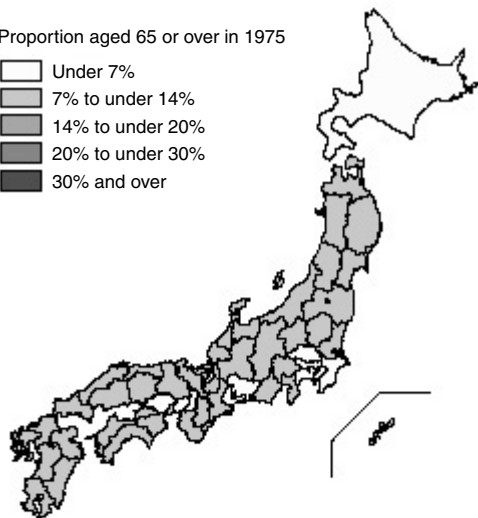
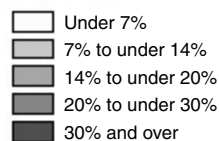


Sources: MIC, *Population Census*; METI, *Census of Commerce*.

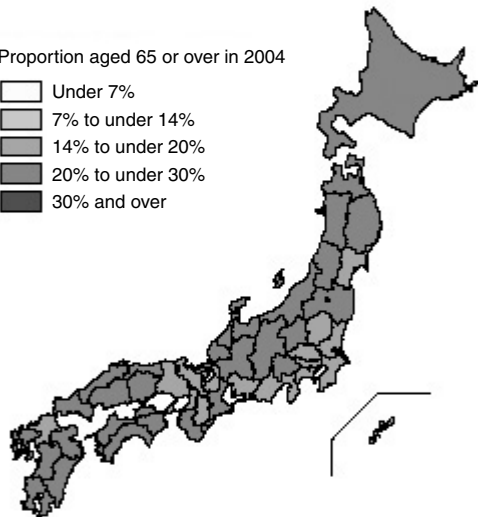
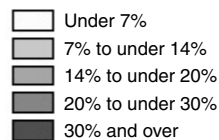


Appended Note 3-4-4 Trends in proportion of population aged 65 or over

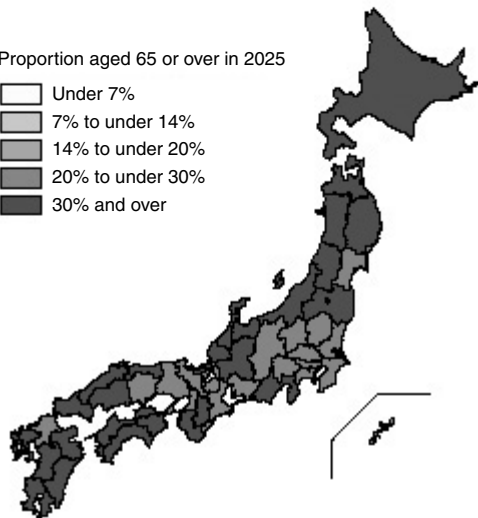
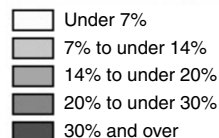
Proportion aged 65 or over in 1975



Proportion aged 65 or over in 2004



Proportion aged 65 or over in 2025



Prefecture	1975	2004	2025
Hokkaido	6.9	20.8	32.3
Aomori	7.5	21.7	32.0
Iwate	8.5	23.9	31.6
Miyagi	7.7	19.3	27.6
Akita	8.9	26.0	35.4
Yamagata	10.1	24.9	32.0
Fukushima	9.2	22.1	30.2
Ibaraki	8.4	18.5	29.8
Tochigi	8.3	18.8	28.9
Gunma	8.8	19.9	29.9
Saitama	5.3	15.5	27.8
Chiba	6.3	16.8	29.2
Tokyo	6.3	18.0	25.0
Kanagawa	5.3	16.2	25.8
Niigata	9.6	23.4	31.4
Toyama	9.5	22.7	31.9
Ishikawa	9.1	20.3	30.2
Fukui	10.1	22.2	30.2
Yamanashi	10.2	21.3	29.4
Nagano	10.7	23.2	29.9
Gifu	8.6	20.3	30.0
Shizuoka	7.9	19.9	30.5
Aichi	6.3	16.6	26.1
Mie	9.9	20.8	29.9
Shiga	9.3	17.5	24.5
Kyoto	9.0	19.7	28.6
Osaka	6.0	17.5	27.4
Hyogo	7.9	19.1	27.4
Nara	8.5	19.1	30.0
Wakayama	10.4	23.2	32.3
Tottori	11.1	23.6	30.8
Shimane	12.5	26.8	32.8
Okayama	10.7	22.0	29.9
Hiroshima	8.9	20.4	30.1
Yamaguchi	10.2	24.3	34.0
Tokushima	10.7	23.8	31.9
Kagawa	10.5	22.6	31.4
Ehime	10.4	23.3	32.5
Kochi	12.2	25.3	33.3
Fukuoka	8.3	19.2	27.6
Saga	10.7	22.1	30.4
Nagasaki	9.5	22.8	33.1
Kumamoto	10.7	23.2	31.0
Oita	10.6	23.8	33.2
Miyazaki	9.5	22.8	32.4
Kagoshima	11.5	24.3	30.8
Okinawa	7.0	16.1	24.0

Source: Cabinet Office, *Annual Report on the Aging Society 2005* (MIC, *Population Census for 1975*; MIC, *Estimated Population as of October 1, 2004* for 2004; National Institute of Population and Social Security Research, *Population Projections by Prefecture (Estimated as of March 2002)* for 2025).

Appended Note 3-4-5 Relationship between entry of medium and large stores and changes in sales of small and medium retailers

1. Summary of analysis

An analysis was performed to determine whether any change was observed in the sales of small and medium retailers in districts in which there were entries or withdrawals of medium and large retailers (referred to collectively as “large retailers” below).

2. Model

Dependent variable: Change in sales of small and medium retailers between 1997 and 2002

Small and medium retailers are defined as small business establishments with a sales floor area of less than 500m², excluding convenience stores, fuel retailers, and automobile retailers

Explanatory variables: 1) Large store entry dummy, withdrawal dummy, increase/decrease dummy

- No change in large stores dummy: No large stores in both 1997 and 2002 = 1, other = 0

- Large store entry dummy: No large store in 1997 and one or more large stores in 2002 = 1, other = 0

- Increase in large stores dummy: One or more large stores in 1997 and more in 2002 = 1, other = 0

- Large store withdrawal dummy: One or more large stores in 1997 and none in 2002 = 1, other = 0

- Decrease in large stores dummy: One or more large stores in 1997 and fewer in 2002 = 1, other = 0

2) Proportion of population aged 65 and over (population aged 65 or over in mesh / total population in mesh)

3) Ratio of day-and-night population (number of employed persons in mesh / total population in mesh)

4) Car ownership rate (total car ownership by municipality / number of households by municipality)

3. Data

Rate of change in sales of small and medium stores, number of medium and large retailers: METI, *Census of Commerce Mesh Data* (1997, 2002)

Proportion of persons aged 65 or over: MIC, *Establishment and Enterprise Census of Japan Mesh Data* (1996, 2001)

Ratio of day-and-night population: MIC, *Population Census, Establishment and Enterprise Census of Japan Mesh Data* (1996, 2001)

Car ownership: MLIT, *Monthly Report on Car Ownership by Vehicle Type* (1996, 2001)

Number of households by municipality: MIC, *Basic Resident Register* (1996, 2001)

4. Results (estimated by least squares method)

Region		Major urban areas	Provincial areas
Dependent variable		Change in sales of small and medium stores (log difference)	Change in sales of small and medium stores (log difference)
Sample size		10450	34081
Degrees of freedom corrected coefficient of determination		0.0116	0.0179
F-value		0.000	0.000
3,000m ² and over	No change in number of large stores (large stores present)	0.126 [2.47]**	0.155 [2.79]***
	Large store entry dummy	0.269 [4.67]***	0.422 [8.59]***
	Large store increase dummy	0.141 [1.13]	0.234 [1.77]*
	Large store withdrawal dummy	-0.039 [-0.51]	-0.073 [-1.16]
	Large store decrease dummy	0.004 [0.03]	-0.044 [-0.33]
	1,500m ² to under 3,000m ²	No change in number of large stores (large stores present)	0.058 [1.04]
Large store entry dummy		0.178 [3.74]***	0.245 [6.35]***
Large store increase dummy		0.054 [0.52]	0.149 [1.31]
Large store withdrawal dummy		-0.041 [-0.73]	-0.094 [-1.95]*
Large store decrease dummy		-0.024 [-0.16]	-0.042 [-0.31]
500m ² to under 1,500m ²		No change in number of large stores (large stores present)	0.078 [1.85]*
	Large store entry dummy	0.097 [2.89]***	0.193 [7.46]***
	Large store increase dummy	0.104 [2.35]**	0.112 [2.89]***
	Large store withdrawal dummy	-0.066 [-1.35]	-0.125 [-3.41]***
	Large store decrease dummy	0.092 [1.32]	0.071 [1.23]

Figures in parentheses indicate the t-value. ***= 1% significance level
**= 5% significance level *= 10% significance level

Notes: 1. The coefficients for the proportion of persons aged 65 or over, ratio of day-and-night population, and car ownership rate are omitted for reasons of space.

“Major urban areas” consist of the lesser Tokyo area, lesser Nagoya area, lesser Osaka area, Kobe area, and Kyoto-Otsu area as defined in Asahi Shimbun, *Minryoku*. “Provincial areas” are all other areas.

2. Medium and large stores are here referred to collectively as “large stores.”

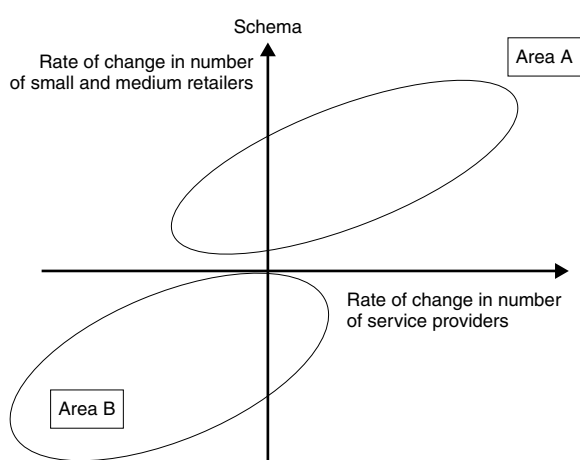
Source: Matsuura and Motohashi (2006), *A Quantitative Analysis of Entries and Withdrawals of Large Retailers, and the Revitalization of City Centers*, RIETI policy discussion paper.

Appended Note 3-4-6 Analysis of correlation between number and sales of small and medium retailers, and eating and drinking places and service providers (beauty, laundry, and bath services)

1. Summary of analysis

An analysis was performed to determine whether there was any association between an increase in the number of small and medium retailers and simultaneous growth of eating and drinking places and service providers (beauty, laundry, and bath services).

Based on the hypothesis that the correlation between the change in number of small and medium retailers and change in service providers would differ between areas in which the number of small and medium retailers increased (area A in diagram) and areas in which the number decreased (area B in the diagram), the sample was divided up according to whether the rate of growth in the number of small and medium retailers was positive (zero or above) or negative (less than zero).



2. Data set

Rate of change in number of small and medium stores: METI, *Census of Commerce Mesh Data* (1997, 2002)

Small and medium retailers are defined as small business establishments with a sales floor area of less than 500m², excluding convenience stores, fuel retailers, and automobile retailers.

Rate of change in number of eating and drinking places and service providers: MIC, *Establishment and Enterprise Census of Japan Mesh Data* (1996, 2001)

Mesh data are for basic meshes obtained by dividing Japan into blocks of one square kilometer.

3. Results of analysis

		Correlation with rate of change in number of small and medium stores	Rate of change in number of eating and drinking places	Rate of change in number of beauty service establishments
Major urban areas	Overall	Area A: obs=2252 Area B: obs=5586	0.125 0.089	0.076 0.069
	Commercial districts	Area A: obs=461 Area B: obs=1662	0.336 0.061	0.196 0.105
	Around station	Area A: obs=165 Area B: obs=735	0.489 -0.010	0.221 0.064
	City area	Area A: obs=36 Area B: obs=169	0.231 0.371	0.403 0.350
	Residential background	Area A: obs=190 Area B: obs=629	0.265 0.065	0.193 0.070
	Roadside	Area A: obs=55 Area B: obs=94	0.198 -0.022	0.090 0.088
	Office	Area A: obs=25 Area B: obs=135	0.499 0.182	0.596 0.120
	Residential	Area A: obs=1088 Area B: obs=2596	0.112 0.110	0.073 0.092
	Overall	Area A: obs=5855 Area B: obs=11743	0.139 0.059	0.095 0.029
	Commercial districts	Area A: obs=1121 Area B: obs=3150	0.258 0.097	0.236 0.086
	Around station	Area A: obs=206 Area B: obs=563	0.174 0.176	0.155 0.061
	City area	Area A: obs=157 Area B: obs=815	0.114 0.094	0.198 0.026
	Residential background	Area A: obs=397 Area B: obs=1154	0.177 0.092	0.234 0.138
Roadside	Area A: obs=258 Area B: obs=362	0.381 0.107	0.258 0.144	
Office	Area A: obs=85 Area B: obs=306	0.419 0.069	0.373 0.046	
Residential	Area A: obs=2066 Area B: obs=4054	0.104 0.060	0.088 0.043	

Notes: Area A indicates cases where the rate of change in the number of small and medium retailers is positive.
Area B indicates cases where the rate of change in the number of small and medium retailers is negative.

Source: Matsuura and Motohashi (2006), *A Quantitative Analysis of Entries and Withdrawals of Large Retailers, and the Revitalization of City Centers*, RIETI policy discussion paper.

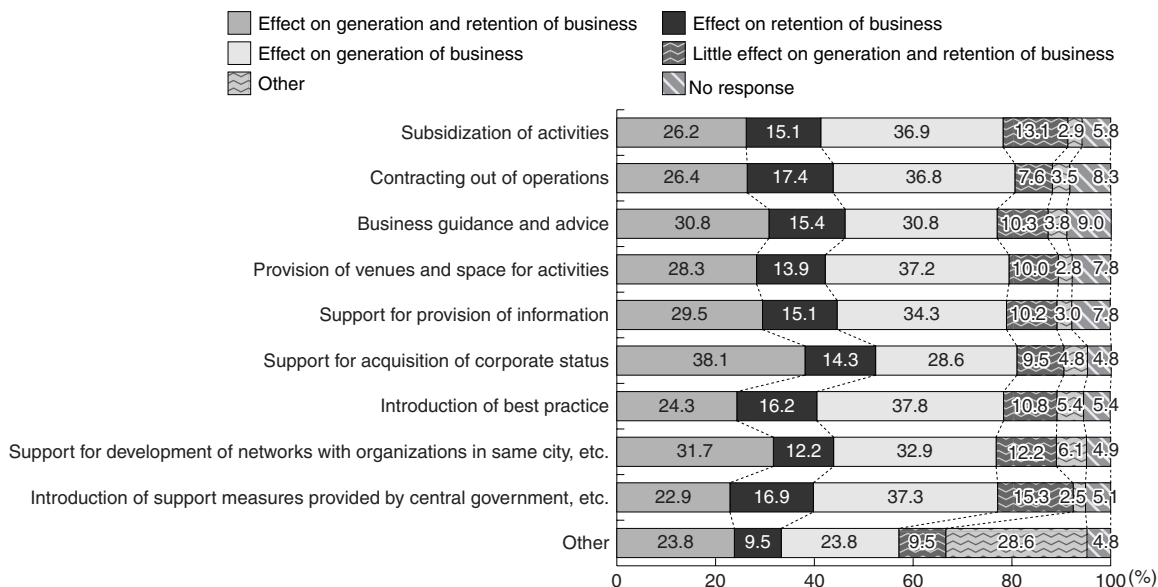
Appended Note 3-4-7 Implementation of measures by local governments to develop revitalization businesses and their effect

1) State of implementation of development measures



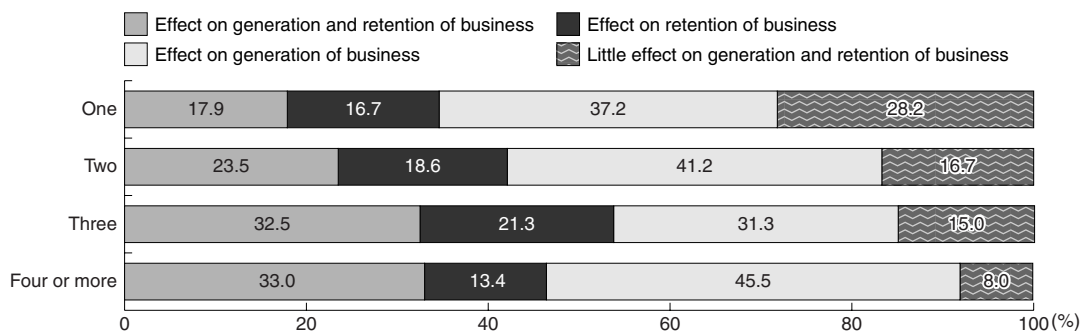
Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

2) Support measures and effects



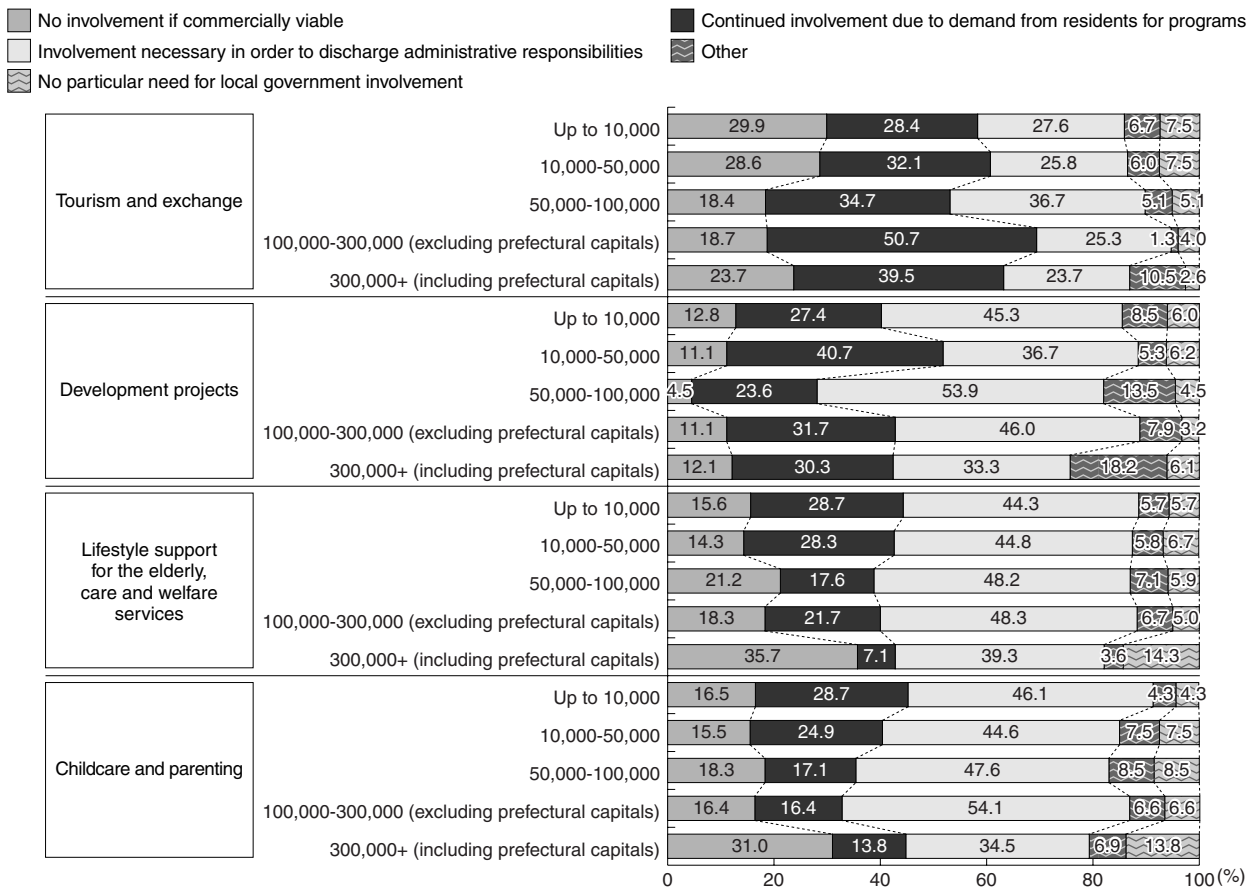
Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

3) Number of measures and effect



Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

Appended Note 3-4-8 Position on local government involvement in revitalization businesses by population size



Source: Mitsubishi Research Institute, Inc., *Questionnaire Survey on Revitalizing Town Centers and Promoting the Development of Small Businesses* (December 2005).

