

Reconsidering The Changing Economic Structure and SMEs in Japan

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Debating Points

Dual Structure and Differentials— The Winners vs The Weakers – Harmony and Co-existence vs

Mega Competition – SMEs=Vital Majority? – Socially Reasonable Division of Labor

Introduction

Dramatic changes in contemporary society have reached various parts of the world: the official absorption of East Germany into West Germany; the formation of the EU; partial introduction of market economy by China, the former Soviet union, and Socialist countries of Eastern Europe; and so forth. Besides Japan's asset-inflated "bubble" economy has collapsed.

Against the background countries across the world attach more importance to the role of small and medium-sized enterprises in business as a vital factor of the national economy; and drastic and complete public measures are now called for to encourage them.

When problems concerning small and medium—sized enterprises are dealt with, they should not be tackled "independently" or "separately", but within the framework (structure) of Japan's economy as a whole and in relation to world economy.

That is to say, Japanese economy is Keenly felt furthermore international liberalization and contribution fore the world economy.

Therefore I would like to reconsider and emphasize again pressing problems for SMEs' role and contribution in Japan's overseas economic collaboration through my preceded papers which have been contained in "Collections of Papers" presented to "The Rencontres de St-Gall" and so on([1],[2]).

1. Dual structure of Japan's industrial economy

As is well known, Japan's industrial structure has formed a pyramid in which there are only a few large enterprises at the top and a much larger number of small and medium-sized, and little • petty enterprises at the bottom.

The “dual structure” of Japan's industrial economy once made the headlines. Every country has such structure. Then why does the dual structure poses a problem in Japan.

Once accounting for 99.7% of the total number of enterprises in Japan, the offices of small and medium-sized enterprises have recently decreased to 99.1%. Firms with less than four employees are no longer counted in the total.

Even if there is a small difference in the said proportion between countries, it is true in almost every country that small and medium-sized enterprises have a higher percentage than large ones.

What is wrong with the fact in Japan? While there are only a few leading enterprises at the top of the industrial structure, there are a much greater number of enterprises at the bottom which are inferior in facilities and management. That is a problem.

In those days when the dual structure issue was often dealt with, there were wide pay differentials between major enterprises and others.

Suppose employees of major enterprises were paid 100 per cent, then those of small and medium-sized and little • petty enterprises were paid 30 to 80 per cent. While large enterprises had highly modern facilities, small and medium—sized enterprises could not afford to have such facilities yet. There was also a big disparity in labor productivity between them.

As such differences have gradually narrowed since the high growth period of the Japanese economy, some scholars make a casual remark that the dual structure “no longer exists”. As a matter of fact, that is not true. Instead there are widening gaps between them. Therefore such a casual remark should be questioned.

2. Relations with large enterprises

The issue of small and medium—sized enterprises is beginning to assume massive proportions in any countries. Small businesses and large enterprises should maintain the “socially reasonable divi-

sion of labor”, but in some cases the former may solely be affected by the latter’s rationalization of management, etc.

In some areas of industry in which small and medium—sized enterprises compete with major enterprises, the former may give in to the latter bit by bit because the latter is equipped with more advanced facilities than the former. Large enterprises may subcontract part of their operations to small and medium-sized businesses. In other cases small firms compete with each other. Any way it is demanding to manage a small and medium-sized company.

3. Problems of SMEs (Small and Medium-sized Enterprises) and Little • Petty Enterprises

Generally Problems of SMEs and little • petty enterprises include: smallness in the size of production system, organization and management; production of various kinds in small quantities; labor intensiveness; difficulties in financing; subcontracting, cottage industries and family businesses; dependency on wholesalers; too many participants-excessive competition leading to poverty; cooperative, organizational and industrial reorganization.

Considering characteristics of the geographical distribution of the industries, they are also identified as traditional SMIs in production area.

With the shifts of the industrial structure, small and medium industry was also compelled to change structurally, and the conditions supporting its existence or the factors causing changes themselves were subject to variations. These factors of change are (a) technological innovation, (b) structure of demand, (c) labor force,(d) progress of internationalization, etc.

They have operated in the following manner:

- (a) Due to the progress and general diffusion of technological innovation, new materials and substitutes were developed, and the mechanization of work and, consequently, mass—production of standardized articles were made possible.
- (b) Living standards were elevated with the high—pitched growth of the economy, and changes in the composition of demand took place due to the changing way of life.
- (c) As the labor shortage became apparent, small and medium industry was losing its basis of low-wage employment structure and labor intensive method and means of production. Above all, it was subject to the influences from the tendency of a young labor force fresh from school

to concentrate into the rapidly growing types of large enterprises.

(d) With the intensifying international exchanges, foreign products have been entering domestic market, for instance. In particular, the products of developing countries are catching up with those of Japan with accelerating pace by taking advantage of a cheap and abundant labor force which itself has been hitherto the characteristic merit of Japan's small and medium industry. To be sure, these factors of change have also a favorable side for small and medium industry. Some instances might be cited as follows.

- (1) Technological innovation promotes the mechanization of production techniques, modernization and rationalization in small and medium industry.
- (2) As for changes in the demand structure, the rise of living standards stimulates the expansion of small and medium industry by way of increasing demand for high-grade articles.
- (3) With the increasing international exchange, raw materials for instance can be more readily obtained.

Moreover, the development of transporting machinery and progress of the so-called distribution revolution reduce the cost of transportation and make it easy to connect producers with consumers. However, the possibility of survival and growth is opened up only for those among small and medium enterprises, which can adapt themselves skillfully to and cope positively with the changes in the social and economic environment.

So, I would like to summarize and emphasize again.

(1) Development of "Technological innovation" • (2) Changes in "Raw materials" • (3) Changes in "Demand structure" • (4) Changes and shortage in "Labor force" • (5) "Liberalization of trade and globalization" • (6) The "Capital and financial" problem • (7) "Business fluctuation" • (8) Development of "Information network". Aiming at harmonious development of networking and individualization. Especially, nowadays interdisciplinary work and information processing are combined to bring about the establishment of an "information network".

The network will spread over wider areas in the near future.

From such point of view, it is necessary for small businesses to organize themselves as required in the past and at the same time to individualize themselves further. The statement may sound very contradictory. In this connection a Berlin professor's remark at "Swiss International Small Business

Society” was worth listening to. He said ‘That looks like a soccer team’. Soccer is a game played by two teams of eleven players, who of course act for the good of their own team rather than their individual advantage. However, one of them is a star player who leads other players of the team. He is required to display his own flawless technique to help the team to play in an well-organized manner’, he said.

4. Changes in economic structure and management innovation and SMEs through “2005 White Paper on Small and Medium Enterprises in Japan-Structural Change In Japanese Society and dynamism of Small and Medium Enterprises-” ([3])

“Economic revitalization and SMEs”

The Japanese economy has gone through two business cycles since the collapse of the bubble economy. This process has been redolent of stagnation, with adjustments in the business sector, for example, to deal with the “three excesses” of excess debt, excess employment, and excess capacity. In this environment, the number of SMEs, which had grown consistently since the end of the Second World War, went into decline in the 1990s. Taking as a baseline the number of enterprises in each industry in 1981, the declines were particularly marked in manufacturing and commerce. A similar trend is evident in the makeup of newly listed enterprises – counting only enterprises listed on JASDAQ, OSE Hercules and TSE Mothers, which are markets for newly listed stocks (equivalent to enterprises that were until recently SMEs).

During the recent economic upturn following these severe conditions, a virtuous cycle has been apparent in which corporate innovation stimulates latent demand, which in turn encourages further innovation. Recognizing the need for the government to support such developments in the private sector, the Ministry of Economy, Trade and Industry (METI) unveiled a comprehensive strategy in May 2004, entitled “Creating Innovation Based on the New Industry Promotion Strategy”.

This strategy calls for the injection of policy resources in three key areas: internationally competitive high-value-adding pioneering industries, industries (such as services) meeting broadening social needs such as health, welfare and environmental needs, and industries contributing to regional regeneration. In order for these moves toward revitalization of Japan’s economic and industrial structure to bear fruit, however, considerable changes among the SMEs that make up the bulk of

the economy are a prerequisite. Action must be taken at the level of individual SMEs to take on the challenge and risk of innovation and starting up in business in line with changes in the overall economic structure.