Appended Note 3-4-9 Town management in the United Kingdom, Germany, and France

(1) United Kingdom

- In the U.K. since the 1990s, the public and private sectors have worked in partnership on town center management (TCM) activities, such as mall improvement activities and marketing and promotional activities, led largely by leading retailers in an effort to improve the attractiveness of city centers and draw in more customers, and there are now estimated to be more than 400 TCM projects throughout the country.
- The position and organizational form of TCMs differ according to local circumstances, and include internal agencies of local governments and separately formed companies.
- In the course of pursuit of TCM activities, securing stable business funds has become an issue. One particular difficulty is that as conditions improve and city centers pull in more customers, the large stores that hitherto led activities lose interest, creating the problem of “free rider” due to their enjoying the benefits of activities without participating in them. How the cost burden can be fairly apportioned if TCM activities are to continue has thus become a concern.
- Against this background, a BID law introducing a “BID levy” (Business Improvement District levy) for revitalization of city centers was enacted in September 2004 based to an extent on BIDs in the U.S. Votes were held on the introduction of BIDs around the country, and BIDs had been introduced in 20 districts as of December 2005. In the U.K., BID levies are collected as an addition to the non-domestic rate on business assets charged from businesses in the area concerned.

(2) Germany

- In Germany, too, the hollowing out of city centers due to the spread of large suburban stores has become a

problem, and many cities are taking steps to revitalize their city centers. One reason why joint action at the regional level has traditionally been somewhat scarce is that retailers have been operated increasingly by large chains. In order to play the leading role in city center redevelopment, therefore, city management agencies have been established.

- According to the “Questionnaire on City Management in Germany,” which polled six cities in December 2005, city management agencies have the following characteristics.

Respondent cities: Köln, Gelsenkirchen, Hamm, and Bochum in Nordrhein-Westfalen, Stuttgart in Baden-Württemberg, and Göttingen in Niedersachsen

- City management agencies are approved and licensed by individual cities, and are not regulated under state law.
- A single city and even a single city center can have multiple city management agencies.
- City management agencies take various forms and can have a variety of corporate statuses. While some are corporations with municipal backing along the lines of “third sector” (semi-public) ventures in Japan, others are internal agencies of the city government (attached, for example, to the tourism department) or are operated by existing bodies such as chambers of commerce and industry or retailers’ associations.
- One of the roles that cities expect city management agencies to play is that of “solving problems in areas mainly relating to commercial development,” along with “liaison between authorities and private sector,” “liaison with related private-sector agencies,” and “solving problems in areas related mainly to creating hustle and bustle.”
- Regarding the types of activity undertaken by city management agencies, “event planning and execution” and “advertising and marketing” are undertaken by all the agencies from which responses were received. (Three agencies engaged in these two types of activity only, and two agencies also engaged in “provision of business guidance and business information to individual stores.”) “Operation of commercial facilities” and “lease of stores,” on the other hand, are performed by the private sector in all the cities polled, and “planning and consideration of commercial cluster industries and mix” is also the function of the private sector in all cities but one. Within the field of commercial development, then, it can be seen that city management agencies are primarily responsible for activities designed to draw in more shoppers.
- While it is unclear whether city management agencies have similar powers to BIDs in the U.S., some respondents (three out of five agencies) said that they had the power to “levy charges,” and Nordrhein-Westfalen is trialing a model project modeled on BIDs in the U.S. Regarding other powers, some respondents said that they had the “right to review city planning decisions regarding the siting of large stores, etc.” and the “right to review the opening of retail stores (tenant management).” No agencies were authorized to “seize land” or “issue bonds.”
- Common sources of income for city management agencies are “income from membership fees,” “business revenues,” and “city subsidies.” Of these, “income from membership fees” was the biggest source of income at four agencies. Other sources of income include “donations,” “contributions,” “central government subsidies,” and “local government subsidies.”
- Based on the above, it may be concluded that city management agencies in Germany are generally concerned mainly with commercial development rather than town development as a whole, and that they are restricted to a comparatively narrow range of activities, such as events and advertising.

(3) France

- The main concern regarding city centers in France has been how to maintain historic buildings and preserve the townscape from its historical background, and there has been less of a focus on stimulating commerce. In addition, although an emphasis has been placed on developing the attractiveness and competitiveness of individual stores by, for example, developing industry associations and providing business guidance to stores through chambers of commerce and industry, comparatively little effort has in the past been made to stimulate activity in provincial shopping areas.
- Although town management as a concept has not become firmly established in France, posts and organizations have been established in some municipalities to coordinate businesses and revitalize shopping districts by, for example, organizing events and promoting sales.
- The Loi relative à la Solidarité et au Renouveau Urbains (Loi SRU) enacted in 2000 incorporated the concept of revitalization of commercial districts, and provided for the formulation of prefectural level Schémas de Développement Commercial (SDC) consistent with urban Schémas de Cohérence Territoriale (SCOT). The aim of this is to achieve a balanced mix of various types of business meeting consumer needs, and guidelines are laid down regarding what kind of commercial mix to aim for in designated districts within each prefecture. Although not binding on municipalities, the fact that formation of commercial clusters is made one of the functions of urban planning is a distinctive feature. However, this formation of commercial clusters does not necessarily mean promoting the revitalization of specific city centers. Accordingly, the revitalization of city centers is ultimately left to the judgment and action of each region.

- Against this backdrop, some regions have a city, chamber of commerce and industry or shopping district official who functions as a “town manager” responsible for liaising between commercial districts in city centers and organizing events. A voluntary “town managers’ club” has been established to act as a vehicle for information sharing among town managers, and around 50 regions are now members of this organization. (Given that there are 36,000 local governments in France, though, one would have to say that the scale of activity is still extremely limited.)
- If we look then at these 50 or so regions with town managers, we find that most established such posts or organizations in or after 2000.
- These organizations are financed from all kinds of sources. Some are funded independently by local governments and chambers of commerce and industry, for example, while others are financed jointly by their cities, chambers of commerce and industry, shopping areas, and other private-sector organizations. Regarding planning of redevelopment of commercial districts and revitalization of shopping areas, however, many receive Fonds d’Intervention pour les Services, l’Artisanat et le Commerce (FISAC) provided by the central government to local governments, public agencies, shopping areas, and so on for a maximum of three years. As this subsidization program also includes the cost of personnel expenditures on staff responsible for planning, use of these subsidies in many cases encouraged the appointment of town manager positions in local governments, public agencies, shopping districts, and similar bodies. However, it is also not uncommon for posts to be abolished when the subsidies run out due to inability to maintain personnel expenditures on them.
- These town manager positions are often filled not only by experts, such as persons with experience as developers of suburban shopping centers, but also people chosen precisely because they have little familiarity with a region in order to ensure their neutrality in coordinating and liaising between businesses.

Appended Note 4 Summary of survey

Title of survey	Industries covered	Survey size	Sample source	Response rate
<i>Survey of Use of Human Resources and the Parenting Environment at Small and Medium Enterprises</i>	All industries excluding agriculture, forestry, fisheries, and government service (not otherwise classified)	15,000	Tokyo Shoko Research database	29.7%

- Notes:
1. SMEs are defined in accordance with the Small and Medium Enterprise Basic Law.
 2. The sample was obtained by drawing random samples according to number of employees.

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Supplementary statistical data

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Table 1 Number of business establishments and enterprises by industry and size (private)

(1) Business establishments

Industry	Year	Small and medium business establishments				Large business establishments		Total		(Of which number of establishments with temporary employment service or subcontracted workers only)
		No.	% of total	Of which small business establishments		No.	% of total	No.	% of total	
Mining	1999	4,155	99.9	3,541	85.1	5	0.1	4,160	100.0	—
	2001	3,760	99.9	3,285	87.3	4	0.1	3,764	100.0	(7)
	2004	3,284	99.9	2,920	88.8	3	0.1	3,287	100.0	(12)
Construction	1999	611,785	99.9	566,904	92.6	365	0.1	612,150	100.0	—
	2001	606,656	100.0	564,188	93.0	287	0.0	606,943	100.0	(96)
	2004	564,100	100.0	528,027	93.6	252	0.0	564,352	100.0	(113)
Manufacturing	1999	678,075	99.4	583,960	85.6	3,780	0.6	681,855	100.0	—
	2001	639,869	99.4	549,397	85.4	3,776	0.6	643,645	100.0	(198)
	2004	572,965	99.4	489,562	84.9	3,447	0.6	576,412	100.0	(245)
Electricity, gas, heat supply, and water	1999	3,513	97.3	1,925	53.3	96	2.7	3,609	100.0	—
	2001	3,389	97.7	1,802	51.9	81	2.3	3,470	100.0	(23)
	2004	2,984	97.1	1,595	51.9	89	2.9	3,073	100.0	(24)
Information and communications	1999	44,448	96.0	24,834	53.6	1,841	4.0	46,289	100.0	—
	2001	57,257	96.4	34,105	57.4	2,113	3.6	59,370	100.0	(130)
	2004	52,397	96.2	30,282	55.6	2,065	3.8	54,462	100.0	(151)
Transport	1999	141,226	99.7	104,451	73.7	495	0.3	141,721	100.0	—
	2001	137,142	99.6	99,975	72.6	501	0.4	137,643	100.0	(261)
	2004	129,544	99.6	94,099	72.4	512	0.4	130,056	100.0	(392)
Wholesaling/retailing	1999	1,843,477	99.0	1,313,088	70.5	18,298	1.0	1,861,775	100.0	—
	2001	1,783,800	98.9	1,258,898	69.8	20,629	1.1	1,804,429	100.0	(1,410)
	2004	1,607,384	98.8	1,116,545	68.6	19,059	1.2	1,626,443	100.0	(2,069)
Wholesale trade	1999	441,302	99.2	238,670	53.6	3,577	0.8	444,879	100.0	—
	2001	400,302	99.1	216,998	53.7	3,496	0.9	403,798	100.0	(358)
	2004	383,718	99.2	210,909	54.5	3,018	0.8	386,736	100.0	(384)
Retail trade	1999	1,402,175	99.0	1,074,418	75.8	14,721	1.0	1,416,896	100.0	—
	2001	1,383,498	98.8	1,041,900	74.4	17,133	1.2	1,400,631	100.0	(1,052)
	2004	1,223,666	98.7	905,636	73.1	16,041	1.3	1,239,707	100.0	(1,685)
Finance and insurance	1999	101,394	99.7	80,192	78.8	337	0.3	101,731	100.0	—
	2001	99,600	99.6	80,632	80.7	369	0.4	99,969	100.0	(124)
	2004	85,219	99.6	68,676	80.3	354	0.4	85,573	100.0	(152)
Real estate	1999	323,141	100.0	317,435	98.2	68	0.0	323,209	100.0	—
	2001	326,714	100.0	321,173	98.3	76	0.0	326,790	100.0	(683)
	2004	316,395	100.0	311,012	98.3	76	0.0	316,471	100.0	(755)
Eating and drinking places, accommodations	1999	878,439	99.4	675,442	76.4	5,276	0.6	883,715	100.0	—
	2001	862,612	99.4	644,660	74.3	4,819	0.6	867,431	100.0	(1,077)
	2004	798,775	99.5	587,268	73.2	3,932	0.5	802,707	100.0	(753)
Medical, health care, and welfare	1999	235,891	98.0	128,665	53.4	4,847	2.0	240,738	100.0	—
	2001	252,855	97.9	130,989	50.7	5,382	2.1	258,237	100.0	(94)
	2004	269,248	97.7	133,277	48.4	6,251	2.3	275,499	100.0	(123)
Education, learning support	1999	158,962	99.2	119,390	74.5	1,334	0.8	160,296	100.0	—
	2001	165,194	99.2	123,026	73.9	1,351	0.8	166,545	100.0	(429)
	2004	162,968	99.2	119,878	72.9	1,365	0.8	164,333	100.0	(269)
Compound services	1999	32,806	98.6	18,718	56.3	458	1.4	33,264	100.0	—
	2001	33,673	98.6	18,922	55.4	484	1.4	34,157	100.0	(132)
	2004	30,143	98.5	16,834	55.0	444	1.5	30,587	100.0	(219)
Services (not otherwise classified)	1999	1,083,730	99.4	850,546	78.0	6,587	0.6	1,090,317	100.0	—
	2001	1,099,133	99.3	857,308	77.5	7,535	0.7	1,106,668	100.0	(1,199)
	2004	1,068,961	99.3	834,709	77.5	7,758	0.7	1,076,719	100.0	(2,004)
Non-primary industry total	1999	6,141,042	99.3	4,789,091	77.4	43,787	0.7	6,184,829	100.0	—
	2001	6,071,654	99.2	4,688,360	76.6	47,407	0.8	6,119,061	100.0	(5,863)
	2004	5,664,367	99.2	4,334,684	75.9	45,607	0.8	5,709,974	100.0	(7,281)

Source: Recompiled from MIC, *Establishment and Enterprise Census of Japan*.

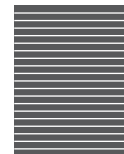
- Notes:
1. Business establishments with 300 or fewer workers (100 or fewer in wholesaling and services, 50 or fewer in retailing and eating and drinking places) are treated as small and medium business establishments as defined under the revised Small and Medium Enterprise Basic Law.
 2. Business establishments with 20 or fewer workers (5 or fewer in wholesaling, retailing, eating and drinking places, and services) are treated as small business establishments.
 3. The percentages of the total for small business establishments indicate their proportion of the total number of business establishments.
 4. Industries are classified according to the March 2002 revised system of industry classification. The old minor industry groups for 1999 and 2001 were concatenated with the minor industry groups under the new system of classification.
 5. The figures for 2001 and 2004 include business establishments with only temporary staff and subcontracted workers (total number of workers = 0).

(2) Enterprises

		SMEs				Large enterprises		Total	
				Of which small enterprises					
Industry	Year	No.	% of total	No.	% of total	No.	% of total	No.	% of total
Mining	1999	3,074	99.8	2,633	85.5	5	0.2	3,079	100.0
	2001	2,618	99.7	2,276	86.6	9	0.3	2,627	100.0
	2004	2,306	99.8	2,027	87.7	5	0.2	2,311	100.0
Construction	1999	555,372	99.9	526,027	94.6	475	0.1	555,847	100.0
	2001	543,397	99.9	516,405	95.0	363	0.1	543,760	100.0
	2004	507,086	99.9	484,828	95.6	319	0.1	507,405	100.0
Manufacturing	1999	599,512	99.6	532,691	88.5	2,382	0.4	601,894	100.0
	2001	548,830	99.6	489,306	88.8	2,121	0.4	550,951	100.0
	2004	489,115	99.6	433,917	88.4	1,941	0.4	491,056	100.0
Electricity, gas, heat supply, and water	1999	521	95.2	274	50.1	26	4.8	547	100.0
	2001	510	94.8	266	49.4	28	5.2	538	100.0
	2004	490	94.6	262	50.6	28	5.4	518	100.0
Information and communications	1999	26,314	96.3	15,566	57.0	1,014	3.7	27,328	100.0
	2001	32,240	96.8	19,486	58.5	1,070	3.2	33,310	100.0
	2004	30,815	96.5	18,358	57.5	1,129	3.5	31,944	100.0
Transport	1999	91,918	99.6	71,969	78.0	328	0.4	92,246	100.0
	2001	86,046	99.7	66,999	77.6	281	0.3	86,327	100.0
	2004	80,479	99.7	62,345	77.2	262	0.3	80,741	100.0
Wholesaling/retailing	1999	1,378,112	99.6	1,148,472	83.0	6,043	0.4	1,384,155	100.0
	2001	1,309,984	99.5	1,092,042	83.0	5,938	0.5	1,315,922	100.0
	2004	1,160,469	99.6	958,117	82.2	4,789	0.4	1,165,258	100.0
Wholesale trade	1999	293,903	99.2	203,261	68.6	2,259	0.8	296,162	100.0
	2001	255,587	99.1	176,374	68.4	2,394	0.9	257,981	100.0
	2004	252,390	99.2	176,360	69.3	2,130	0.8	254,520	100.0
Retail trade	1999	1,084,209	99.7	945,211	86.9	3,784	0.3	1,087,993	100.0
	2001	1,054,397	99.7	915,668	86.6	3,544	0.3	1,057,941	100.0
	2004	908,079	99.7	781,757	85.8	2,659	0.3	910,738	100.0
Finance and insurance	1999	33,118	98.9	31,842	95.1	363	1.1	33,481	100.0
	2001	34,281	99.1	33,126	95.8	313	0.9	34,594	100.0
	2004	30,192	99.1	29,120	95.6	283	0.9	30,475	100.0
Real estate	1999	294,976	100.0	291,309	98.7	102	0.0	295,078	100.0
	2001	297,082	100.0	293,782	98.9	94	0.0	297,176	100.0
	2004	287,005	100.0	283,704	98.8	91	0.0	287,096	100.0
Eating and drinking places, accommodations	1999	772,760	99.9	683,485	88.3	1,158	0.1	773,918	100.0
	2001	742,710	99.9	655,641	88.2	914	0.1	743,624	100.0
	2004	677,390	99.9	597,980	88.2	870	0.1	678,260	100.0
Medical, health care, and welfare	1999	169,588	99.8	132,772	78.2	275	0.2	169,863	100.0
	2001	175,542	99.9	134,995	76.8	261	0.1	175,803	100.0
	2004	178,912	100.0	136,098	76.0	80	0.0	178,992	100.0
Education, learning support	1999	115,764	99.9	105,171	90.7	154	0.1	115,918	100.0
	2001	119,100	99.9	108,115	90.7	122	0.1	119,222	100.0
	2004	114,722	99.9	104,167	90.7	121	0.1	114,843	100.0
Compound services	1999	3,590	100.0	3,588	99.9	0	0.0	3,590	100.0
	2001	3,960	100.0	3,957	99.9	0	0.0	3,960	100.0
	2004	3,588	100.0	3,587	100.0	0	0.0	3,588	100.0
Services (not otherwise classified)	1999	792,144	99.7	682,982	86.0	2,016	0.3	794,160	100.0
	2001	793,308	99.8	685,773	86.2	1,917	0.2	795,225	100.0
	2004	763,773	99.8	662,353	86.5	1,875	0.2	765,648	100.0
Non-primary industry total	1999	4,836,763	99.7	4,228,781	87.2	14,341	0.3	4,851,104	100.0
	2001	4,689,608	99.7	4,102,169	87.2	13,431	0.3	4,703,039	100.0
	2004	4,326,342	99.7	3,776,863	87.1	11,793	0.3	4,338,135	100.0

Source: Recompiled from MIC, *Establishment and Enterprise Census of Japan*.

- Notes:
1. Number of enterprises = number of companies + business establishments of sole proprietors (independent establishments and head offices).
 2. SMEs are enterprises with 300 or fewer regular employees (100 or fewer in wholesaling and services, and 50 or fewer in retailing and eating and drinking places) or capital stock of ¥300 million or less (¥100 million or less in wholesaling, and ¥50 million or less in retailing, eating and drinking places, and services) as defined under the Small and Medium Enterprise Basic Law.
 3. Small enterprises are enterprises with 20 or fewer regular employees (5 or fewer in wholesaling, retailing, eating and drinking places, and services).
 4. The percentages of the total for small business enterprises indicate their proportion of the total number of enterprises.
 5. Industries are classified according to the March 2002 revised system of industry classification. The old minor industry groups for 1999 and 2001 were concatenated with the minor industry groups under the new system of classification.



(3) Companies

Industry		SMEs				Large enterprises		Total	
		No.		% of total		No.		% of total	
Year	No.	% of total	No.	% of total	No.	% of total	No.	% of total	
Mining	1999	2,496	99.8	2,061	82.4	5	0.2	2,501	100.0
	2001	2,136	99.6	1,797	83.8	9	0.4	2,145	100.0
	2004	1,909	99.7	1,634	85.4	5	0.3	1,914	100.0
Construction	1999	301,407	99.8	272,282	90.2	475	0.2	301,882	100.0
	2001	298,977	99.9	272,228	90.9	363	0.1	299,340	100.0
	2004	283,465	99.9	261,377	92.1	319	0.1	283,784	100.0
Manufacturing	1999	312,893	99.2	246,808	78.3	2,382	0.8	315,275	100.0
	2001	290,555	99.3	231,648	79.1	2,121	0.7	292,676	100.0
	2004	267,370	99.3	212,689	79.0	1,941	0.7	269,311	100.0
Electricity, gas, heat supply, and water	1999	499	95.0	252	48.0	26	5.0	525	100.0
	2001	508	94.8	264	49.3	28	5.2	536	100.0
	2004	489	94.6	261	50.5	28	5.4	517	100.0
Information and communications	1999	23,709	95.9	13,022	52.7	1,014	4.1	24,723	100.0
	2001	28,771	96.4	16,104	54.0	1,070	3.6	29,841	100.0
	2004	28,155	96.1	15,747	53.8	1,129	3.9	29,284	100.0
Transport	1999	49,292	99.3	29,403	59.3	328	0.7	49,620	100.0
	2001	48,096	99.4	29,119	60.2	281	0.6	48,377	100.0
	2004	46,215	99.4	28,139	60.5	262	0.6	46,477	100.0
Wholesaling/retailing	1999	511,438	99.0	321,036	62.1	5,208	1.0	516,646	100.0
	2001	488,509	99.0	312,181	63.2	5,092	1.0	493,601	100.0
	2004	448,986	98.9	284,163	62.6	4,789	1.1	453,775	100.0
Wholesale trade	1999	207,421	98.9	120,616	57.5	2,259	1.1	209,680	100.0
	2001	187,170	98.7	111,287	58.7	2,391	1.3	189,561	100.0
	2004	181,516	98.8	108,452	59.1	2,130	1.2	183,646	100.0
Retail trade	1999	304,017	99.0	200,420	65.3	2,949	1.0	306,966	100.0
	2001	301,339	99.1	200,894	66.1	2,701	0.9	304,040	100.0
	2004	267,470	99.0	175,711	65.0	2,659	1.0	270,129	100.0
Finance and insurance	1999	15,558	97.7	14,283	89.7	363	2.3	15,921	100.0
	2001	16,594	98.1	15,440	91.3	313	1.9	16,907	100.0
	2004	16,195	98.3	15,124	91.8	283	1.7	16,478	100.0
Real estate	1999	97,100	99.9	93,534	96.2	102	0.1	97,202	100.0
	2001	100,057	99.9	96,861	96.7	94	0.1	100,151	100.0
	2004	97,309	99.9	94,083	96.6	91	0.1	97,400	100.0
Eating and drinking places, accommodations	1999	103,114	98.9	50,292	48.2	1,140	1.1	104,254	100.0
	2001	93,581	99.1	47,180	49.9	887	0.9	94,468	100.0
	2004	89,892	99.0	45,905	50.6	870	1.0	90,762	100.0
Medical, health care, and welfare	1999	5,133	99.2	3,011	58.2	39	0.8	5,172	100.0
	2001	6,069	99.2	3,431	56.1	46	0.8	6,115	100.0
	2004	10,066	99.2	4,390	43.3	80	0.8	10,146	100.0
Education, learning support	1999	10,971	98.7	4,620	41.5	150	1.3	11,121	100.0
	2001	11,048	99.0	4,909	44.0	116	1.0	11,164	100.0
	2004	11,642	99.0	5,517	46.9	121	1.0	11,763	100.0
Compound services	1999	33	100.0	31	93.9	0	0.0	33	100.0
	2001	46	100.0	43	93.5	0	0.0	46	100.0
	2004	35	100.0	34	97.1	0	0.0	35	100.0
Services (not otherwise classified)	1999	211,510	99.1	121,074	56.7	1,995	0.9	213,505	100.0
	2001	210,545	99.1	122,829	57.8	1,898	0.9	212,443	100.0
	2004	206,466	99.1	122,634	58.9	1,875	0.9	208,341	100.0
Non-primary industry total	1999	1,645,153	99.2	1,171,709	70.7	13,227	0.8	1,658,380	100.0
	2001	1,595,492	99.2	1,154,034	71.8	12,318	0.8	1,607,810	100.0
	2004	1,508,194	99.2	1,091,697	71.8	11,793	0.8	1,519,987	100.0

Source: Recompiled from MIC, *Establishment and Enterprise Census of Japan*.