Globalization and the prolonged slump are altering the subcontracting environment. As large enterprises have transplanted their operations overseas and their own business performances have worsened, the merits and capacity to maintain *keiretsu* have been lost. From the point of view of subcontractors as well, subcontracting has lost its luster. In actuality, the proportion to subcontractors fell from over 65.5% in 1981 to 47.9% in 1998, and among enterprises currently heavily dependent on subcontracting, many hope to reduce the proportion of business that they receive from subcontracting. The number of subcontractors is therefore expected to fall even further in the years ahead. Another factor prompting the migration away from subcontracting is the growing modularization of product architecture. Modularization is a method of raising overall productivity by breaking down complex products into several parts (modules) designed in accordance with uniform standards, and making separate innovations at the level of each module. At the same time, however, a common practice in production in Japan is the use of “integral” technologies, which allow adjustments to be made between individual processes to combine them to produce a single product, and within Japan’s subcontracting structure, the industries that require integral technologies are those that are competitive. Comparing the automobile parts industry (transportation machinery and equipment), in which the subcontracting ratio has traditionally been high, with electronics industries such as desktop computers and semiconductors (electrical machinery and equipment), the scale of the decline in the proportion of subcontractors is greater in the electronics industry, where modularization has made greater inroads than in the typically integral technology oriented automobile parts industry.

There is thus occurring a gradual decline in the proportion of subcontractors, which have until now supported the Japanese economy, and this means that growing numbers of SMEs are independently planning and marketing their own products. In order to survive under conditions of greater independence, enterprises must therefore develop their markets and generate profits for themselves. There are, generally speaking, two ways of raising profits—by reducing costs, and by increasing value added—and SMMs need to take actions in these two areas.

Among SMEs, which have relatively scarce business resources, there are few that can plan, pro-

duce and market products completely by themselves. In recent years, therefore, it has grown more important that they supplement the resources that they lack through cooperation with other entities, including universities, research institutes, other companies such as customers, suppliers and contractors .

Conclusion

Now, I have to emphasize over and over fundamental and pressing problems for survival and development of SMEs in the so-called “Borderless Ages”. And furthermore, I would like to introduce again the great opinion and doctrine by Professor Dr. Alfred Gutersohn, because we – colleagues at the Rencontres de St-Gall – have to think deeply about what our the greatest Teacher had emphasized.

That is to say, with focus on SMEs –

The international economic environment is undergoing increasingly dramatic changes. The globalization and simultaneous localization of economy have promoted shifts in and diversification of values themselves. Rather shifts in and diversification of values have caused changes in the world economic environment. For entrepreneurs and companies, particularly small enterprises, it is their basic problem how to cope with changes in and diversification of, the society, ethics, and physics; sociology and political science; the legal system, ecology, politics, and economy; and in natural and cultural values. It was a main topic at the “Rencontres de St-Gall 1996 (Swiss International Small Business Society)” ([4]).

As stressed there by Prof. Dr. Alfred Gutersohn, founder of the Society, what is called for to solve the basic problem is ‘entrepreneurship and managing ability of small businesses which are confronted with drastically changing environment and changes in and diversification of values; and reeducation and training which have an accurate grasp of such motivation, concept and factors as enable them to maintain and develop their operations’.

In the circumstances, it is requested that there should be shifts in points of view on justification for the existence of small enterprises, such as their standing and role in the national economy. In order to place small businesses as the vital majority in a true sense, it is required to reform the old order in which they are strategically put at the bottom of the industrial hierarchy, to install them at the

center of the industrial circle for social and reasonable purposes, and to cause a centripetal, centrifugal, or circular ripple effect on other segments of the industry. Now, “The time is ripe for it” ([5]).

What is the more important as another basic factor is not only corporate efforts of a small business itself, but also government policy to encourage them and the role of a leader or catalyst who makes a proposal to both of them from the international point of view. I dare to repeat the importance.

Keywords for Development of SMEs

1. Flexibility
2. Creativity
3. Demonstration of Entrepreneurial Daring
4. Accumulation of Special technology and Skills
5. Integrated Management of Operators and Employees
6. Construction of Equal and “Socially Reasonable Division of Labor” between SMEs and LEs and “Network”

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