Notes:

1. Business establishments of sole proprietors not included.
2. SMEs are enterprises with 300 or fewer regular employees (100 or fewer in wholesaling and services, and 50 or fewer in retailing and eating and drinking places) or capital stock of ¥300 million or less (¥100 million or less in wholesaling, and ¥50 million or less in retailing, eating and drinking places, and services) as defined under the Small and Medium Enterprise Basic Law.
3. Small enterprises are enterprises with 20 or fewer regular employees (5 or fewer in wholesaling, retailing, eating and drinking places, and services).
4. The percentages of the total for small business enterprises indicate their proportion of the total number of enterprises.
5. Industries are classified according to the March 2002 revised system of industry classification. The old minor industry groups for 1999 and 2001 were concatenated with the minor industry groups under the new system of classification.

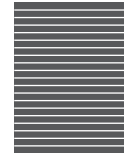
Table 2 Number of enterprises and number of regular employees/workers by prefecture (private, non-primary industry, 2004)

(1) Number of enterprises

	SMEs				Large enterprises		Total	
	No.	% of total	Of which small enterprises		No.	% of total	No.	% of total
			No.	% of total				
Hokkaido	171,056	99.8	147,324	86.0	350	0.2	171,406	100.0
Aomori	51,400	99.8	45,433	88.3	78	0.2	51,478	100.0
Iwate	47,935	99.9	42,206	87.9	70	0.1	48,005	100.0
Miyagi	73,768	99.8	64,360	87.0	171	0.2	73,939	100.0
Akita	44,011	99.9	39,192	89.0	45	0.1	44,056	100.0
Yamagata	49,431	99.8	44,078	89.0	84	0.2	49,515	100.0
Fukushima	75,290	99.9	66,993	88.9	87	0.1	75,377	100.0
Ibaraki	94,957	99.9	84,321	88.7	116	0.1	95,073	100.0
Tochigi	72,926	99.9	65,141	89.2	104	0.1	73,030	100.0
Gunma	80,028	99.9	71,757	89.6	102	0.1	80,130	100.0
Saitama	179,573	99.9	159,131	88.5	265	0.1	179,838	100.0
Chiba	136,131	99.8	118,899	87.2	239	0.2	136,370	100.0
Tokyo	505,274	99.1	423,197	83.0	4,477	0.9	509,751	100.0
Kanagawa	206,373	99.7	177,457	85.7	577	0.3	206,950	100.0
Niigata	97,131	99.8	86,241	88.6	153	0.2	97,284	100.0
Toyama	44,135	99.8	38,742	87.6	90	0.2	44,225	100.0
Ishikawa	50,611	99.7	44,761	88.2	127	0.3	50,738	100.0
Fukui	36,577	99.9	32,551	88.9	49	0.1	36,626	100.0
Yamanashi	38,024	99.9	34,345	90.2	47	0.1	38,071	100.0
Nagano	88,444	99.8	79,351	89.6	162	0.2	88,606	100.0
Gifu	87,799	99.9	78,026	88.7	119	0.1	87,918	100.0
Shizuoka	146,628	99.8	129,835	88.4	223	0.2	146,851	100.0
Aichi	246,950	99.7	212,171	85.7	684	0.3	247,634	100.0
Mie	62,790	99.9	55,536	88.3	91	0.1	62,881	100.0
Shiga	40,082	99.9	35,186	87.7	53	0.1	40,135	100.0
Kyoto	101,364	99.8	89,655	88.3	186	0.2	101,550	100.0
Osaka	330,737	99.6	286,604	86.3	1,256	0.4	331,993	100.0
Hyogo	173,811	99.8	152,029	87.3	327	0.2	174,138	100.0
Nara	36,122	99.9	31,907	88.3	33	0.1	36,155	100.0
Wakayama	43,211	99.9	39,294	90.9	31	0.1	43,242	100.0
Tottori	20,185	99.8	17,671	87.4	37	0.2	20,222	100.0
Shimane	28,480	99.9	25,211	88.4	28	0.1	28,508	100.0
Okayama	60,823	99.8	53,067	87.1	107	0.2	60,930	100.0
Hiroshima	96,268	99.8	83,655	86.7	176	0.2	96,444	100.0
Yamaguchi	49,731	99.9	43,387	87.1	66	0.1	49,797	100.0
Tokushima	31,500	99.9	28,498	90.4	25	0.1	31,525	100.0
Kagawa	37,554	99.8	33,107	88.0	75	0.2	37,629	100.0
Ehime	54,843	99.9	48,779	88.8	76	0.1	54,919	100.0
Kochi	31,267	99.9	28,061	89.7	28	0.1	31,295	100.0
Fukuoka	160,831	99.8	138,114	85.7	367	0.2	161,198	100.0
Saga	29,882	99.9	26,178	87.5	31	0.1	29,913	100.0
Nagasaki	51,864	99.9	45,709	88.0	53	0.1	51,917	100.0
Kumamoto	59,705	99.9	52,068	87.1	78	0.1	59,783	100.0
Oita	43,010	99.9	37,640	87.4	54	0.1	43,064	100.0
Miyazaki	42,530	99.9	37,735	88.6	51	0.1	42,581	100.0
Kagoshima	61,125	99.9	54,420	88.9	79	0.1	61,204	100.0
Okinawa	54,175	99.9	47,840	88.2	66	0.1	54,241	100.0
Total	4,326,342	99.7	3,776,863	87.1	11,793	0.3	4,338,135	100.0

Source: Recompiled from MIC, *Establishment and Enterprise Census of Japan* (2004).

- Notes:
1. Number of enterprises = number of companies + business establishments of sole proprietors (independent establishments and head offices).
 2. SMEs are enterprises with 300 or fewer regular employees (100 or fewer in wholesaling and services, 50 or fewer in retailing and eating and drinking places) or capital stock of ¥300 million or less (¥100 million or less in wholesaling, ¥50 million or less in retailing, eating and drinking places, and services).
 3. Small enterprises are enterprises with 20 or fewer regular employees (5 or fewer in wholesaling, retailing, eating and drinking places, and services).
 4. The percentages of the total for small enterprises indicate their proportion of the total number of enterprises.
 5. Industries are classified according to the March 2002 revised system of industry classification.



(2) Number of regular employees and workers

	SMEs				Large enterprises		Total	
	No. of regular company employees + total no. of workers of sole proprietors	% of total	Of which small enterprises		No. of regular company employees + total no. of workers of sole proprietors	% of total	No. of regular company employees + total no. of workers of sole proprietors	% of total
			No. of regular company employees + total no. of workers of sole proprietors	% of total				
Hokkaido	1,119,079	83.6	377,352	28.2	219,410	16.4	1,338,489	100.0
Aomori	296,138	89.3	116,453	35.1	35,565	10.7	331,703	100.0
Iwate	297,189	89.9	112,785	34.1	33,491	10.1	330,680	100.0
Miyagi	468,085	83.4	167,945	29.9	93,344	16.6	561,429	100.0
Akita	251,397	92.2	102,894	37.7	21,255	7.8	272,652	100.0
Yamagata	277,135	85.9	113,105	35.1	45,349	14.1	322,484	100.0
Fukushima	428,366	87.5	173,687	35.5	61,236	12.5	489,602	100.0
Ibaraki	550,423	86.4	228,362	35.9	86,565	13.6	636,988	100.0
Tochigi	392,511	86.5	165,963	36.6	61,244	13.5	453,755	100.0
Gunma	445,104	81.5	182,949	33.5	101,022	18.5	546,126	100.0
Saitama	1,065,571	83.6	418,203	32.8	209,298	16.4	1,274,869	100.0
Chiba	800,349	77.4	299,303	28.9	234,037	22.6	1,034,386	100.0
Tokyo	4,323,764	44.3	1,051,123	10.8	5,426,468	55.7	9,750,232	100.0
Kanagawa	1,368,996	76.6	444,668	24.9	417,442	23.4	1,786,438	100.0
Niigata	584,173	87.5	230,989	34.6	83,111	12.5	667,284	100.0
Toyama	287,568	82.2	108,250	30.9	62,268	17.8	349,836	100.0
Ishikawa	307,157	85.4	119,169	33.1	52,666	14.6	359,823	100.0
Fukui	220,438	90.3	89,089	36.5	23,622	9.7	244,060	100.0
Yamanashi	194,876	89.7	88,549	40.8	22,374	10.3	217,250	100.0
Nagano	492,153	84.2	198,818	34.0	92,587	15.8	584,740	100.0
Gifu	514,708	85.4	211,197	35.0	88,270	14.6	602,978	100.0
Shizuoka	899,884	81.5	343,600	31.1	203,750	18.5	1,103,634	100.0
Aichi	1,798,843	69.9	579,930	22.5	775,072	30.1	2,573,915	100.0
Mie	374,725	87.2	148,506	34.5	55,172	12.8	429,897	100.0
Shiga	253,038	84.2	94,621	31.5	47,501	15.8	300,539	100.0
Kyoto	601,473	78.3	229,421	29.9	166,284	21.7	767,757	100.0
Osaka	2,373,617	62.8	776,321	20.5	1,406,022	37.2	3,779,639	100.0
Hyogo	1,086,300	81.4	401,949	30.1	248,466	18.6	1,334,766	100.0
Nara	215,100	92.4	90,510	38.9	17,609	7.6	232,709	100.0
Wakayama	207,133	88.4	100,984	43.1	27,075	11.6	234,208	100.0
Tottori	127,718	93.0	47,748	34.8	9,605	7.0	137,323	100.0
Shimane	162,417	91.9	68,667	38.9	14,298	8.1	176,715	100.0
Okayama	401,349	85.4	140,387	29.9	68,843	14.6	470,192	100.0
Hiroshima	650,821	79.5	217,408	26.5	168,113	20.5	818,934	100.0
Yamaguchi	311,079	83.0	114,171	30.5	63,657	17.0	374,736	100.0
Tokushima	157,846	91.6	71,443	41.5	14,386	8.4	172,232	100.0
Kagawa	226,599	79.5	84,139	29.5	58,488	20.5	285,087	100.0
Ehime	323,448	86.4	127,897	34.2	50,848	13.6	374,296	100.0
Kochi	165,954	91.9	70,879	39.3	14,620	8.1	180,574	100.0
Fukuoka	1,139,064	76.6	369,757	24.9	347,758	23.4	1,486,822	100.0
Saga	179,669	91.0	71,748	36.3	17,727	9.0	197,396	100.0
Nagasaki	294,099	91.5	120,917	37.6	27,365	8.5	321,464	100.0
Kumamoto	350,419	89.2	135,741	34.5	42,501	10.8	392,920	100.0
Oita	250,964	84.3	97,488	32.7	46,719	15.7	297,683	100.0
Miyazaki	233,568	89.8	97,192	37.4	26,569	10.2	260,137	100.0
Kagoshima	328,263	87.9	137,704	36.9	45,318	12.1	373,581	100.0
Okinawa	287,984	90.1	116,760	36.5	31,819	9.9	319,803	100.0
Total	28,086,554	71.0	9,856,741	24.9	11,466,209	29.0	39,552,763	100.0

Source: Recompiled from MIC, *Establishment and Enterprise Census of Japan* (2004).

- Notes:
1. Data are compiled according to the definitions provided under the revised Small and Medium Enterprise Basic Law (December 1999).
 2. The figures shown indicate the combined sum of regular employees of companies and the total number of workers of sole proprietors.
 3. "Regular employees" refers to permanent employees, part-time workers, and temporary workers (sole proprietors, unpaid family workers, and paid directors are not included). The total number of workers represents the total number of workers, including sole proprietors and unpaid family workers as well as regular employees.
 4. SMEs are companies with 300 or fewer regular employees (100 or fewer in wholesaling and services, 50 or fewer in retailing and eating and drinking places) or with capital stock of ¥300 million or less (¥100 million in wholesaling, ¥50 million or less in retailing, eating and drinking places, and services) and sole proprietors with 300 or fewer workers (100 or fewer in wholesaling and services, 50 or fewer in retailing).
 5. Small enterprises are companies with 20 or fewer regular employees (5 or fewer in wholesaling, retailing and services) and sole proprietors with 20 or fewer workers (5 or fewer in wholesaling, retailing and services).
 6. The percentages of the total small enterprises indicate the proportion of regular employees of companies and workers of sole proprietors accounted for by small enterprises.
 7. Industries are classified according to the March 2002 revised system of industry classification.

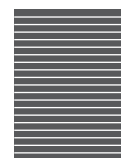
Table 3 Number of workers by industry and size (private)

(1) Business establishments

Industry	Year	Size Item	SMEs				Large business establishments		Total	
			No.	% of total	Of which small business establishments		No.	% of total	No.	% of total
Mining	1999		51,787	94.3	27,636	50.3	3,147	5.7	54,934	100.0
	2001		44,262	94.1	25,427	54.0	2,795	5.9	47,057	100.0
	2004		36,101	96.1	21,912	58.4	1,448	3.9	37,549	100.0
Construction	1999		4,875,254	95.8	3,005,959	59.1	214,246	4.2	5,089,500	100.0
	2001		4,778,737	96.7	3,024,411	61.2	164,874	3.3	4,943,611	100.0
	2004		4,240,384	96.8	2,764,947	63.1	142,029	3.2	4,382,413	100.0
Manufacturing	1999		8,425,330	74.7	3,083,844	27.3	2,855,662	25.3	11,280,992	100.0
	2001		8,137,677	74.3	2,964,485	27.1	2,819,073	25.7	10,956,750	100.0
	2004		7,455,508	75.0	2,629,993	26.5	2,484,941	25.0	9,940,449	100.0
Electricity, gas, heat supply, and water	1999		153,713	71.6	14,746	6.9	60,837	28.4	214,550	100.0
	2001		148,979	71.1	14,473	6.9	60,414	28.9	209,393	100.0
	2004		126,933	67.2	13,013	6.9	61,981	32.8	188,914	100.0
Information and communications	1999		664,484	54.3	106,801	8.7	559,472	45.7	1,223,956	100.0
	2001		774,407	54.9	142,895	10.1	636,829	45.1	1,411,236	100.0
	2004		740,757	53.6	129,919	9.4	641,559	46.4	1,382,316	100.0
Transport	1999		2,640,685	90.5	607,141	20.8	275,884	9.5	2,916,569	100.0
	2001		2,650,382	90.7	609,310	20.8	272,756	9.3	2,923,138	100.0
	2004		2,544,003	90.1	578,465	20.5	278,171	9.9	2,822,174	100.0
Wholesaling/retailing	1999		10,740,633	81.5	3,229,831	24.5	2,434,728	18.5	13,175,361	100.0
	2001		10,587,887	79.7	3,202,982	24.1	2,690,686	20.3	13,278,573	100.0
	2004		9,747,677	79.8	2,845,464	23.3	2,471,142	20.2	12,218,819	100.0
Wholesale trade	1999		3,944,553	82.9	701,803	14.7	814,029	17.1	4,758,582	100.0
	2001		3,559,465	82.6	643,366	14.9	751,982	17.4	4,311,447	100.0
Retail trade	2004		3,338,697	83.5	624,883	15.6	660,723	16.5	3,999,420	100.0
	1999		6,796,080	80.7	2,528,028	30.0	1,620,699	19.3	8,416,779	100.0
Finance and insurance	2001		7,028,422	78.4	2,559,616	28.5	1,938,704	21.6	8,967,126	100.0
	2004		6,408,980	78.0	2,220,581	27.0	1,810,419	22.0	8,219,399	100.0
Real estate	1999		1,491,079	86.5	556,030	32.3	232,303	13.5	1,723,382	100.0
	2001		1,391,465	84.6	548,181	33.3	253,199	15.4	1,644,664	100.0
	2004		1,201,074	83.9	469,052	32.8	230,066	16.1	1,431,140	100.0
Eating and drinking places, accommodations	1999		917,277	96.6	714,755	75.3	32,299	3.4	949,576	100.0
	2001		962,574	96.4	761,033	76.3	35,468	3.6	998,042	100.0
	2004		929,534	96.2	725,871	75.2	36,293	3.8	965,827	100.0
Medical, health care, and welfare	1999		4,360,996	88.7	1,608,029	32.7	556,103	11.3	4,917,099	100.0
	2001		4,586,932	89.8	1,573,881	30.8	520,805	10.2	5,107,737	100.0
	2004		4,365,775	90.6	1,427,037	29.6	450,947	9.4	4,816,722	100.0
Education, learning support	1999		2,060,994	64.1	345,809	10.7	1,156,042	35.9	3,217,036	100.0
	2001		2,359,179	65.3	361,838	10.0	1,252,297	34.7	3,611,476	100.0
	2004		2,719,112	65.4	368,181	8.9	1,437,124	34.6	4,156,236	100.0
Compound services	1999		939,351	75.1	207,226	16.6	310,918	24.9	1,250,269	100.0
	2001		997,008	76.0	222,789	17.0	315,616	24.0	1,312,624	100.0
	2004		1,027,798	75.1	219,074	16.0	339,944	24.9	1,367,742	100.0
Services (not otherwise classified)	1999		303,625	78.6	46,401	12.0	82,751	21.4	386,376	100.0
	2001		312,603	77.8	46,864	11.7	89,225	22.2	401,828	100.0
	2004		278,431	78.3	41,212	11.6	77,350	21.7	355,781	100.0
Non-primary industry total	1999		5,662,373	78.7	1,865,158	25.9	1,528,340	21.3	7,190,713	100.0
	2001		5,972,172	76.2	1,955,353	25.0	1,862,290	23.8	7,834,462	100.0
	2004		5,763,217	74.1	1,880,993	24.2	2,015,881	25.9	7,779,098	100.0
Non-primary industry total	1999		43,287,581	80.8	15,419,366	28.8	10,302,732	19.2	53,590,313	100.0
	2001		43,704,264	79.9	15,453,922	28.3	10,976,327	20.1	54,680,591	100.0
	2004		41,176,304	79.4	14,115,133	27.2	10,668,876	20.6	51,845,180	100.0

Source: Recompiled from MIC, *Establishment and Enterprise Census of Japan*.

- Notes:
1. Business establishments with 300 or fewer workers (100 or fewer in wholesaling and services, 50 or fewer in retailing and eating and drinking places) are treated as small and medium business establishments as defined under the revised Small and Medium Enterprise Basic Law.
 2. Business establishments with 20 or fewer workers (5 or fewer in wholesaling, retailing, eating and drinking places, and services) are treated as small business establishments.
 3. The percentages of the total for small business establishments indicate their proportion of the total number of business establishments.
 4. Industries are classified according to the March 2002 revised system of industry classification. The old minor industry groups for 1999 and 2001 were concatenated with the minor industry groups under the new system of classification.



(2) Enterprises (number of regular employees of companies and total number of workers of sole proprietors)

Industry	Size Item	SMEs				Large enterprises		Total	
		No. of regular company employees + total no. of workers of sole proprietors	% of total	Of which small enterprises		No. of regular company employees + total no. of workers of sole proprietors	% of total	No. of regular company employees + total no. of workers of sole proprietors	% of total
				No. of regular company employees + total no. of workers of sole proprietors	% of total				
Mining		25,242	87.6	12,266	42.6	3,568	12.4	28,810	100.0
Construction		3,074,742	88.0	1,942,530	55.6	420,697	12.0	3,495,439	100.0
Manufacturing		5,958,655	65.4	1,873,895	20.6	3,156,185	34.6	9,114,840	100.0
Electricity, gas, heat supply, and water		26,113	13.1	2,113	1.1	172,971	86.9	199,084	100.0
Information and communications		576,748	45.7	59,587	4.7	684,607	54.3	1,261,355	100.0
Transport		1,807,959	71.8	287,423	11.4	710,124	28.2	2,518,083	100.0
Wholesaling/retailing		6,848,868	67.9	2,007,430	19.9	3,231,336	32.1	10,080,204	100.0
Wholesale trade		2,326,957	69.7	396,103	11.9	1,009,349	30.3	3,336,306	100.0
Retail trade		4,521,911	67.1	1,611,327	23.9	2,221,987	32.9	6,743,898	100.0
Finance and insurance		166,977	16.0	68,497	6.5	878,823	84.0	1,045,800	100.0
Real estate		688,610	89.4	460,083	59.8	81,401	10.6	770,011	100.0
Eating and drinking places, accommodations		2,999,689	81.2	1,329,288	36.0	693,435	18.8	3,693,124	100.0
Medical, health care, and welfare		999,456	92.1	313,601	28.9	85,446	7.9	1,084,902	100.0
Education, learning support		454,076	88.7	171,402	33.5	57,881	11.3	511,957	100.0
Compound services		7,759	100.0	7,736	99.7	0	0.0	7,759	100.0
Services (not otherwise classified)		4,451,660	77.5	1,320,890	23.0	1,289,735	22.5	5,741,395	100.0
Non-primary industry total		28,086,554	71.0	9,856,741	24.9	11,466,209	29.0	39,552,763	100.0

Source: Recompiled from MIC, *Establishment and Enterprise Census of Japan (2004)*.

- Notes:
- Figures indicate the number of regular employees of companies combined with the total number of workers of sole proprietors (independent establishments and head offices).
 - SMEs are companies with 300 or fewer regular employees (100 or fewer in wholesaling and services, 50 or fewer in retailing and eating and drinking places) or with capital stock of ¥300 million or less (¥100 million or less in wholesaling, ¥50 million or less in retailing, eating and drinking places, and services) and sole proprietors with 300 or fewer workers (100 or fewer in wholesaling and services, 50 or fewer in retailing and eating and drinking places).
 - Small enterprises are companies with 20 or fewer regular employees (5 or fewer in wholesaling, retailing, eating and drinking places, and services) and sole proprietors with 20 or fewer workers (5 or fewer in wholesaling, retailing, eating and drinking places, and services).
 - The percentages of the total small enterprises indicate the proportion of regular employees of companies and workers of sole proprietors accounted for by small enterprises.
 - Industries are classified according to the March 2002 revised system of industry classification.

(3) Companies only (number of regular employees of companies)

Industry	Size Item	SMEs				Large enterprises		Total	
		No. of regular employees	% of total	Of which small enterprises		No. of regular employees	% of total	No. of regular employees	% of total
				No. of regular employees	% of total				
Mining		23,747	86.9	10,897	39.9	3,568	13.1	27,315	100.0
Construction		2,466,467	85.4	1,347,001	46.7	420,324	14.6	2,886,791	100.0
Manufacturing		5,289,260	62.6	1,228,828	14.6	3,156,185	37.4	8,445,445	100.0
Electricity, gas, heat supply, and water		26,111	13.1	2,111	1.1	172,971	86.9	199,082	100.0
Information and communications		569,043	45.4	53,210	4.2	684,607	54.6	1,253,650	100.0
Transport		1,750,381	71.1	232,812	9.5	710,124	28.9	2,460,505	100.0
Wholesaling/retailing		4,727,240	59.7	590,152	7.5	3,188,402	40.3	7,915,642	100.0
Wholesale trade		2,109,493	67.6	238,689	7.7	1,009,234	32.4	3,118,727	100.0
Retail trade		2,617,747	54.6	351,463	7.3	2,179,168	45.4	4,796,915	100.0
Finance and insurance		140,009	13.7	41,554	4.1	878,823	86.3	1,018,832	100.0
Real estate		416,090	83.6	189,352	38.1	81,401	16.4	497,491	100.0
Eating and drinking places, accommodations		1,185,297	63.2	113,202	6.0	691,375	36.8	1,876,672	100.0
Medical, health care, and welfare		160,792	75.1	10,008	4.7	53,244	24.9	214,036	100.0
Education, learning support		209,002	78.5	11,478	4.3	57,362	21.5	266,364	100.0
Compound services		90	100.0	67	74.4	0	0.0	90	100.0
Services (not otherwise classified)		3,111,790	70.8	272,912	6.2	1,285,318	29.2	4,397,108	100.0
Non-primary industry total		20,075,319	63.8	4,103,584	13.0	11,383,704	36.2	31,459,023	100.0

Source: Recompiled from MIC, *Establishment and Enterprise Census of Japan (2004)*.

- Notes:
- Business establishments of sole proprietors not included.
 - SMEs are companies with 300 or fewer regular employees (100 or fewer in wholesaling and services, 50 or fewer in retailing and eating and drinking places) or with capital stock of ¥300 million or less (¥100 million or less in wholesaling, ¥50 million or less in retailing, eating and drinking places, and services).
 - Small enterprises are companies with 20 or fewer regular employees (5 or fewer in wholesaling, retailing, eating and drinking places, and services).
 - The percentages of the total for small enterprises indicate the proportion of regular employees at enterprises of all size accounted for by small enterprises.
 - Industries are classified according to the March 2002 revised system of industry classification.

Table 4 Number of business establishments and workers and value of shipments in manufacturing

(1) Number of business establishments

No. of workers	Year										
	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
4~9	206,621	213,308	198,411	190,640	206,808	186,111	186,698	161,085	144,216	150,551	129,947
10~19	77,733	76,789	74,823	72,639	73,743	70,132	67,724	71,678	67,719	65,823	64,007
20~99	82,865	82,099	80,991	79,645	78,181	74,710	72,562	69,321	65,351	64,003	63,232
100~299	11,852	11,823	11,721	11,703	11,422	11,066	11,049	10,807	10,348	10,376	10,486
300~999	3,080	3,062	3,046	3,014	2,972	2,876	2,859	2,854	2,748	2,715	2,704
1,000 or more	674	645	620	605	587	562	529	522	466	443	461
4~299	379,071	384,019	365,946	354,627	370,154	342,019	338,033	312,891	287,634	290,753	267,672
300 or more	3,754	3,707	3,666	3,619	3,559	3,438	3,388	3,376	3,214	3,158	3,165
Total	382,825	387,726	369,612	358,246	373,713	345,457	341,421	316,267	290,848	293,911	270,837

(2) Number of workers

Upper row: 1,000 workers, lower row: % of total

No. of workers	Year										
	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
4~9	1,247	1,272	1,199	1,155	1,231	1,119	1,111	957	860	879	777
	12.0	12.3	11.9	11.6	12.5	11.9	12.1	10.8	10.3	10.7	9.6
10~19	1,074	1,061	1,036	1,007	1,021	971	938	976	921	894	869
	10.3	10.3	10.3	10.1	10.4	10.4	10.2	11.0	11.1	10.9	10.7
20~99	3,218	3,192	3,152	3,107	3,044	2,921	2,846	2,722	2,579	2,533	2,504
	30.9	30.9	31.2	31.3	30.9	31.1	31.0	30.7	31.0	30.8	30.9
100~299	1,903	1,897	1,879	1,881	1,834	1,776	1,776	1,739	1,664	1,675	1,693
	18.3	18.4	18.6	18.9	18.6	18.9	19.3	19.6	20.0	20.4	20.9
300~999	1,549	1,539	1,528	1,511	1,484	1,427	1,417	1,405	1,337	1,328	1,317
	14.9	14.9	15.1	15.2	15.1	15.2	15.4	15.8	16.1	16.1	16.2
1,000 or more	1,424	1,359	1,309	1,276	1,224	1,164	1,097	1,067	963	920	947
	13.7	13.2	13.0	12.8	12.4	12.4	11.9	12.0	11.6	11.2	11.7
4~299	7,443	7,422	7,266	7,150	7,130	6,787	6,670	6,395	6,024	5,980	5,843
	71.5	71.9	71.9	72.0	72.5	72.4	72.6	72.1	72.4	72.7	72.1
300 or more	2,973	2,898	2,837	2,787	2,708	2,591	2,513	2,471	2,300	2,248	2,264
	28.5	28.1	28.1	28.0	27.5	27.6	27.4	27.9	27.6	27.3	27.9
Total	10,416	10,321	10,103	9,937	9,838	9,378	9,184	8,866	8,324	8,228	8,107
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

(3) Value of shipments

Upper row: ¥ billion, lower row: % of total

No. of workers	Year										
	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
4~9	13,545	13,750	13,491	13,400	13,722	12,194	12,198	10,250	9,103	9,055	8,445
	4.5	4.5	4.3	4.1	4.5	4.2	4.1	3.6	3.4	3.3	3.0
10~19	16,219	16,318	16,314	16,492	16,280	15,001	14,742	14,733	13,384	12,986	13,033
	5.4	5.3	5.2	5.1	5.3	5.1	4.9	5.1	5.0	4.7	4.6
20~99	66,039	67,531	68,957	70,216	67,445	63,630	63,915	61,267	57,135	57,163	58,937
	22.1	22.1	22.0	21.7	22.1	21.8	21.3	21.4	21.2	20.9	20.7
100~299	57,698	59,541	60,761	63,917	60,493	59,724	62,770	60,568	58,154	59,069	63,640
	19.3	19.5	19.4	19.8	19.8	20.5	20.9	21.1	21.6	21.6	22.4
300~999	68,075	70,635	73,377	76,835	72,466	68,720	73,269	70,269	66,184	69,312	71,080
	22.8	23.1	23.4	23.8	23.7	23.6	24.4	24.5	24.6	25.3	25.0
1,000 or more	77,451	78,256	80,169	82,212	75,463	72,180	73,585	69,580	65,402	66,149	69,035
	25.9	25.6	25.6	25.4	24.7	24.8	24.5	24.3	24.3	24.2	24.3
4~299	153,501	157,139	159,523	164,025	157,940	150,550	153,624	146,818	137,776	138,274	144,056
	51.3	51.3	51.0	50.8	51.6	51.7	51.1	51.2	51.1	50.5	50.7
300 or more	145,526	148,890	153,546	159,047	147,929	140,900	146,854	139,849	131,586	135,461	140,115
	48.7	48.7	49.0	49.2	48.4	48.3	48.9	48.8	48.9	49.5	49.3
Total	299,027	306,030	313,068	323,072	305,869	291,450	300,478	286,667	269,362	273,734	284,171
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: METI, *Census of Manufactures*.

Notes: 1. Based on statistics for business establishments.

2. Preliminary estimates for 2004.

3. Table (1) shows the number of business establishments by number of workers at business establishments (plants).

Table 5 Capital investment and value added in manufacturing

(1) Capital investment

Upper row: ¥ billion, lower row: % of total

No. of workers \ Year	Year										
	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
30~99	1,864 16.9	1,734 15.4	1,962 15.5	2,137 16.0	1,975 14.8	1,659 15.0	1,522 13.4	1,712 14.5	1,416 14.9	1,399 15.7	1,463 14.2
100~299	2,536 22.9	2,658 23.6	2,829 22.4	2,982 22.3	2,929 22.0	2,621 23.6	2,604 23.0	2,812 23.7	2,292 24.1	2,121 23.8	2,371 22.9
300~999	3,111 28.1	3,209 28.5	3,906 30.9	4,052 30.3	4,195 31.4	3,271 29.5	3,529 31.2	3,571 30.1	2,859 30.1	2,606 29.2	2,901 28.1
1,000 or more	3,545 32.1	3,643 32.4	3,936 31.2	4,210 31.5	4,244 31.8	3,539 31.9	3,670 32.4	3,751 31.7	2,942 30.9	2,799 31.4	3,603 34.9
30~299	4,401 39.8	4,392 39.1	4,791 37.9	5,119 38.3	4,904 36.8	4,280 38.6	4,127 36.4	4,524 38.2	3,708 39.0	3,520 39.4	3,834 37.1
300 or more	6,656 60.2	6,852 60.9	7,842 62.1	8,262 61.7	8,439 63.2	6,809 61.4	7,199 63.6	7,322 61.8	5,800 61.0	5,405 60.6	6,503 62.9
Total	11,056 100.0	11,244 100.0	12,632 100.0	13,380 100.0	13,343 100.0	11,089 100.0	11,326 100.0	11,845 100.0	9,508 100.0	8,925 100.0	10,337 100.0

Investment per worker

(Unit: ¥1,000)

No. of workers \ Year	Year										
	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
30~99	844	791	906	1,000	940	820	771	907	788	792	839
100~299	1,333	1,401	1,506	1,585	1,597	1,476	1,466	1,617	1,377	1,266	1,401
300~999	2,008	2,085	2,557	2,681	2,827	2,292	2,490	2,542	2,138	1,962	2,202
1,000 or more	2,489	2,680	3,006	3,299	3,466	3,041	3,347	3,516	3,056	3,042	3,804
30~299	1,070	1,074	1,184	1,274	1,248	1,127	1,100	1,247	1,071	1,023	1,116
300 or more	2,239	2,364	2,764	2,964	3,116	2,628	2,864	2,963	2,522	2,404	2,872
Overall average	1,561	1,609	1,836	1,966	2,009	1,736	1,808	1,943	1,650	1,569	1,813

(2) Value added

Upper row: ¥ billion, lower row: % of total

No. of workers \ Year	Year										
	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
4~9	7,124 6.3	7,322 6.2	7,163 6.0	7,071 5.9	7,280 6.4	6,487 6.0	6,531 5.9	5,379 5.2	4,771 4.9	4,778 4.8	4,426 4.4
10~19	7,318 6.5	7,453 6.4	7,458 6.3	7,482 6.2	7,452 6.6	6,869 6.4	6,760 6.1	7,114 6.9	6,514 6.7	6,317 6.4	6,282 6.2
20~99	26,414 23.5	27,402 23.4	28,045 23.5	28,215 23.5	27,025 23.9	25,773 23.9	26,014 23.6	24,849 24.1	22,945 23.5	22,800 23.1	23,339 23.0
100~299	21,915 19.5	22,935 19.6	23,227 19.5	23,977 20.0	22,482 19.9	22,502 20.9	23,168 21.0	22,266 21.6	21,483 22.0	22,209 22.5	23,467 23.1
300~999	24,456 21.8	25,564 21.8	26,055 21.8	26,263 21.9	24,907 22.0	23,638 21.9	24,707 22.4	22,801 22.1	21,352 21.9	21,733 22.0	22,913 22.5
1,000 or more	25,122 22.4	26,527 22.6	27,355 22.9	26,865 22.4	24,090 21.3	22,590 20.9	23,063 20.9	20,896 20.2	20,394 20.9	20,821 21.1	21,250 20.9
4~299	62,771 55.9	65,113 55.6	65,894 55.2	66,745 55.7	64,239 56.7	61,631 57.1	62,472 56.7	59,608 57.7	55,713 57.2	56,104 56.9	57,513 56.6
10~299	55,647 49.5	57,791 49.3	58,731 49.2	59,673 49.8	56,959 50.3	55,144 51.1	55,942 50.7	54,229 52.5	50,942 52.3	51,326 52.0	53,087 52.2
300 or more	49,578 44.1	52,091 44.4	53,410 44.8	53,128 44.3	48,997 43.3	46,229 42.9	47,770 43.3	43,697 42.3	41,746 42.8	42,554 43.1	44,163 43.4
Total	112,349 100.0	117,204 100.0	119,304 100.0	119,873 100.0	113,236 100.0	107,860 100.0	110,243 100.0	103,305 100.0	97,459 100.0	98,658 100.0	101,677 100.0

Source: METI, *Census of Manufactures*.

Notes: 1. Based on statistics for business establishments.

2. Preliminary estimates for 2004.

3. Capital investment equals the value of acquisitions of tangible fixed assets plus the annual change in construction in progress.

4. Where business establishments of the head office are separate from plants, investment in the same is not included.

5. In Table (2), figures for business establishments with 4~9 workers up to 2000 and business establishments with 29 or fewer workers since 2001 indicate gross value added.

Table 6 Number of business establishments and workers and value of sales in wholesaling

(1) Number of business establishments and workers

No. of workers	No. of business establishments (1,000)						No. of workers (1,000)					
	1991	1994	1997	1999	2002	2004	1991	1994	1997	1999	2002	2004
1~2	101.8 (21.4)	90.4 (21.1)	83.1 (21.2)	95.5 (22.4)	84.7 (22.3)	86.4 (23.0)	177.5 (3.7)	158.2 (3.5)	144.1 (3.5)	155.4 (3.5)	143.5 (3.6)	145.2 (3.8)
3~4	123.3 (25.9)	103.0 (24.0)	94.1 (24.0)	98.2 (23.1)	88.7 (23.4)	89.7 (23.9)	424.8 (8.9)	356.4 (7.8)	325.4 (7.8)	339.8 (7.6)	306.8 (7.7)	309.7 (8.1)
5~9	132.1 (27.8)	120.1 (28.0)	109.0 (27.8)	118.1 (27.7)	105.4 (27.8)	102.9 (27.4)	861.1 (18.0)	786.0 (17.2)	714.4 (17.2)	774.1 (17.2)	690.5 (17.3)	674.0 (17.7)
10~19	70.5 (14.8)	67.8 (15.8)	61.8 (15.8)	67.2 (15.8)	59.7 (15.7)	57.3 (15.3)	938.0 (19.7)	901.8 (19.7)	823.2 (19.8)	895.4 (19.9)	795.3 (19.9)	764.2 (20.1)
20~49	36.4 (7.6)	36.0 (8.4)	32.7 (8.4)	35.3 (8.3)	30.9 (8.1)	29.6 (7.9)	1,066.1 (22.3)	1,055.4 (23.0)	960.6 (23.1)	1,038.4 (23.1)	904.9 (22.6)	866.8 (22.8)
50~99	8.4 (1.8)	8.4 (2.0)	7.6 (1.9)	8.1 (1.9)	7.1 (1.9)	6.5 (1.7)	567.6 (11.9)	565.2 (12.3)	514.5 (12.4)	546.4 (12.2)	477.9 (11.9)	433.2 (11.4)
1~99	472.5 (99.3)	425.7 (99.2)	388.4 (99.2)	422.5 (99.2)	376.4 (99.2)	372.4 (99.2)	4,034.8 (84.5)	3,823.1 (83.4)	3,482.3 (83.5)	3,749.5 (83.4)	3,319.0 (82.9)	3,193.1 (83.9)
100 or more	3.5 (0.7)	3.6 (0.8)	3.2 (0.8)	3.3 (0.8)	3.1 (0.8)	2.8 (0.8)	737.9 (15.5)	758.3 (16.6)	682.4 (16.4)	746.8 (16.6)	682.9 (17.1)	610.5 (16.1)
Total	476.0	429.3	391.6	425.9	379.5	375.3	4,772.7	4,581.4	4,164.7	4,496.2	4,002.0	3,803.7

(2) Total sales during the year and total sales during the year per worker

No. of workers	Total sales during the year (¥ billion)						Total sales during the year per worker (¥10,000)					
	1991	1994	1997	1999	2002	2004	1991	1994	1997	1999	2002	2004
1~2	8,162 (1.4)	6,595 (1.3)	6,524 (1.4)	7,122 (1.4)	6,703 (1.6)	6,761 (1.7)	4,626	4,180	4,541	4,589	4,684	4,664
3~4	23,788 (4.2)	19,413 (3.8)	18,761 (3.9)	18,269 (3.7)	16,468 (4.0)	16,347 (4.0)	5,610	5,453	5,774	5,380	5,379	5,284
5~9	64,403 (11.2)	54,115 (10.5)	53,712 (11.2)	51,949 (10.5)	46,523 (11.3)	45,869 (11.3)	7,487	6,890	7,526	6,714	6,745	6,809
10~19	82,024 (14.3)	72,162 (14.0)	71,782 (15.0)	71,069 (14.3)	61,319 (14.8)	61,045 (15.1)	8,753	8,008	8,727	7,940	7,720	7,993
20~49	108,734 (19.0)	98,992 (19.2)	96,020 (20.0)	97,431 (19.7)	83,828 (20.3)	85,057 (21.0)	10,212	9,380	10,006	9,387	9,274	9,821
50~99	68,696 (12.0)	64,689 (12.6)	61,076 (12.7)	62,778 (12.7)	51,321 (12.4)	52,348 (12.9)	12,122	11,452	11,878	11,499	10,745	12,093
1~99	355,807 (62.1)	315,966 (61.4)	307,875 (64.2)	308,618 (62.3)	266,162 (64.4)	267,426 (66.0)	8,831	8,265	8,851	8,235	8,030	8,381
100 or more	217,358 (37.9)	198,351 (38.6)	171,939 (35.8)	186,835 (37.7)	147,192 (35.6)	138,071 (34.0)	29,468	26,158	25,212	25,022	21,567	22,627
Total	573,165	514,317	479,813	495,453	413,355	405,497	12,024	11,236	11,533	11,024	10,341	10,668

Source: METI, *Census of Commerce*.

- Notes:
- The figures are tabulated according to the January 1984 revised system of industry classification for 1991, the May 1993 revised system for 1994-1999, and the March 2002 revised system for 2002-2004.
 - The 1999 survey was conducted at the same time as the MIC's *Establishment and Enterprise Census of Japan* (a simplified questionnaire was used for both surveys), which enabled existing business establishments to be determined. The figures are not therefore continuous with the figures for previous years.
 - "Number of business establishments" is expressed as "number of stores" in the *Census of Commerce* up to 1999. However, the two are the same in content.
 - Workers for calculating annual sales per worker exclude those employed in agency and intermediary business.

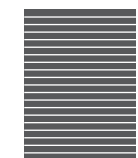


Table 7 Number of business establishments and workers and value of sales in retailing

(1) Number of business establishments and workers

No. of workers	No. of business establishments (1,000)						No. of workers (1,000)					
	1991	1994	1997	1999	2002	2004	1991	1994	1997	1999	2002	2004
1~2	847.2 (53.2)	764.8 (51.0)	709.0 (49.9)	685.0 (48.7)	603.4 (46.4)	568.8 (45.9)	1,381.3 (19.9)	1,240.0 (16.8)	1,146.0 (15.6)	1,035.1 (12.9)	966.3 (12.1)	906.8 (11.7)
3~4	416.9 (26.2)	370.9 (24.7)	350.3 (24.7)	317.2 (22.5)	297.6 (22.9)	284.1 (22.9)	1,404.5 (20.2)	1,256.1 (17.0)	1,186.6 (16.1)	1,076.0 (13.4)	1,011.4 (12.7)	962.4 (12.4)
5~9	214.0 (13.4)	222.5 (14.8)	212.4 (15.0)	226.8 (16.1)	218.7 (16.8)	207.7 (16.8)	1,336.9 (19.3)	1,405.2 (19.0)	1,342.5 (18.3)	1,448.8 (18.0)	1,404.5 (17.6)	1,334.9 (17.2)
10~19	71.9 (4.5)	89.6 (6.0)	93.5 (6.6)	111.9 (8.0)	114.8 (8.8)	112.4 (9.1)	948.2 (13.7)	1,187.2 (16.1)	1,248.3 (17.0)	1,503.8 (18.7)	1,543.0 (19.4)	1,516.5 (19.5)
20~49	33.1 (2.1)	42.0 (2.8)	43.3 (3.0)	51.9 (3.7)	50.7 (3.9)	50.2 (4.1)	956.4 (13.8)	1,200.9 (16.3)	1,232.2 (16.8)	1,470.3 (18.3)	1,439.8 (18.1)	1,421.6 (18.3)
1~49	1,583.1 (99.5)	1,489.9 (99.3)	1,408.5 (99.2)	1,392.8 (99.0)	1,285.1 (98.8)	1,223.1 (98.8)	6,027.3 (86.9)	6,289.4 (85.2)	6,155.7 (83.7)	6,534.0 (81.4)	6,364.9 (79.8)	6,142.2 (79.1)
50 or more	8.1 (0.5)	10.1 (0.7)	11.2 (0.8)	14.1 (1.0)	14.9 (1.1)	14.9 (1.2)	909.2 (13.1)	1,094.7 (14.8)	1,195.1 (16.3)	1,494.6 (18.0)	1,607.9 (20.2)	1,620.1 (20.9)
Total	1,591.2	1,499.9	1,419.7	1,406.9	1,300.1	1,238.0	6,936.5	7,384.2	7,350.7	8,028.6	7,972.8	7,762.3

(2) Total sales during the year and total sales during the year per worker

No. of workers	Total sales during the year (¥ billion)						Total sales during the year per worker (¥10,000)					
	1991	1994	1997	1999	2002	2004	1991	1994	1997	1999	2002	2004
1~2	15,224 (10.8)	13,332 (9.3)	12,485 (8.5)	10,830 (7.5)	8,816 (6.5)	8,411 (6.3)	1,102	1,075	1,089	1,046	912	928
3~4	23,006 (16.4)	20,054 (14.0)	19,573 (13.2)	15,464 (10.8)	13,457 (10.0)	12,646 (9.5)	1,638	1,597	1,649	1,437	1,331	1,314
5~9	28,878 (20.5)	28,999 (20.2)	28,558 (19.3)	26,305 (18.3)	24,398 (18.1)	23,395 (17.6)	2,160	2,064	2,127	1,816	1,737	1,753
10~19	21,409 (15.2)	23,826 (16.6)	26,051 (17.6)	27,050 (18.8)	26,510 (19.6)	26,253 (19.7)	2,258	2,007	2,087	1,799	1,718	1,731
20~49	21,151 (15.0)	23,919 (16.7)	25,198 (17.1)	25,774 (17.9)	24,223 (17.9)	24,445 (18.3)	2,211	1,992	2,045	1,753	1,682	1,720
1~49	109,668 (78.0)	110,131 (76.8)	111,865 (75.7)	105,423 (73.3)	97,404 (72.1)	95,151 (71.4)	1,820	1,751	1,817	1,613	1,530	1,549
50 or more	30,971 (22.0)	33,194 (23.2)	35,878 (24.3)	38,409 (26.7)	37,706 (27.9)	38,128 (28.6)	3,406	3,032	3,002	2,570	2,345	2,353
Total	140,639	143,325	147,743	143,832	135,109	133,279	2,028	1,941	2,010	1,791	1,695	1,717

Source: METI, *Census of Commerce*.

- Notes:
1. The figures are tabulated according to the January 1984 revised system of industry classification for 1991, the May 1993 revised system for 1994-1999, and the revised March 2002 system for 2002-2004.
 2. The 1999 survey was conducted at the same time as the MIC's *Establishment and Enterprise Census of Japan* (a simplified questionnaire was used for both surveys), which enabled existing business establishments to be determined. The figures are not therefore continuous with the figures for previous years.
 3. "Number of business establishments" is expressed as "number of stores" in the *Census of Commerce* up to 1999. However, the two are the same in content.

Table 8 Financial status, profit status and key financial indices of business corporations (median values)

(1) All industries

Item		Size	SMEs			Large enterprises		
		FY	2002	2003	2004	2002	2003	2004
Finances and profits	Sales		35,715	35,743	38,400	2,398,600	2,415,600	2,664,350
	Total assets		45,200	43,600	46,400	1,985,150	1,990,800	2,107,250
	Value added		8,800	8,900	9,600	468,050	468,300	506,950
	(Personnel costs)		7,100	6,900	7,100	330,700	322,100	343,150
	(Interest expenses)		147	100	100	5,700	4,900	4,400
	No. of workers (including officers)		16	16	17	538	527	560
Key financial indices	Quick ratio		84.7	88.6	92.4	76.3	78.5	79.3
	Equity ratio		24.8	25.9	26.6	32.5	33.7	35.0
	ROA		1.3	1.7	1.9	2.8	3.2	3.6
	Ratio of ordinary profit to sales		1.1	1.5	1.7	2.1	2.5	2.8
	Total capital turnover		1.0	1.1	1.1	1.2	1.2	1.3
	Interest rate on borrowing		1.7	1.6	1.1	1.6	1.6	1.3
	Value-added ratio		27.4	27.1	26.9	21.0	20.8	20.5
	Labor productivity		511	512	600	825	862	890
	Capital-labor ratio		500	475	417	946	936	931
	Ratio of fixed assets to long-term capital		73.5	65.1	67.8	86.9	73.2	82.3
	Debt redemption period (years)		12.8	10.4	9.1	6.5	5.7	5.1

(2) Manufacturing

Item		Size	SMEs			Large enterprises		
		FY	2002	2003	2004	2002	2003	2004
Finances and profits	Sales		112,450	105,400	108,600	3,005,450	3,261,400	3,524,250
	Total assets		104,000	94,500	95,150	3,226,150	3,298,900	3,434,900
	Value added		25,850	24,400	24,800	658,100	698,400	757,550
	(Personnel costs)		20,900	19,399	19,500	489,550	495,950	512,150
	(Interest expenses)		400	300	300	9,450	7,950	6,400
	No. of workers (including officers)		45	43	43	729	729	735
Key financial indices	Quick ratio		87.5	90.5	92.6	82.9	85.4	86.5
	Equity ratio		25.0	26.2	26.7	41.0	42.8	44.2
	ROA		1.8	2.4	2.8	3.0	3.6	4.2
	Ratio of ordinary profit to sales		1.3	1.8	2.3	2.8	3.5	4.2
	Total capital turnover		1.1	1.1	1.1	0.9	1.0	1.0
	Interest rate on borrowing		1.7	1.6	1.4	1.6	1.5	1.2
	Value-added ratio		27.2	27.0	26.3	22.5	22.6	22.2
	Labor productivity		548	552	654	907	954	1,027
	Capital-labor ratio		620	579	611	1,182	1,173	1,183
	Ratio of fixed assets to long-term capital		72.2	65.0	67.8	80.3	66.4	78.7
	Debt redemption period (years)		11.2	9.6	8.3	5.0	4.3	3.5

(3) Wholesaling/retailing

Item		Size	SMEs			Large enterprises		
		FY	2002	2003	2004	2002	2003	2004
Finances and profits	Sales		19,028	21,651	30,100	2,244,100	2,257,000	2,515,650
	Total assets		13,800	15,300	21,783	1,440,550	1,409,250	1,468,700
	Value added		3,200	3,700	4,400	280,150	270,750	293,000
	(Personnel costs)		3,100	3,137	3,800	196,600	181,150	190,700
	(Interest expenses)		64	66	80	4,600	4,100	3,800
	No. of workers (including officers)		8	9	10	358	344	355
Key financial indices	Quick ratio		78.7	82.0	85.6	66.2	67.9	71.4
	Equity ratio		17.1	16.6	18.1	25.2	25.2	26.3
	ROA		0.1	0.7	0.8	2.5	2.7	3.1
	Ratio of ordinary profit to sales		0.3	0.5	0.5	1.3	1.5	1.7
	Total capital turnover		1.6	1.7	1.7	1.7	1.8	1.8
	Interest rate on borrowing		1.5	1.4	0.9	1.6	1.6	1.3
	Value-added ratio		15.5	14.8	13.7	13.9	14.0	13.4
	Labor productivity		400	403	536	712	734	786
	Capital-labor ratio		206	220	226	755	759	802
	Ratio of fixed assets to long-term capital		59.8	53.2	54.4	96.7	82.3	87.9
	Debt redemption period (years)		24.8	20.9	18.8	10.3	9.7	8.7



(4) Services

Item	Size FY	SMEs			Large enterprises		
		2002	2003	2004	2002	2003	2004
Finances and profits	Sales	29,650	31,900	19,400	802,950	852,900	810,400
	Total assets	40,050	41,905	24,700	863,950	865,600	785,800
	Value added	8,600	9,300	6,300	287,700	288,100	279,900
	(Personnel costs)	8,100	8,100	5,100	188,250	187,500	186,800
	(Interest expenses)	21	6	6	1,800	1,700	1,700
	No. of workers (including officers)	18	19	14	336	337	393
Key financial indices	Quick ratio	104.8	113.2	100.0	99.3	98.7	86.8
	Equity ratio	31.6	34.7	26.5	35.9	37.4	33.0
	ROA	0.8	1.4	1.1	4.0	4.3	3.9
	Ratio of ordinary profit to sales	1.1	1.7	1.1	3.3	3.8	3.2
	Total capital turnover	0.8	0.9	1.0	1.2	1.1	1.2
	Interest rate on borrowing	1.4	1.4	0.1	1.7	1.7	1.2
	Value-added ratio	35.4	36.0	37.6	40.1	38.3	37.9
	Labor productivity	470	480	477	772	808	733
	Capital-labor ratio	330	229	187	430	475	440
	Ratio of fixed assets to long-term capital	72.9	58.7	68.7	77.7	68.9	83.4
	Debt redemption period (years)	6.5	5.9	7.1	3.7	3.3	3.6

(5) Construction

Item	Size FY	SMEs			Large enterprises		
		2002	2003	2004	2002	2003	2004
Finances and profits	Sales	27,400	25,000	28,492	4,802,850	4,195,100	4,458,900
	Total assets	20,000	18,200	20,500	4,214,900	3,820,400	3,836,000
	Value added	6,200	5,530	6,100	685,600	595,700	663,100
	(Personnel costs)	5,700	4,900	5,300	520,550	489,750	520,900
	(Interest expenses)	100	100	100	8,950	7,150	7,300
	No. of workers (including officers)	14	13	14	775	694	727
Key financial indices	Quick ratio	90.6	93.5	99.8	78.3	80.8	82.4
	Equity ratio	26.1	28.1	28.3	26.9	28.5	30.0
	ROA	1.4	1.4	1.7	1.8	2.2	2.2
	Ratio of ordinary profit to sales	0.9	0.9	1.1	1.5	1.9	1.7
	Total capital turnover	1.4	1.4	1.4	1.1	1.1	1.1
	Interest rate on borrowing	2.0	1.8	1.4	1.7	1.7	1.5
	Value-added ratio	21.8	21.9	20.6	14.8	15.5	15.2
	Labor productivity	485	460	600	955	943	958
	Capital-labor ratio	263	250	304	804	822	828
	Ratio of fixed assets to long-term capital	54.2	49.3	50.3	70.8	59.0	67.8
	Debt redemption period (years)	16.4	14.0	12.0	11.8	10.7	8.5

Source: Recompiled from MOF, *Financial Statements Statistics of Corporations by Industry*.

- Notes:
- Up to fiscal 2003, SMEs are defined as enterprises with capital of ¥300 million or less, or 300 or fewer employees (capital of ¥100 million or less, or 100 or fewer employees in wholesaling and services, and capital of ¥50 million or less, or 50 or fewer employees in retailing). In fiscal 2004, they are defined as enterprises with capital of ¥300 million or less, or 300 or fewer employees (capital of ¥100 million or less, or 100 or fewer employees in wholesaling, capital of ¥50 million or less, or 100 or fewer employees in services, and capital of ¥50 million or less, or 50 or fewer employees in retailing).
Large enterprises are all enterprises other than those defined as SMEs.
 - Value added = net operating profit + personnel costs (officers' pay, employees' pay, employee benefits) + interest expenses and discount charges + rent of movable property and real estate + taxes and public impositions
Quick ratio = quick assets / current liabilities x 100
Quick assets = cash and deposits + trade receivables
Equity ratio = equity / total capital x 100
ROA = operating profit / total capital (average of beginning and end of period) x 100
Ratio of ordinary profit to sales = ordinary profit / sales x 100
Total capital turnover = sales / total capital (average of beginning and end of period)
Interest rate on borrowing = Interest expenses and discount charges / short-term and long-term borrowing + bonds + notes receivable discounted (average of beginning and end of period) x 100
Value-added ratio = value added / sales x 100
Labor productivity = value added / number of employees
Capital-labor ratio = tangible fixed assets (excluding construction in progress, average of beginning and end of period) / number of employees
Ratio of fixed assets to long-term capital = fixed assets / fixed liabilities + equity x 100
Debt redemption period (years) = (short-term and long-term borrowing + bonds) (average at beginning and end of period) / (ordinary profit x 50% + depreciation costs + special depreciation costs - officers' bonus - interim dividends - dividends)
 - Figures for sales, total assets, value added (personnel costs, interest expenses, discount charges), labor productivity and capital-labor ratio are in units of ¥10,000.
Unit for number of employees (including officers): individual employees
Debt redemption period: in years
Figures for other financial ratios are expressed as percentages.
 - Figures are population medians.
 - The debt redemption period (in years) for enterprises whose denominator is negative is treated as infinite (i.e. unredeemable regardless of how many years elapse).

Table 9 Outstanding lending to SMEs by type of financial institution

(Unit: ¥ trillion)

Financial institution	Year Month	2000				2001				2002			
		Mar.	Jun.	Sept.	Dec.	Mar.	Jun.	Sept.	Dec.	Mar.	Jun.	Sept.	Dec.
City banks		96.4	100.3	103.2	101.2	102.7	96.4	97.5	93.9	93.9	92.8	89.9	90.0
Regional banks		70.6	74.9	76.1	76.5	75.6	72.6	72.9	72.9	71.5	68.8	68.2	68.8
Member banks of the Second Association of Regional Banks		30.3	30.5	30.5	30.8	28.9	27.1	27.1	27.2	26.3	25.4	25.2	25.5
Other		22.0	22.2	22.3	21.9	22.3	21.0	21.5	20.3	20.7	13.0	13.3	12.7
Domestically-licensed bank banking accounts total		219.2	228.0	232.0	230.4	229.5	217.1	218.9	214.4	212.4	200.0	196.6	197.0
Domestically-licensed bank trust accounts, etc.		3.5	3.4	3.1	2.8	3.9	3.5	3.1	2.9	2.7	2.4	2.6	2.4
Credit associations		48.0	47.1	47.7	47.6	45.9	45.0	45.1	45.2	43.5	42.4	42.3	43.0
Credit cooperatives		14.2	14.0	13.9	13.8	13.4	12.9	12.8	12.4	11.9	10.5	9.7	9.3
Private-sector financial institutions total		285.0	292.5	296.8	294.7	292.7	278.5	280.0	274.9	270.5	255.3	251.1	251.6
Private-sector financial institutions total (excluding trust accounts, etc.)		281.5	289.1	293.7	291.8	288.8	275.0	276.9	272.0	267.8	252.9	248.5	249.3
Shoko Chukin Bank		11.2	10.9	11.0	10.9	10.9	10.7	10.7	10.6	10.5	10.4	10.2	10.3
Japan Finance Corporation for Small and Medium Enterprise		7.5	7.5	7.6	7.6	7.5	7.5	7.5	7.6	7.5	7.5	7.5	7.6
National Life Finance Corporation		10.0	10.0	9.9	10.1	9.8	9.8	9.8	9.9	9.6	9.5	9.4	9.5
Government-affiliated financial institutions total		28.7	28.4	28.5	28.6	28.2	28.0	28.0	28.1	27.6	27.4	27.1	27.3
Total outstanding lending to SMEs		313.7	320.9	325.3	323.3	320.9	306.5	308.0	302.9	298.1	282.6	278.3	279.0
Total outstanding lending to SMEs (excluding trust accounts, etc.)		310.1	317.4	322.2	320.4	317.0	303.0	304.9	300.0	295.4	280.2	275.7	276.6

Financial institution	Year Month	2003				2004				2005			
		Mar.	Jun.	Sept.	Dec.	Mar.	Jun.	Sept.	Dec.	Mar.	Jun.	Sept.	Dec.
City banks		89.3	83.4	83.1	79.2	—	—	—	—	—	—	—	—
Regional banks		67.8	66.0	66.4	66.8	—	—	—	—	—	—	—	—
Member banks of the Second Association of Regional Banks		24.4	23.2	23.2	23.7	—	—	—	—	—	—	—	—
Other		12.5	11.1	11.9	10.7	—	—	—	—	—	—	—	—
Domestically-licensed bank banking accounts total		194.0	183.7	184.6	180.5	183.2	173.5	176.2	175.6	176.4	168.6	172.8	174.6
Domestically-licensed bank trust accounts, etc.		2.6	2.1	2.0	1.9	1.8	1.6	1.6	1.7	1.6	1.7	1.6	1.9
Credit associations		41.6	41.0	41.3	41.8	40.6	40.0	40.5	41.1	40.5	40.1	40.8	41.5
Credit cooperatives		9.2	9.1	9.2	9.2	9.1	9.0	9.1	9.2	9.2	9.1	9.2	9.3
Private-sector financial institutions total		247.4	235.8	237.1	233.4	234.7	224.2	227.5	227.7	227.6	219.5	224.4	227.3
Private-sector financial institutions total (excluding trust accounts, etc.)		244.7	233.7	235.1	231.5	232.9	222.6	225.9	226.0	226.1	217.8	222.8	225.4
Shoko Chukin Bank		10.1	9.9	9.9	10.0	9.8	9.7	9.7	9.8	9.6	9.5	9.5	9.6
Japan Finance Corporation for Small and Medium Enterprise		7.5	7.5	7.6	7.6	7.6	7.6	7.6	7.6	7.5	7.4	7.3	7.2
National Life Finance Corporation		9.2	9.2	9.1	9.2	8.9	8.9	8.8	8.8	8.4	8.3	8.2	8.2
Government-affiliated financial institutions total		26.8	26.6	26.7	26.8	26.3	26.1	26.1	26.2	25.5	25.2	25.0	24.9
Total outstanding lending to SMEs		274.1	262.5	263.7	260.3	261.0	250.3	253.5	253.9	253.1	244.7	249.4	252.3
Total outstanding lending to SMEs (excluding trust accounts, etc.)		271.5	260.4	261.7	258.4	259.2	248.7	251.9	252.2	251.6	243.0	247.8	250.3

Sources: Compiled by the SME Agency from sources including BOJ, *Monthly Financial and Economic Statistics*.

- Notes:
1. Outstanding lending to SMEs through domestically-licensed banking accounts and trust accounts, etc. indicates lending to enterprises with capital stock of ¥300 million [¥100 million] or less (¥100 million [¥30 million] or less in wholesaling, ¥50 million [¥10 million] or less in retailing, eating and drinking places, and services) or 300 or fewer regular employees (100 or fewer in wholesaling and services [50 or fewer in services], 50 or fewer in retailing and eating and drinking places). Figures in square brackets indicate definitions up to March 2000.
 2. "Other banks" are trust banks and long-term credit banks.
 3. "Domestically-licensed bank trust accounts, etc." includes overseas yen loans (to domestic borrowers).
 4. Outstanding lending to SMEs by credit associations is total outstanding lending excluding lending to individuals, local governments, overseas yen loans and domestic loans transferred overseas.
 5. Outstanding lending to SMEs by credit cooperatives is total outstanding lending including lending to individuals and local governments, etc.
 6. Outstanding lending by the Japan Finance Corporation for Small and Medium Enterprise does not include equipment loan lending and outstanding lending to small and medium business investment consultation companies.
 7. Due to the formation of the National Life Finance Corporation by the merger of the People's Finance Corporation and the Environmental Hygiene Corporation in October 1999, figures for lending represent the combined total of ordinary loans and environmental hygiene loans.
 8. No breakdown is given of the domestically-licensed banks banking accounts total from March 2004 onward as no coefficients according to type of financial institution are published for domestic banks from that month.



Table 10 State of corporate bankruptcies

(1) No. of corporate bankruptcies and debts

(Unit: no. of bankruptcies, ¥100 million)

Year		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
No. of bankruptcies	Overall	15,108	14,834	16,464	18,988	15,352	18,769	19,164	19,087	16,255	13,679	12,998
	Enterprises with capital stock of under ¥100 million	14,970	14,731	16,293	18,749	15,135	18,497	18,819	18,687	15,877	13,392	12,755
Debts	Overall	92,411	81,229	140,447	137,484	136,214	238,850	165,196	137,824	115,818	78,177	67,035
	Enterprises with capital stock of under ¥100 million	46,561	49,693	57,494	68,329	80,640	65,691	73,151	77,540	57,651	53,656	47,209

(2) No. of bankruptcies and debts by industry

(Unit: no. of bankruptcies, ¥100 million)

Year		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Construction	No. of bankruptcies	3,982	4,065	5,096	5,668	4,650	6,214	6,154	5,976	5,113	4,002	3,783
	Debts	8,006	8,939	24,000	22,236	12,860	14,510	20,592	24,976	15,591	11,037	8,439
Manufacturing	No. of bankruptcies	3,150	2,989	3,022	3,710	2,891	3,529	3,670	3,615	2,787	2,195	1,971
	Debts	10,075	9,188	9,702	18,844	11,443	12,167	18,289	17,628	13,060	6,643	6,393
Commerce	No. of bankruptcies	4,771	4,723	5,100	5,884	4,427	5,448	5,535	5,411	4,573	3,811	3,512
	Debts	14,463	10,948	26,098	22,563	14,036	46,506	41,047	19,566	14,745	10,619	7,909
Real estate	No. of bankruptcies	707	594	591	694	682	629	667	665	574	518	485
	Debts	11,737	20,526	17,703	20,013	47,664	48,604	30,042	21,771	24,892	15,352	17,058
Financial and insurance	No. of bankruptcies	91	66	82	87	136	77	89	75	75	61	95
	Debts	35,260	23,172	35,842	16,283	27,921	92,008	23,734	10,784	8,096	1,982	3,065
Services	No. of bankruptcies	1,778	1,743	1,825	2,000	1,868	2,052	2,198	2,398	2,380	2,245	2,329
	Debts	10,637	7,015	25,263	34,508	19,823	21,552	26,004	39,235	31,919	29,408	21,009
Other	No. of bankruptcies	629	654	748	945	698	820	851	947	753	847	823
	Debts	2,233	1,441	1,839	3,037	2,468	3,503	5,488	3,864	7,515	3,136	3,162
Total	No. of bankruptcies	15,108	14,834	16,464	18,988	15,352	18,769	19,164	19,087	16,255	13,679	12,998
	Debts	92,411	81,229	140,447	137,484	136,214	238,850	165,196	137,824	115,818	78,177	67,035

(3) Breakdown of number of bankruptcies by cause

(Unit: %)

Year	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Slump in sales	47.4	46.9	47.5	50.5	54.2	55.2	55.2	57.9	62.9	65.8	65.2
Careless management	17.4	17.3	15.6	13.8	13.0	11.2	9.5	8.0	7.3	7.6	7.8
Chain reaction bankruptcy	7.5	7.9	9.8	9.9	7.9	7.7	8.3	8.8	8.2	7.3	6.9
Past difficulties	8.1	10.6	11.1	12.0	11.4	12.9	14.7	14.6	12.5	10.0	10.9
Other	19.6	17.3	16.0	13.8	13.5	13.0	12.3	10.7	9.1	9.2	9.2

Source: Tokyo Shoko Research, Ltd., *Bankruptcy White Paper*.

Notes: 1. Only enterprises with debts of at least ¥10 million are included.

2. (2) is tabulated using the revised industry code from fiscal 2004 onward. Data for and up to 2003 are not corrected retrospectively.

3. (3) Totals do not all sum to 100% due to rounding to two decimal places.

Table 11 Trends in entry and exit rates (non-primary industries)

1) Enterprises (sole proprietorships + business companies)

Year	Survey interval (months)	No. of enterprises at start of period	No. of entries	Entry survey period (months)	Increase in no. of enterprises	Annual average increase in no. of enterprises	Annual average no. of entries	Annual average no. of exits	Entry rate (%)	Exit rate (%)
75-78	37	4,738,331	681,775	29.5	299,246	97,053	277,332	180,279	5.9	3.8
78-81	36.5	5,037,577	739,996	30	318,925	104,852	295,998	191,146	5.9	3.8
81-86	60	5,356,502	1,039,351	54	72,096	14,419	230,967	216,548	4.3	4.0
86-91	60	5,428,598	853,991	54	-126,240	-25,248	189,776	215,024	3.5	4.0
91-96	63	5,302,358	967,779	81	-147,968	-28,184	143,375	171,559	2.7	3.2
96-99	33	5,154,390	507,531	33	-253,477	-92,173	184,557	288,147	3.6	5.6
99-01	27	4,900,913	264,642	21	-160,984	-71,548	151,224	222,772	3.1	4.5
As of 2001 (1993 classification)		4,739,929								
01-04	32	4,739,635	447,148	32	-360,347	-135,130	167,681	289,731	3.5	6.1
As of 2004		4,379,288								

2) Business companies (independent establishments and head offices, not including branches)

Year	Survey interval (months)	No. of enterprises at start of period	No. of entries	Entry survey period (months)	Increase in no. of enterprises	Annual average increase in no. of enterprises	Annual average no. of entries	Annual average no. of exits	Entry rate (%)	Exit rate (%)
75-78	37	978,007	113,039	29.5	62,666	20,324	45,982	25,658	4.7	2.6
78-81	36.5	1,040,673	139,678	30	138,146	45,418	55,871	10,453	5.4	1.0
81-86	60	1,178,819	234,223	54	143,689	28,738	52,050	23,312	4.4	2.0
86-91	60	1,322,508	266,717	54	230,506	46,101	59,270	13,169	4.5	1.0
91-96	63	1,553,014	310,761	81	112,167	21,365	46,039	24,674	3.0	1.6
96-99	33	1,665,181	174,728	33	-6,801	-2,473	63,537	87,773	3.8	5.3
99-01	27	1,658,380	80,346	21	-50,570	-22,476	45,912	68,388	2.8	4.1
As of 2001 (1993 classification)		1,607,810								
01-04	32	1,607,648	155,161	32	-87,661	-32,873	58,185	88,739	3.6	5.5
As of 2004		1,519,987								

3) Sole proprietorships (independent establishments, head offices and branches)

Year	Survey interval (months)	No. of enterprises at start of period	No. of entries	Entry survey period (months)	Increase in no. of enterprises	Annual average increase in no. of enterprises	Annual average no. of entries	Annual average no. of exits	Entry rate (%)	Exit rate (%)
75-78	37	3,760,324	568,736	29.5	236,580	76,729	231,350	154,622	6.2	4.1
78-81	36.5	3,996,904	600,318	30	180,779	59,434	240,127	180,693	6.0	4.5
81-86	60	4,177,683	805,128	54	-71,593	-14,319	178,917	193,236	4.3	4.6
86-91	60	4,106,090	587,274	54	-356,746	-71,349	130,505	201,855	3.2	4.9
91-96	63	3,749,344	657,018	81	-260,135	-49,550	97,336	146,886	2.6	3.9
96-99	33	3,489,209	332,803	33	-246,676	-89,700	121,019	200,374	3.5	5.7
99-01	27	3,242,533	184,296	21	-110,414	-49,073	105,312	154,385	3.2	4.8
As of 2001 (1993 classification)		3,132,119								
01-04	32	3,131,987	291,987	32	-272,686	-102,257	109,495	200,991	3.5	6.4
As of 2004		2,859,301								

4) Business establishments

Year	Survey interval (months)	No. of enterprises at start of period	No. of entries	Entry survey period (months)	Increase in no. of enterprises	Annual average increase in no. of enterprises	Annual average no. of entries	Annual average no. of exits	Entry rate (%)	Exit rate (%)
66-69	36	4,230,738	964,474	42	419,757	139,919	275,564	135,645	6.5	3.2
69-72	38	4,650,495	863,915	32	463,228	146,283	323,968	177,686	7.0	3.8
72-75	32.5	5,113,723	744,865	28.5	275,577	101,752	313,627	211,876	6.1	4.1
75-78	37	5,389,300	818,730	29.5	460,021	149,196	333,043	183,847	6.2	3.4
78-81	36.5	5,849,321	896,325	30	419,750	138,000	358,530	220,530	6.1	3.8
81-86	60	6,269,071	1,324,318	54	225,270	45,054	294,293	249,239	4.7	4.0
86-89	36	6,494,341	826,723	36	127,905	42,635	275,574	232,939	4.2	3.6
89-91	24	6,622,246	406,977	18	-80,505	-40,253	271,318	311,571	4.1	4.7
91-94	33.7	6,541,741	846,139	33.7	-9,761	-3,476	301,296	305,774	4.6	4.7
94-96	29.3	6,531,980	418,613	21	-29,056	-11,900	239,207	251,107	3.7	3.8
96-99	33	6,502,924	740,389	33	-318,095	-115,671	269,232	384,884	4.1	5.9
99-01	27	6,184,829	406,705	21	-65,768	-29,230	232,403	261,633	3.8	4.2
As of 2001 (1993 classification)		6,119,061								
01-04	32	6,118,721	691,029	32	-408,747	-153,280	259,136	392,019	4.2	6.4
As of 2004		5,709,974								

Source: MIC, *Establishment and Enterprise Census of Japan*.

- Notes:
- The annual average number of exits in 1986-89 (business establishments only), 1991-94 (business establishments only), 1996-99, and 2001-04 are calculated based on the published figures for exits of business establishments. However, the numbers of entries (exits) of business corporations in 1996-99 and 2001-04 are calculated by adding in entries (exits) of independent establishments and head offices according to *Volume 1 Result of Establishments for Japan Table 7* of the 1999 survey and *Volume 1 Result of Establishments for Japan Table 10* of the 2004 survey.
 - The number of entries in 1999-2001 is the number of business establishments established in and after 2000.
 - Survey conducted as *The Establishment Census* until 1991, and the *Establishment Directory Maintenance Survey* in 1994.
 - The classification of industries as of 2004 is according to MIC, *Japan Standard Industrial Classification* (revised March 2002).
 - As the revision of the *Japan Standard Industrial Classification* in March 2002 resulted in the transfer of some industry groups between primary and non-primary industries, the annual average entry and exit rates in 2001-04 were calculated based on the number of enterprises and business establishments at the beginning of the period under the new system of classification.
 - As the number of enterprises calculated based on the number of enterprises given in Supplementary Statistical Data Table 1(2) does not include the business establishments of sole proprietors classified as branches, the number does not match the number of enterprises at the start of the period shown in 1) above.

Note: Method of calculation of entry and exit rates based on MIC's *Establishment and Enterprise Census of Japan*.

1. Definitions

The entry rate indicates “(1) the average number of establishments (or enterprises) newly established” during a particular period as a proportion of “(2) the number of establishments (or enterprises) already in existence at the start of the period,” and is calculated by dividing (1) by (2). The exit rate is calculated in a similar manner.

2. Example of calculation

The annual average number of entries and exits of establishments, which serves as the numerator in the above formula, is calculated differently according to the period for which the entry and exit rates are being calculated. This is because there are differences in how the results of the MIC's *Establishment and Enterprise Census of Japan* are tabulated depending on the year of the survey. Entry and exit rates were calculated according to (1) below for the periods 1986~1989, 1991~1994 and 1996~1999, and according to (2) for other periods. If the periods are the same, the entry and exit rates based on both the number of establishments and number of enterprises can be calculated by the same method.

(1) Example of calculation for 1986~1989, 1991~1994, 1996~1999 and 2001~2004
(2001~2004 based on number of establishments)

- 1) In MIC's *Establishment and Enterprise Census of Japan* at the end of the period classifies the number of establishments into continuing establishments, new establishments and closed establishments according to the state of changes. The number of new establishments (i.e. entries) and number of closed establishments are each divided by the 32-month period from October 1, 2001 (the date of the previous survey) until June 1, 2004, and then multiplied by 12 to calculate the annual average number of entries of establishments and annual average number of exits of establishments.

$$(\text{annual average number of entries of establishments}) = 691,029 \div 32 \times 12 \cong 259,136$$

$$(\text{annual average number of exits of establishments}) = 1,045,383 \div 32 \times 12 \cong 392,019$$

- 2) The annual average number of entries of establishments and annual average number of exits of establishments calculated in 1) are each divided by the number of establishments at the start of the period (2001), and multiplied by 100.

$$(\text{entry rate}) = 259,136 \div 6,118,721 \times 100 \cong 4.2 (\%)$$

$$(\text{exit rate}) = 392,019 \div 6,118,721 \times 100 \cong 6.4 (\%)$$

(2) Example of calculation for periods other than 1986~1989, 1991~1994 and 1996~1999
(1999~2001 based on number of establishments)

- 1) MIC's *Establishment and Enterprise Census of Japan* at the end of the period classifies the number of establishments according to timing of entry, and the number of entries of establishments from 2000 onward was 406,705. As the period of surveying of entries from January 1, 2000 to the end of the period on October 1, 2001 is 21 months, the number of entries of establishments is divided by 21 and multiplied by 12 to calculate the annual average number of entries of establishments. As this census does not report the number of exits of establishments, the annual average number of exits of establishments is calculated by subtracting the annual average increase in the number of establishments from the annual average number of entries of establishments. The annual average increase in the number of establishments is calculated by dividing the number of establishments at the end of the period less the number of establishments at the start of the period by 27, which is the number of months from the beginning through the end of the period, and then multiplying by 12.

$$(\text{annual average number of entries of establishments}) = 406,705 \div 21 \times 12 \cong 232,403$$

$$(\text{annual average increase in number of establishments}) = (6,119,061 - 6,184,829) \div 27 \times 12 \cong -29,230$$

$$(\text{annual average number of closed establishments}) = (232,403 - (-29,230)) = 261,633$$

- 2) The annual average number of entries of establishments and the annual average number of exits of establishments calculated in 1) are each divided by the number of establishments (6,184,829) at the beginning of the period (1999), and then multiplied by 100.

$$(\text{entry rate}) = 232,403 \div 6,184,829 \cong 3.8 (\%)$$

$$(\text{exit rate}) = 261,633 \div 6,184,829 \cong 4.2 (\%)$$

3. Additional information

Another method of calculating the entry and exit rates in MIC's *Establishment and Enterprise Census of Japan* other than by using the above published data is to calculate the number of entries and exits by tracing them back using the data from

individual questionnaires. Surveys since 1991 have assigned a code consisting of a municipality code, survey block number and establishment number, and this code can be used to concatenate establishments with the results of surveys in other years in order to calculate the entry and exit rates.

Example: Number of entries and exits of establishments in 1999~2001

Number of entries of establishments: Number of establishments not found to exist at the start of the period (1999) and whose existence could be confirmed at the end of the period (2001).

Number of exits of establishments: Number of establishments found to exist at the start of the period (1999) and whose existence could not be confirmed at the end of the period (2001).

However, as the data from individual questionnaires cannot be traced back to 1991 and earlier, the calculations in this publication are as a rule performed according to 2. above based on data published by MIC so as to ensure the continuity of data.

By way of exception, entry and exit rates by industry subcategory and municipality are calculated based on data from individual questionnaires due to the difficulty in practice of calculating the rates by timing of establishment using data published by MIC (which significantly reflect changes in industry, etc.).

* Important points regarding MIC's *Establishment and Enterprises Census of Japan*

Establishments that migrated across the boundaries of survey blocks (which numbered 248,000 as of March 2001 and each consisted of around 30 establishments) are counted as new establishments in their new locations, and closed establishments in their former locations.

As establishments from which questionnaires could not be collected for reasons such as temporary closure at the time of the survey are also counted as new establishments (entries) or closed establishments, it needs to be noted that both the number of new establishments and closed establishments may in reality be larger than the figures suggest.

Table 12 Trends in entry and exit rates by industry (based on number of business establishments, annual average)

(Unit: %)

Year		66~69	69~72	72~75	75~78	78~81	81~86	86~89	89~91	91~94	94~96	96~99	99~01	01~04
Non-primary industry total	Entry rate	6.5	7.0	6.1	6.2	6.1	4.7	4.2	4.1	4.6	3.7	4.1	3.8	4.2
	Exit rate	3.2	3.8	4.1	3.4	3.8	4.0	3.6	4.7	4.7	3.8	5.9	4.2	6.4
Manufacturing	Entry rate	6.0	5.6	4.3	3.4	3.7	3.1	3.1	2.8	3.1	1.5	1.9	1.6	2.2
	Exit rate	2.5	3.2	3.4	2.3	2.5	3.1	2.9	4.0	4.5	4.0	5.3	4.1	5.7
Wholesaling	Entry rate	6.5	8.1	8.0	6.8	6.4	5.1	4.8	3.2	5.0	3.3	4.9	3.1	3.9
	Exit rate	6.5	3.8	5.3	3.7	3.8	3.7	4.1	3.2	5.0	5.3	7.4	7.2	7.0
Retailing	Entry rate	5.0	4.9	4.3	4.8	4.4	3.4	3.1	2.8	3.9	3.6	4.3	3.9	3.9
	Exit rate	2.1	3.3	3.6	3.2	4.0	4.0	3.4	6.4	4.3	4.6	6.8	4.4	6.7
Services	Entry rate	6.3	6.7	6.1	6.1	6.4	5.3	4.9	4.7	5.0	3.8	4.2	4.0	4.4
	Exit rate	3.8	4.0	3.8	3.3	3.1	3.2	3.6	2.9	4.2	2.8	4.8	2.9	5.5

Source: MIC, *Establishment and Enterprise Census of Japan*.

- Notes:
1. Entries and exit of business establishments, including openings and closures due to opening, closure and movement of branches and factories.
 2. Survey conducted as the *Establishment Census* up to 1991 and the *Establishment Directory Maintenance Survey* in 1994.
 3. See Table 11 regarding the method of calculation of the entry and exit rates.
 4. The annual average entry and exit rates for 2001-04 were calculated based on the *Japan Standard Industrial Classification* (revised March 2002).
 5. "Services" in 2001-04 consists of "services (not otherwise classified)."

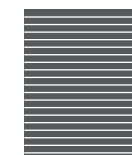


Table 13 Trends in entry and exit rates based on number of business establishments with employees

(Unit: %)

FY	81	82	83	84	85	86	87	88	89	90
Entry rate	7.2	6.4	6.1	5.9	5.8	6.0	6.8	7.4	6.7	6.3
Exit rate	3.7	5.8	4.3	4.2	4.2	4.1	3.7	3.4	3.2	3.0

	91	92	93	94	95	96	97	98	99	00
	5.8	5.1	4.6	4.8	4.6	4.7	4.2	3.9	4.4	4.9
	3.3	3.3	3.4	3.4	3.6	2.5	2.8	3.1	4.0	4.0

	01	02	03	04
	4.4	4.1	4.0	4.1
	4.4	4.6	4.8	4.5

Source: MHLW, *Annual Report on Employment Insurance Programs*.

- Notes:
1. Entry rate = number of business establishments newly covered by employment insurance in fiscal year concerned / number of business establishments covered by employment insurance at end of previous fiscal year x 100 (%).
 2. Exit rate = number of business establishments that cease to be covered by employment insurance in fiscal year concerned / number of business establishments covered by employment insurance at end of previous fiscal year x 100 (%).
 3. Business establishments covered by employment insurance are business establishments established under Article 5 of the Employment Insurance Law and Article 4 of the Law on Collection of Labor Insurance Premiums.

Table 14 Trends in number of incorporation registrations and company entry and exit rates

Year	55	56	57	58	59	60	61	62	63	64
No. of incorporation registrations	77,323	51,391	54,216	53,452	57,270	62,143	65,155	63,402	71,483	72,926
Company entry rate (%)	19.6	12.5	12.4	12.2	12.0	12.4	12.1	11.0	11.5	11.1
Company exit rate (%)	15.2	6.1	12.7	3.0	6.6	5.1	4.9	3.9	5.4	3.4

	65	66	67	68	69	70	71	72	73	74
	71,145	81,418	88,214	77,857	88,521	93,778	97,692	112,903	119,226	96,286
	10.1	10.9	11.1	9.3	9.9	10.0	10.0	10.7	10.6	8.0
	4.4	4.7	5.5	2.8	4.8	5.4	2.7	4.0	3.4	1.2

	75	76	77	78	79	80	81	82	83	84
	96,158	102,950	100,845	93,799	103,972	100,802	96,071	93,293	95,879	104,061
	7.5	7.7	7.2	6.3	6.8	6.3	5.9	5.5	5.5	5.8
	3.2	3.0	1.6	2.9	2.5	3.7	2.5	2.9	2.5	1.7

	85	86	87	88	89	90	91	92	93	94
	105,941	105,133	117,475	140,520	165,718	176,058	172,105	107,459	97,603	92,522
	5.7	5.5	6.0	7.0	8.0	8.1	7.6	4.5	3.9	3.6
	4.1	3.0	3.5	3.5	3.1	3.4	1.7	1.0	1.6	1.9

	95	96	97	98	99	00	01	02	03	04
	92,885	103,723	92,610	82,502	88,036	98,350	90,687	87,544	95,381	101,100
	3.6	3.9	3.5	3.1	3.3	3.6	3.3	3.2	3.4	3.7
	2.1	2.3	4.5	2.0	2.2	2.4	2.5	2.7	4.1	3.1

Sources: MOJ, *Annual Report of Statistics on Civil Affairs, Litigation and Civil Liberties*; National Tax Agency, *National Tax Agency Annual Statistics Report*.

- Notes:
1. The number of incorporation registrations is from *Annual Registration Statistics* from 1955 to 1960, *Annual Report of Registration, Litigation and Civil Liberties* from 1961 to 1971, and *Annual Report of Statistics on Civil Affairs, Litigation and Civil Liberties* from 1972 onward.
 2. The numbers of companies in 1963 and 1964 are estimates based on the National Tax Agency's *Results of the Corporation Sample Survey*. The number of companies from 1967 includes associations.
 3. Company entry rate = number of incorporation registrations / number of companies in previous year x 100 (%).
 4. Company exit rate = company entry rate - rate of increase (%).
 (= (number of companies in previous year + number of incorporation registrations - number of companies in current year) / number of companies in previous year x 100).

Table 15 Sales and operating costs of SMEs (surveyed industries)

(Unit: ¥ million)

Survey items	Total	Business corporations (no. of workers)					Sole proprietorship
		Total	5 or fewer	6~20	21~50	51 or more	
No. of enterprises in parent population	3,838,087	1,421,720	823,572	410,788	119,780	67,580	2,416,367
No. of workers	30,580,839	23,540,747	3,726,607	5,906,609	4,371,885	9,535,646	7,040,092
Sales (operating revenue)	534,465,485	493,779,047	64,743,364	117,407,261	97,329,866	214,298,557	40,686,437
Operating expenses	516,730,705	482,314,637	64,338,249	115,843,829	94,997,940	207,134,619	34,416,068
Cost of sales	390,969,974	372,860,147	44,690,124	85,764,318	73,073,491	169,332,214	18,109,827
Cost of goods purchased	...	167,138,294	26,815,496	42,947,378	34,318,382	63,057,038	...
Material costs	...	74,780,889	5,516,599	13,634,688	12,309,180	43,320,422	...
Labor costs	...	33,372,866	2,311,168	6,691,412	5,886,096	18,484,190	...
Outsourcing costs	...	61,029,849	7,394,120	15,193,755	13,279,659	25,162,316	...
Depreciation costs	...	5,522,617	259,257	703,387	1,489,116	3,070,857	...
Other costs	...	31,015,632	2,393,484	6,593,699	5,791,058	16,237,391	...
Selling and general administrative expenses	125,760,731	109,454,489	19,648,125	30,079,510	21,924,448	37,802,405	16,306,242
Personnel costs	59,214,014	53,297,784	9,707,518	14,962,536	10,641,963	17,985,767	5,916,231
Rent	7,743,086	6,448,503	1,549,699	1,703,752	1,139,499	2,055,553	1,294,582
Utilities expense	...	2,371,961	471,484	709,060	502,599	688,817	...
Freight and packing costs	...	4,652,229	278,218	786,512	960,229	2,627,270	...
Sales commission	...	2,447,668	278,075	540,897	422,335	1,206,360	...
Advertising expenses	...	1,953,166	212,655	453,590	352,739	934,182	...
Entertainment expenses	...	1,819,737	454,251	634,962	335,179	395,345	...
Depreciation costs	6,519,244	4,948,074	1,080,416	1,291,881	964,799	1,610,978	1,571,170
Employee training costs	...	256,469	32,989	90,896	46,583	86,001	...
Taxes and public charges	4,050,473	3,240,192	725,782	964,535	675,790	874,085	810,281
Other costs	48,233,914	28,018,707	4,857,037	7,940,888	5,882,735	9,338,047	6,713,978
Non-operating profit and loss	...	571,933	43,954	190,352	29,893	307,734	...
Non-operating revenue	...	6,343,698	1,263,060	1,618,618	1,179,048	2,282,971	...
Non-operating expenses	...	5,771,766	1,219,106	1,428,266	1,149,156	1,975,238	...
Interest and discount expenses	...	3,876,353	831,049	1,013,265	817,743	1,214,295	...
Other costs	...	1,895,413	388,057	415,001	331,412	760,943	...
Ordinary profit (ordinary loss)	18,306,707	12,036,342	449,066	1,753,785	2,361,820	7,471,670	6,270,366
Pretax net profit (pretax net loss)	...	10,750,664	397,466	1,912,371	2,114,037	6,326,789	...
After-tax net profit (after-tax net loss)	...	5,762,546	6,371	1,018,292	1,178,318	3,559,565	...
Number of enterprises including acquisition value of petty sum depreciable assets under expenses	264,395	171,664	62,914	62,785	26,011	19,954	92,731
Amount included in expenses for acquisition value of petty sum depreciable assets	390,998	343,511	67,910	99,766	60,541	115,295	47,486

Source: SME Agency, *Basic Surveys of Small and Medium Enterprises*.

- Notes:
- The survey results are estimates based on the 2005 Basic Survey of Small and Medium Enterprises conducted in September 2005.
 - The number of enterprises in the parent population is estimated as of September 2005 based on the 2004 Establishment and Enterprise Census of Japan taking into consideration entries, exits, and changes in size according to industry (medium group) between the 2001 Establishment and Enterprise Census of Japan and the 2004 Establishment and Enterprise Census of Japan.
 - The survey results are estimates based on a fact-finding survey of SMEs (including sole proprietorships) selected by drawing a sample from industries in the following major industry groups according to the *Japan Standard Industrial Classification*: construction, manufacturing, information and communications (excluding certain industry groups), transport (excluding certain industry groups), wholesaling and retailing, real estate, eating and drinking places, accommodations, and services (not otherwise classified) (excluding certain industry groups).
 - "Other costs" under totals and sole proprietorships' selling and general administrative expenses includes utilities, freight and packing, sales charges, advertising costs, entertainment costs, and employee training costs.
 - The ordinary profit of sole proprietorships is income before deduction of employees' (family employees') pay.
 - Items that were not surveyed in the case of sole proprietorships are treated as unknown (indicated by "..." in the table).



Table 16 Capital investment by SMEs (surveyed industries)

(Unit: ¥ million)

	Total	Business corporations (no. of workers)					Sole proprietorship
		Total	5 or fewer	6~20	21~50	51 or more	
Number of enterprises in parent population	3,838,087	1,421,720	823,572	410,788	119,780	67,580	2,416,367
Number of enterprises that engaged in capital investment	484,715	316,734	101,520	117,102	53,377	44,735	167,981
Value of capital investment	11,217,383	10,691,792	872,463	1,994,425	1,677,055	6,147,849	525,591
Tangible fixed assets	...	10,435,429	860,414	1,930,752	1,606,766	6,037,497	...
Buildings and structures	...	3,033,350	243,154	659,485	485,259	1,645,453	...
Machinery and equipment	...	3,070,963	75,984	527,825	431,856	2,035,298	...
Ships and vessels, motor vehicles and transport equipment, industrial tools, appliances and fixtures	...	2,421,131	401,443	522,266	415,679	1,081,743	...
Land	...	1,408,451	100,048	201,805	216,835	889,763	...
Construction in progress	...	501,534	39,784	19,372	57,138	385,241	...
Intangible fixed assets	...	256,363	12,049	63,674	70,289	110,352	...
Value of capital investment by purpose of investment	11,217,383	10,691,792	872,463	1,994,425	1,677,055	6,147,849	525,591
Labor saving and rationalization (direct departmental investment)	...	1,159,396	43,276	143,962	189,807	782,351	...
Labor saving and rationalization (administration departmental investment)	...	282,498	17,203	30,804	47,475	187,017	...
Diversification, e.g. expansion into new fields of business, change of business, strengthening of subsidiary business	...	1,327,429	72,489	219,268	199,825	835,847	...
Maintenance, repair and renewal of existing buildings, facilities and equipment, etc.	...	3,447,225	345,685	782,665	578,731	1,740,144	...
Expansion of sales of existing operations	...	3,260,241	252,799	511,694	532,373	1,963,375	...
Other	...	1,215,002	141,011	306,032	128,844	639,115	...
Breakdown of capital investment by purpose	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Labor saving and rationalization (direct departmental investment)	...	10.8%	5.0%	7.2%	11.3%	12.7%	...
Labor saving and rationalization (administration departmental investment)	...	2.6%	2.0%	1.5%	2.8%	3.0%	...
Diversification, e.g. expansion into new fields of business, change of business, strengthening of subsidiary business	...	12.4%	8.3%	11.0%	11.9%	13.6%	...
Maintenance, repair and renewal of existing buildings, facilities and equipment, etc.	...	32.2%	39.6%	39.2%	34.5%	28.3%	...
Expansion of sales of existing operations	...	30.5%	29.0%	25.7%	31.7%	31.9%	...
Other	...	11.4%	16.2%	15.3%	7.7%	10.4%	...

Source: SME Agency, *Basic Survey of Small and Medium Enterprises*.

- Notes:
- The survey results are estimates based on the 2005 *Basic Survey of Small and Medium Enterprises* conducted in September 2005.
 - The number of enterprises in the parent population is estimated as of September 2005 based on the 2004 *Establishment and Enterprise Census of Japan* taking into consideration entries, exits, and changes in size according to industry (medium group) between the 2001 *Establishment and Enterprise Census of Japan* and the 2004 *Establishment and Enterprise Census of Japan*.
 - The survey results are estimates based on a fact-finding survey of SMEs (including sole proprietorships) selected by drawing a sample from industries in the following major industry groups according to the *Japan Standard Industrial Classification*: construction, manufacturing, information and communications (excluding certain industry groups), transport (excluding certain industry groups), wholesaling and retailing, real estate, eating and drinking places, accommodations, and services (not otherwise classified) (excluding certain industry groups).
 - Percentages are rounded to two decimal places, and so do not sum to the totals.
 - Items that were not surveyed in the case of sole proprietorships are treated as unknown (indicated by “...” in the table).

Table 17 Use of leases by SMEs (surveyed industries)

	Total	Business corporations (no. of workers)					Sole proprietorship
		Total	5 or fewer	6~20	21~50	51 or more	
Number of enterprises in parent population	3,838,087	1,421,720	823,572	410,788	119,780	67,580	2,416,367
Number of enterprises entering new leases	315,804	233,924	83,747	79,626	38,283	32,268	81,880
Number of enterprises by type of newly leased property
Production machinery and equipment	...	21,027	2,233	7,201	4,427	7,166	...
Construction machinery	...	5,941	2,518	1,602	986	835	...
Computers and peripherals	...	85,057	26,966	24,947	17,096	16,048	...
Office equipment and communications equipment	...	106,609	41,524	34,838	16,685	13,562	...
Store and commercial facilities	...	12,931	5,421	2,615	2,910	1,985	...
Kitchen facilities	...	6,846	2,618	1,889	1,260	1,079	...
Transport machinery	...	60,366	13,385	21,302	11,732	13,947	...
Other	...	18,305	3,371	8,714	3,379	2,841	...
Value of new leases (¥ million)	2,062,039	1,978,986	189,009	365,689	432,390	991,899	83,053

Source: SME Agency, *Basic Survey of Small and Medium Enterprises*.

- Notes:
- The survey results are estimates based on the 2005 *Basic Survey of Small and Medium Enterprises* conducted in September 2005.
 - The number of enterprises in the parent population is estimated as of September 2005 based on the 2004 *Establishment and Enterprise Census of Japan* taking into consideration entries, exits, and changes in size according to industry (medium group) between the 2001 *Establishment and Enterprise Census of Japan* and the 2004 *Establishment and Enterprise Census of Japan*.
 - The survey results are estimates based on a fact-finding survey of SMEs (including sole proprietorships) selected by drawing a sample from industries in the following major industry groups according to the *Japan Standard Industrial Classification*: construction, manufacturing, information and communications (excluding certain industry groups), transport (excluding certain industry groups), wholesaling and retailing, real estate, eating and drinking places, accommodations, and services (not otherwise classified) (excluding certain industry groups).
 - No totals were calculated for the “number of enterprises by type of newly leased property” as the survey allowed multiple responses.
 - The “number of enterprises by type of newly leased property” was not surveyed for sole proprietorships, and so is unknown (indicated by “...” in the table).

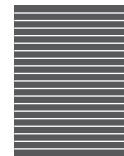
Table 18 Business conditions DI by prefecture

(1) All industries

Change from previous quarter (seasonally adjusted)

Prefecture	2003			2004				2005			
	Apr.-Jun.	Jul.-Sep.	Oct.-Dec.	Jan.-Mar.	Apr.-Jun.	Jul.-Sep.	Oct.-Dec.	Jan.-Mar.	Apr.-Jun.	Jul.-Sep.	Oct.-Dec.
National	-33.2	-30.1	-26.4	-23.8	-24.9	-25.4	-27.3	-24.2	-26.2	-24.2	-23.3
Hokkaido	-31.5	-30.2	-27.9	-27.5	-26.4	-31.1	-26.1	-23.3	-31.6	-28.1	-25.9
South/central Hokkaido	-30.2	-31.1	-27.4	-25.5	-26.3	-30.0	-26.1	-24.9	-28.8	-25.1	-20.2
North Hokkaido/Okhotsk	-38.2	-34.6	-34.5	-31.4	-22.2	-40.2	-21.6	-21.5	-26.3	-26.2	-33.9
Tokachi, Kushiro, Nemuro	-25.7	-25.4	-24.4	-32.2	-26.0	-28.7	-30.3	-21.3	-43.3	-39.0	-37.5
Tohoku	-35.7	-35.0	-31.1	-28.4	-29.9	-28.0	-31.9	-30.6	-33.0	-30.8	-27.6
Aomori	-39.6	-41.5	-43.2	-40.1	-38.7	-34.5	-42.7	-39.3	-38.2	-36.7	-33.6
Iwate	-25.4	-26.0	-21.3	-20.5	-19.8	-24.9	-27.1	-24.7	-27.9	-24.5	-24.4
Miyagi	-43.2	-40.1	-35.4	-35.1	-36.6	-30.9	-36.7	-36.3	-32.8	-30.4	-26.8
Akita	-25.8	-23.6	-18.0	-23.3	-23.8	-27.0	-25.7	-19.4	-31.7	-29.4	-27.4
Yamagata	-39.6	-37.5	-32.5	-24.4	-27.6	-24.4	-24.2	-33.0	-32.5	-27.3	-20.5
Fukushima	-39.0	-40.6	-34.0	-27.7	-32.6	-28.4	-35.3	-31.8	-35.8	-35.8	-33.8
Kanto	-30.8	-27.8	-23.4	-19.2	-22.7	-21.9	-24.8	-21.7	-23.6	-20.5	-16.8
Ibaraki	-33.1	-26.2	-28.1	-18.4	-27.9	-23.1	-23.5	-22.4	-21.8	-23.8	-20.3
Tochigi	-34.1	-32.1	-29.0	-25.0	-21.2	-17.7	-24.4	-22.7	-20.2	-17.9	-15.2
Gunma	-26.4	-27.8	-25.7	-24.9	-29.1	-28.8	-29.1	-24.9	-28.9	-25.6	-21.8
Saitama	-30.8	-27.2	-22.3	-15.3	-19.2	-18.5	-23.0	-24.0	-13.8	-19.1	-12.1
Chiba	-30.2	-30.9	-24.5	-18.2	-19.5	-20.9	-24.0	-16.7	-22.0	-19.9	-18.8
Tokyo	-29.2	-22.5	-21.5	-16.1	-15.6	-19.2	-18.0	-15.0	-20.5	-14.2	-12.6
Kanagawa	-26.6	-29.4	-22.8	-18.4	-19.2	-15.5	-14.7	-14.0	-19.6	-16.7	-14.1
Niigata	-30.9	-27.3	-24.6	-20.3	-26.9	-22.6	-34.8	-20.6	-23.7	-16.1	-13.9
Yamanashi	-28.8	-26.6	-23.4	-19.5	-24.7	-22.2	-27.6	-31.3	-37.2	-27.2	-21.4
Nagano	-37.4	-30.0	-24.6	-20.7	-17.6	-20.3	-27.4	-24.9	-25.3	-24.9	-14.6
Shizuoka	-28.2	-29.8	-20.8	-17.6	-28.2	-30.5	-30.2	-32.4	-31.1	-25.3	-28.0
Chubu	-36.4	-30.9	-26.4	-23.5	-21.7	-23.9	-25.9	-22.8	-26.3	-24.9	-21.5
Toyama	-34.4	-23.2	-18.1	-20.0	-19.4	-22.8	-22.1	-16.4	-23.2	-21.1	-14.2
Ishikawa	-39.9	-40.8	-31.3	-23.2	-23.2	-25.5	-28.9	-22.5	-32.1	-27.3	-21.9
Gifu	-41.7	-27.6	-32.3	-30.0	-22.3	-30.0	-29.8	-29.6	-29.3	-32.6	-29.7
Aichi	-34.4	-36.1	-24.0	-20.5	-18.9	-19.6	-22.9	-20.6	-23.8	-21.4	-18.6
Mie	-32.4	-28.5	-26.7	-22.7	-26.4	-24.1	-27.4	-23.0	-25.4	-23.8	-23.5
Kinki	-36.0	-31.0	-24.5	-22.9	-23.1	-23.1	-24.8	-19.5	-22.4	-22.5	-23.0
Fukui	-36.2	-31.7	-22.0	-26.8	-24.6	-24.3	-23.1	-9.5	-19.2	-23.2	-23.4
Shiga	-38.1	-37.4	-28.7	-28.6	-28.7	-26.6	-27.9	-18.9	-29.8	-23.8	-26.7
Kyoto	-33.2	-28.2	-13.6	-24.9	-22.1	-23.1	-22.3	-23.1	-27.9	-21.6	-23.0
Osaka	-36.1	-29.7	-24.8	-18.9	-21.3	-19.8	-20.9	-20.7	-15.6	-19.4	-17.9
Hyogo	-39.6	-27.2	-25.8	-21.1	-18.1	-21.9	-24.9	-17.6	-18.3	-21.1	-21.1
Nara	-34.8	-32.5	-21.4	-24.4	-22.5	-24.8	-25.6	-19.5	-31.5	-24.7	-24.9
Wakayama	-36.9	-34.8	-30.9	-31.6	-37.3	-26.7	-31.7	-27.4	-32.2	-30.6	-32.6
Chugoku	-35.5	-29.4	-27.8	-26.5	-28.9	-29.5	-30.1	-28.5	-30.3	-28.7	-28.4
Tottori	-34.1	-29.1	-21.3	-26.5	-25.6	-29.7	-37.3	-32.6	-38.4	-39.4	-41.7
Shimane	-26.0	-26.1	-20.3	-26.0	-33.6	-32.0	-31.1	-27.1	-32.7	-31.2	-32.8
Okayama	-34.2	-25.2	-27.9	-25.2	-25.2	-26.7	-30.5	-28.9	-27.7	-28.4	-31.2
Hiroshima	-38.0	-26.0	-28.8	-23.5	-28.8	-29.0	-26.1	-25.7	-28.3	-25.8	-25.8
Yamaguchi	-41.4	-38.2	-34.3	-30.2	-30.8	-30.3	-28.1	-29.4	-28.5	-23.6	-19.5
Shikoku	-35.0	-32.2	-28.8	-29.2	-29.7	-33.4	-32.3	-29.8	-26.4	-26.2	-29.1
Tokushima	-35.1	-30.9	-31.3	-28.1	-34.6	-35.0	-27.7	-34.3	-29.6	-29.5	-30.7
Kagawa	-33.2	-27.6	-29.8	-23.0	-21.0	-23.3	-24.1	-21.7	-23.6	-27.7	-20.4
Ehime	-36.3	-36.4	-24.8	-31.8	-31.8	-36.8	-38.9	-33.7	-27.8	-24.5	-32.4
Kochi	-37.0	-34.5	-29.9	-31.8	-33.5	-41.0	-37.2	-25.8	-24.3	-24.7	-31.9
Kyushu/Okinawa	-31.3	-28.2	-25.9	-24.7	-26.9	-25.5	-26.6	-25.1	-24.7	-22.9	-26.0
Fukuoka	-35.8	-35.5	-27.8	-31.7	-32.0	-22.4	-22.4	-24.7	-22.4	-23.0	-25.6
Saga	-32.4	-30.8	-24.6	-25.5	-28.9	-26.5	-29.5	-25.9	-25.1	-25.4	-29.3
Nagasaki	-35.1	-31.9	-32.4	-33.4	-34.3	-36.2	-38.4	-32.3	-30.9	-27.0	-28.2
Kumamoto	-32.9	-28.4	-26.7	-25.0	-25.4	-25.1	-21.4	-22.1	-22.7	-21.4	-27.9
Oita	-25.7	-24.6	-19.9	-21.0	-22.8	-23.5	-27.3	-25.0	-30.2	-24.4	-32.8
Miyazaki	-34.7	-33.9	-34.0	-22.3	-28.1	-27.1	-25.9	-24.2	-27.2	-24.4	-23.8
Kagoshima	-30.7	-20.9	-23.2	-23.8	-23.3	-30.3	-29.5	-31.1	-27.3	-23.9	-25.2
Okinawa	-16.5	-12.6	-13.3	-9.7	-11.4	-13.4	-15.2	-17.1	-10.8	-12.6	-9.1

Source: SMRJ, Survey on SME Business Conditions.



(2) Manufacturing

Change from previous quarter (seasonally adjusted)

Prefecture	2003			2004				2005			
	Apr.-Jun.	Jul.-Sep.	Oct.-Dec.	Jan.-Mar.	Apr.-Jun.	Jul.-Sep.	Oct.-Dec.	Jan.-Mar.	Apr.-Jun.	Jul.-Sep.	Oct.-Dec.
National	-25.2	-20.5	-15.5	-12.5	-14.5	-13.6	-17.6	-16.8	-16.6	-15.0	-13.9
Hokkaido	-27.6	-20.6	-20.1	-17.5	-24.0	-27.4	-18.8	-17.6	-29.6	-22.6	-17.3
South/central Hokkaido	-24.4	-22.6	-18.1	-7.8	-23.2	-18.4	-13.9	-14.4	-21.9	-18.4	-7.8
North Hokkaido/Okhotsk	-34.7	-15.9	-21.7	-32.3	-32.5	-62.5	-27.7	-19.6	-34.2	-30.1	-42.4
Tokachi, Kushiro, Nemuro	-29.5	-22.1	-29.8	-30.0	-15.5	-26.3	-29.8	-20.9	-46.2	-33.4	-26.3
Tohoku	-28.9	-26.1	-20.4	-17.3	-20.9	-17.6	-22.3	-20.6	-23.1	-22.4	-19.5
Aomori	-40.1	-43.5	-35.6	-21.9	-41.7	-34.6	-36.3	-34.2	-39.7	-35.3	-22.9
Iwate	-23.7	-21.9	-14.8	-12.7	-13.9	-19.4	-21.6	-22.8	-21.3	-15.4	-14.9
Miyagi	-32.0	-26.4	-18.8	-16.0	-25.6	-18.7	-18.9	-19.8	-21.5	-18.6	-15.8
Akita	-16.8	-10.0	-6.6	-15.6	-19.8	-14.5	-21.3	-7.5	-22.1	-15.4	-20.2
Yamagata	-34.4	-24.3	-19.9	-16.0	-9.8	-10.0	-16.3	-17.4	-12.1	-19.9	-13.4
Fukushima	-30.5	-30.6	-26.6	-18.4	-23.6	-12.2	-23.0	-21.5	-29.8	-32.9	-29.9
Kanto	-21.5	-16.8	-11.4	-6.9	-10.5	-8.3	-17.6	-17.4	-16.4	-12.5	-8.6
Ibaraki	-18.0	4.4	-5.1	-2.0	-8.3	-4.1	-11.5	-16.0	-14.2	-16.3	-12.3
Tochigi	-20.1	-19.2	-16.4	-18.5	-0.6	4.0	-17.9	-6.0	-2.5	-1.2	-1.7
Gunma	-12.8	-21.5	-18.9	-12.9	-12.8	-8.9	-15.7	-18.1	-14.6	-9.4	-5.8
Saitama	-20.3	-18.0	-6.5	-5.3	-4.8	-4.7	-9.2	-15.7	-3.4	-10.4	2.5
Chiba	-9.6	-15.9	-11.6	-0.3	-7.1	-15.1	-32.5	-11.3	-21.6	-18.2	-22.9
Tokyo	-27.0	-15.5	-14.1	-8.5	-8.9	-10.2	-9.9	-15.6	-17.4	-15.8	-8.7
Kanagawa	-27.5	-22.3	-14.6	-8.3	-5.8	-1.0	-2.6	1.5	-9.6	-4.2	-5.7
Niigata	-23.7	-19.1	-11.2	-10.2	-20.2	-10.7	-31.1	-20.9	-20.3	-13.9	-12.0
Yamanashi	-18.4	-17.4	-7.7	-2.5	-11.8	-7.8	-16.0	-26.9	-27.3	-6.8	-6.8
Nagano	-21.3	-11.6	-5.4	1.1	-1.8	2.1	-18.0	-25.3	-16.4	-14.6	0.0
Shizuoka	-26.7	-23.5	-17.1	-8.5	-19.3	-23.5	-25.1	-28.5	-25.1	-15.7	-20.2
Chubu	-27.4	-15.3	-15.7	-11.3	-10.4	-11.7	-15.2	-11.9	-15.1	-15.5	-9.7
Toyama	-31.8	-2.4	-3.9	-8.6	-11.5	-11.8	-9.5	0.9	-14.8	-14.9	-3.4
Ishikawa	-26.8	-20.2	-15.5	0.9	-9.1	-14.3	-17.3	-11.6	-20.6	-8.6	-10.5
Gifu	-27.9	-13.9	-23.6	-19.2	-13.3	-12.5	-18.8	-21.5	-20.3	-22.7	-16.6
Aichi	-31.1	-25.9	-18.4	-9.5	-6.6	-10.1	-15.6	-14.5	-11.5	-9.8	-8.6
Mie	-15.4	-12.1	-14.8	-14.3	-12.8	-14.1	-15.8	-7.3	-13.5	-21.5	-10.0
Kinki	-31.3	-23.9	-16.3	-13.8	-14.5	-11.6	-15.7	-13.5	-12.1	-11.1	-11.9
Fukui	-32.8	-29.7	-19.6	-18.1	-13.0	-11.6	-18.9	-9.4	-7.3	-14.9	-6.7
Shiga	-27.9	-26.6	-7.7	-26.9	-19.9	-11.3	-14.0	-9.1	-14.4	-12.7	-12.9
Kyoto	-29.1	-24.0	-6.6	-11.6	-18.4	-14.8	-16.9	-19.8	-25.0	-16.2	-21.7
Osaka	-28.0	-20.3	-16.1	-9.1	-10.8	-10.0	-11.2	-11.4	-5.8	-9.6	-5.1
Hyogo	-38.5	-25.5	-18.7	-12.7	-10.2	-8.6	-17.6	-15.5	-9.6	-6.0	-7.5
Nara	-33.1	-24.6	-14.8	-17.2	-8.5	-15.0	-18.1	-8.7	-16.6	-13.5	-23.9
Wakayama	-34.1	-26.5	-27.7	-16.3	-41.5	-17.7	-18.7	-19.5	-23.1	-13.5	-18.5
Chugoku	-23.5	-17.2	-13.5	-12.0	-15.1	-16.9	-19.4	-19.6	-16.1	-17.0	-16.9
Tottori	-22.7	-10.4	0.9	-10.9	-11.1	-22.8	-28.4	-18.5	-28.6	-33.7	-34.2
Shimane	-8.0	-16.7	-15.5	-11.3	-30.1	-25.2	-20.2	-23.2	-24.9	-17.0	-19.1
Okayama	-26.6	-14.6	-13.7	-11.2	-12.6	-12.8	-14.7	-14.9	-3.9	-8.7	-13.1
Hiroshima	-31.1	-23.2	-14.3	-8.4	-11.9	-15.6	-18.3	-20.0	-18.6	-17.1	-13.9
Yamaguchi	-27.4	-22.1	-19.6	-15.5	-13.9	-13.5	-16.2	-19.9	-11.4	-14.7	-8.6
Shikoku	-29.3	-31.4	-23.4	-23.2	-24.9	-26.4	-25.1	-22.1	-18.2	-18.0	-18.5
Tokushima	-30.3	-28.1	-21.4	-17.2	-27.3	-25.2	-9.2	-27.4	-27.3	-20.2	-12.8
Kagawa	-23.5	-22.5	-17.7	-14.3	-14.7	-15.3	-19.5	-8.3	-12.3	-16.3	-14.2
Ehime	-23.4	-33.1	-23.3	-28.3	-28.0	-35.9	-36.1	-31.0	-18.1	-22.1	-27.2
Kochi	-46.9	-49.7	-33.1	-32.1	-31.8	-33.1	-38.5	-13.6	-12.1	-12.1	-15.7
Kyushu/Okinawa	-22.0	-19.2	-14.6	-12.2	-15.7	-11.3	-13.8	-16.4	-17.6	-14.3	-21.1
Fukuoka	-20.3	-18.4	-14.3	-20.8	-20.0	-9.5	-11.3	-21.5	-17.6	-6.4	-14.9
Saga	-18.3	-29.5	-17.3	-10.2	-16.4	-7.3	-16.0	-15.6	-15.7	-19.3	-27.6
Nagasaki	-43.3	-31.8	-25.1	-25.7	-26.7	-27.0	-30.1	-25.0	-22.8	-22.1	-31.0
Kumamoto	-27.8	-22.4	-16.3	-19.3	-16.2	-14.3	-16.6	-13.7	-26.2	-17.0	-27.2
Oita	-13.0	-4.8	-4.5	-5.6	-15.4	-14.9	-11.2	-9.6	-22.1	-24.6	-22.2
Miyazaki	-28.4	-34.7	-25.8	-17.1	-16.6	-9.5	-12.8	-16.3	-14.8	-11.0	-18.6
Kagoshima	-13.2	2.8	-5.9	-4.7	-9.2	-9.5	-12.3	-22.4	-11.7	-10.6	-22.2
Okinawa	-10.5	-8.8	-5.4	7.5	1.2	7.0	3.0	-9.7	-9.4	2.5	1.5

Source: SMRJ, Survey on SME Business Conditions.

(3) Non-manufacturing

Change from previous quarter (seasonally adjusted)

Prefecture	2003			2004				2005			
	Apr.-Jun.	Jul.-Sep.	Oct.-Dec.	Jan.-Mar.	Apr.-Jun.	Jul.-Sep.	Oct.-Dec.	Jan.-Mar.	Apr.-Jun.	Jul.-Sep.	Oct.-Dec.
National	-36.7	-34.2	-31.1	-28.7	-29.4	-30.4	-31.4	-27.3	-29.9	-27.9	-27.1
Hokkaido	-32.2	-32.7	-30.3	-30.5	-26.6	-32.3	-28.5	-25.2	-31.7	-29.8	-28.6
South/central Hokkaido	-32.7	-33.5	-29.9	-29.8	-27.8	-33.5	-29.4	-27.4	-30.8	-27.1	-23.5
North Hokkaido/Okhotsk	-41.6	-38.8	-39.5	-30.1	-21.2	-28.6	-19.8	-21.3	-25.6	-23.4	-31.3
Tokachi, Kushiro, Nemuro	-24.6	-26.1	-22.9	-32.5	-28.6	-29.4	-30.5	-21.4	-41.9	-40.6	-41.8
Tohoku	-38.2	-39.5	-35.4	-33.1	-33.2	-32.8	-35.8	-34.6	-36.7	-34.4	-31.0
Aomori	-39.8	-41.9	-45.6	-46.0	-38.0	-35.5	-44.5	-40.2	-38.0	-38.0	-36.4
Iwate	-26.6	-28.1	-23.1	-24.0	-22.8	-27.5	-28.5	-25.5	-31.0	-28.8	-27.7
Miyagi	-49.0	-46.5	-41.8	-43.0	-41.0	-35.7	-42.4	-42.0	-36.9	-34.7	-30.3
Akita	-31.5	-27.2	-22.9	-26.6	-27.2	-30.3	-27.9	-24.6	-35.1	-35.2	-30.3
Yamagata	-41.8	-44.9	-39.5	-28.5	-36.3	-31.7	-28.7	-39.4	-42.5	-31.2	-24.5
Fukushima	-41.6	-44.0	-36.9	-31.3	-35.3	-33.7	-40.2	-35.7	-37.7	-36.6	-35.4
Kanto	-34.2	-32.6	-29.1	-25.1	-27.2	-27.6	-28.3	-23.8	-27.0	-23.9	-20.2
Ibaraki	-42.6	-39.5	-41.3	-26.4	-39.5	-32.0	-29.4	-24.2	-27.7	-26.6	-23.7
Tochigi	-40.8	-37.7	-35.2	-27.9	-30.1	-27.2	-28.3	-30.1	-28.0	-25.3	-22.4
Gunma	-32.6	-30.2	-28.7	-29.7	-37.4	-37.9	-35.6	-28.3	-36.0	-32.9	-29.1
Saitama	-38.4	-33.6	-32.6	-20.7	-28.6	-26.3	-31.0	-27.5	-19.9	-24.0	-20.6
Chiba	-36.0	-34.9	-28.8	-25.2	-23.0	-22.1	-21.3	-19.4	-21.1	-20.1	-17.4
Tokyo	-29.9	-24.9	-24.0	-18.3	-17.6	-22.1	-20.7	-14.6	-21.9	-13.8	-14.2
Kanagawa	-25.2	-32.3	-25.8	-22.1	-22.6	-21.0	-19.0	-19.3	-22.2	-21.6	-16.9
Niigata	-33.6	-31.2	-31.2	-25.7	-29.6	-28.5	-36.7	-21.0	-24.6	-17.4	-14.6
Yamanashi	-32.2	-31.6	-30.6	-27.4	-29.8	-29.5	-33.4	-33.0	-41.4	-35.7	-27.3
Nagano	-44.9	-38.0	-34.8	-31.2	-23.1	-29.0	-31.4	-24.5	-27.4	-29.6	-20.5
Shizuoka	-29.3	-34.6	-23.3	-21.8	-33.8	-35.8	-33.3	-33.0	-33.9	-31.9	-32.3
Chubu	-40.6	-37.4	-31.0	-28.9	-26.7	-28.9	-30.6	-27.5	-30.9	-28.9	-26.5
Toyama	-36.4	-31.1	-23.9	-27.1	-23.7	-26.0	-26.8	-26.0	-26.9	-23.2	-18.4
Ishikawa	-44.2	-49.3	-37.0	-31.4	-27.8	-30.6	-33.1	-25.4	-35.3	-35.0	-26.6
Gifu	-45.3	-34.3	-35.6	-34.5	-23.4	-38.0	-34.0	-32.8	-30.8	-37.7	-34.5
Aichi	-36.3	-41.6	-26.5	-26.0	-25.5	-24.7	-26.3	-23.7	-30.4	-27.3	-22.6
Mie	-40.6	-34.9	-31.5	-25.7	-33.7	-28.2	-32.0	-28.6	-29.8	-24.7	-28.4
Kinki	-38.4	-34.6	-28.5	-27.7	-27.7	-28.7	-29.2	-22.4	-27.7	-28.1	-28.4
Fukui	-38.1	-31.6	-23.8	-31.1	-30.7	-30.1	-26.0	-9.7	-24.2	-25.9	-29.6
Shiga	-43.9	-43.1	-37.2	-30.6	-33.7	-33.5	-31.0	-24.6	-36.2	-29.2	-30.0
Kyoto	-34.5	-30.6	-17.6	-31.7	-23.5	-27.1	-25.7	-24.5	-28.8	-24.3	-24.8
Osaka	-39.8	-34.7	-29.2	-24.3	-26.7	-24.9	-26.2	-25.5	-20.7	-24.6	-25.0
Hyogo	-40.7	-27.8	-30.4	-26.0	-23.1	-29.0	-29.6	-18.4	-23.5	-29.1	-28.8
Nara	-35.7	-35.5	-24.9	-27.6	-28.1	-28.5	-30.0	-24.2	-37.3	-29.8	-25.5
Wakayama	-38.4	-39.6	-31.7	-36.6	-35.8	-32.1	-37.0	-29.5	-38.7	-39.2	-39.3
Chugoku	-40.9	-34.9	-33.9	-32.9	-35.2	-34.8	-34.2	-32.1	-37.0	-33.2	-32.7
Tottori	-40.9	-38.7	-33.5	-34.7	-34.0	-31.7	-41.4	-40.0	-43.2	-41.6	-45.5
Shimane	-33.4	-30.2	-23.2	-32.7	-34.7	-34.8	-36.3	-28.7	-35.6	-37.0	-38.5
Okayama	-38.5	-30.8	-36.3	-32.9	-32.1	-33.5	-39.1	-36.3	-40.9	-38.7	-40.2
Hiroshima	-41.1	-27.6	-34.4	-30.4	-36.0	-35.0	-28.7	-28.2	-32.9	-29.7	-30.5
Yamaguchi	-45.9	-44.6	-39.0	-34.5	-36.0	-37.1	-31.3	-32.0	-33.5	-27.1	-22.2
Shikoku	-38.3	-32.3	-31.1	-31.1	-32.6	-36.0	-35.1	-32.2	-30.5	-29.4	-33.3
Tokushima	-37.6	-32.9	-36.0	-34.5	-38.4	-40.0	-36.6	-38.0	-31.2	-34.8	-39.0
Kagawa	-36.7	-29.9	-34.8	-26.7	-23.0	-26.8	-26.2	-26.8	-28.0	-32.1	-24.4
Ehime	-41.3	-37.3	-26.8	-33.0	-32.9	-36.8	-41.1	-34.4	-31.2	-24.8	-36.0
Kochi	-33.4	-29.3	-29.1	-30.6	-33.9	-44.6	-36.9	-28.7	-27.6	-29.7	-36.3
Kyushu/Okinawa	-34.8	-31.9	-30.4	-29.5	-31.0	-31.1	-31.4	-28.4	-27.4	-26.3	-27.8
Fukuoka	-41.7	-41.2	-31.7	-34.9	-36.8	-26.3	-25.4	-25.4	-25.0	-28.5	-28.5
Saga	-37.4	-31.2	-28.3	-32.0	-33.2	-33.5	-33.9	-30.3	-27.8	-27.8	-29.4
Nagasaki	-32.4	-31.6	-35.1	-36.1	-37.8	-39.4	-41.8	-35.7	-34.5	-28.6	-27.0
Kumamoto	-36.1	-31.2	-31.4	-26.1	-30.3	-29.4	-23.5	-24.3	-21.9	-23.4	-28.0
Oita	-30.9	-32.1	-25.9	-25.7	-25.7	-27.0	-33.6	-29.8	-33.7	-24.7	-37.2
Miyazaki	-37.7	-33.1	-39.4	-23.8	-32.9	-34.4	-32.0	-26.9	-31.7	-29.4	-27.3
Kagoshima	-37.1	-33.3	-31.9	-32.8	-27.6	-40.5	-38.2	-35.5	-31.5	-29.8	-26.7
Okinawa	-20.4	-12.8	-16.4	-16.2	-18.0	-21.1	-22.8	-19.5	-12.2	-17.7	-13.7

Source: SMRJ, Survey on SME Business Conditions.

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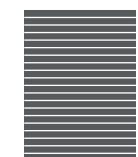


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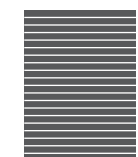


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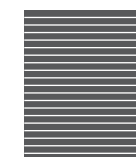


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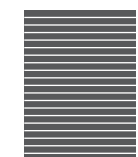
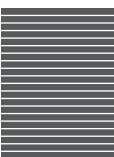


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This white paper was drafted by the Research Office of the SME Agency in the Ministry of Economy, Trade and Industry (Members are as follows: Izuru Hanaki, Mikio Endo, Masa Kanai, Yutaka Hirano, Yoshihiro Hattori, Mai Yaguchi, Koji Oki, Kazunobu Hamamachi, Shin Ichikawa, Hiroshi Negishi, Takashi Tatsuzawa, Shinobu Gomado, Fumio Akiyoshi, and Shu Kawamura).

Thanks are due to Shigeru Matsushima (Professor, Hosei University), Hiroki Sato (Professor, University of Tokyo), Takemasa Ishihara (Professor, Osaka City University), Joji Abe (Professor, Fukushima University), Noriaki Goto (Professor, Nihon University), Toshiaki Takeuchi (Specially Appointed Professor, The University of Electro-Communications), Tomofumi Amano (Associate Professor, Hosei University), Yuji Honjo (Associate Professor, Chuo University), Hideo Okamura (Associate Professor, Kwansai Gakuin University), Kimihiro Furuse (Lecturer, Graduate School of Hitotsubashi University), Masaharu Nakagawa (Deputy International Finance Officer, Daiwa Securities SMBC Co., Ltd.), Nobuaki Yamada (Executive Director, Ota City Industrial Promotion Organization), Ichiro Uesugi (Fellow, Research Institute of Economy, Trade and Industry), Akiko Ono (Postgraduate Student, Department of Urban Engineering, School of Engineering, University of Tokyo), and the many others who kindly gave their assistance.

We should also like to thank the SME entrepreneurs and everyone else who took part in interviews and surveys, and provided valuable advice and comments that contributed to the publication of this white paper.

the 1990s, the number of people with a mental health problem has increased in the UK, and the number of people with a mental health problem who are in contact with mental health services has also increased (Mental Health Act 1983, 1990, 1994, 1997, 2003, 2007).

There is a growing awareness of the need to improve the lives of people with a mental health problem, and to reduce the stigma and discrimination that they experience. This has led to a number of initiatives, including the Mental Health Act 1983, the Mental Health Act 1990, the Mental Health Act 1994, the Mental Health Act 1997, the Mental Health Act 2003, and the Mental Health Act 2007.

The Mental Health Act 1983 was the first of a series of Acts that have been passed in the UK to improve the lives of people with a mental health problem. The Act 1990, 1994, 1997, 2003, and 2007 have all made significant changes to the way in which people with a mental health problem are treated.

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