# Outline of SME White Paper FY2003

## 1. Contents

Part 1 Current Trends of SMEs

-Analyzes severe economic and financial situation facing SMEs

Part 2 Revitalization of Japanese Economy and the Role of SMEs

-Analyzes strengths of SMEs, which have supported the Japanese economy over the long term

-Analyzes challenges to building an economy where businesses can startup, close, revitalize and revive themselves easily.

-Analyzes challenges to creating a new SME network as a form of management innovation

-Analyzes facilitating accounting methods that give consideration to enterprise qualities that cannot be evaluated by financial data alone

## 2. Features

-**Recognizing the strength of SMEs** that have overcome various difficulties and have supported the growth of the Japanese economy, and clarifying that **SMEs are the driver of economic revitalization in Japan.**

-Grasping the trends of the latest business start-ups. **C**onsidering realities of bankruptcies, revival of bankrupted owners and conditions for business reconstruction by using **large-scale, wide-ranging surveys of bankrupted owners**. Also, looking into realities of those who are willing to close businesses through surveys of industrial regions.

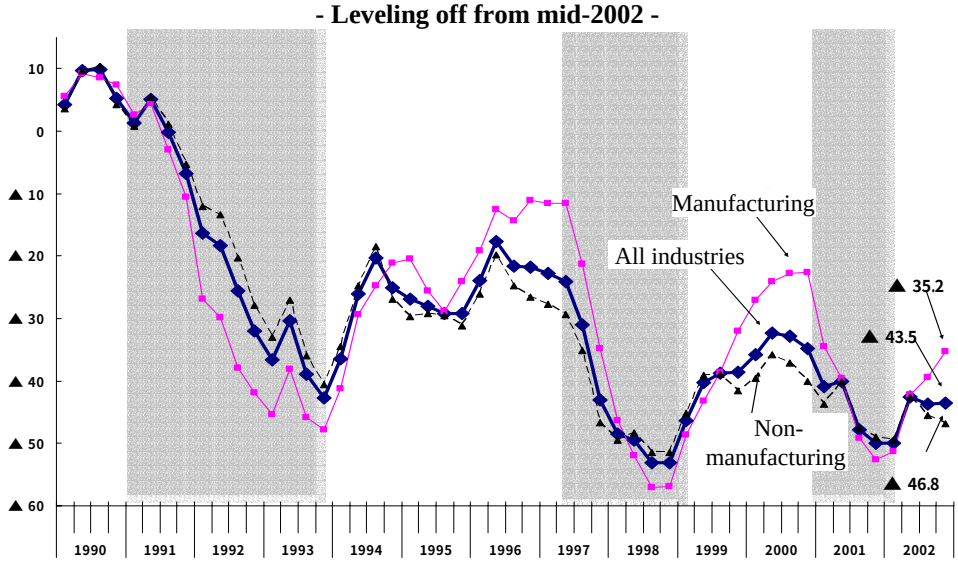
-Finding ways for subcontractors to survive by adjusting to global procurement etc. Analyzing **various conditions for successful horizontal cooperation among SMEs, and collaboration between SMEs and academia.** Identifying conditions for successful joint activities to increase the attractiveness of shopping areas.

-**Reevaluating the role of regional financial institutions in SME financing** amid contracted lending by big banks. Identifying **the effects on SMEs of recent financial environmental changes including mergers and bankruptcies of financial institutions.** Searching for **ways to enhance SMEs' fund-raising capacity** through, for example, diversification of fund providers.

## 1. Overall Economic Trends of SMEs

-The business performances of SMEs signaled some recovery in the first half of 2002 before easing or leveling off in the rest of the year. A performance gap expanded between manufacturers supported by rising exports and non-manufacturing industries hit by weak domestic demand.

**Figure 1-1 Changes in SME Business Confidence**
**- Leveling off from mid-2002 -**

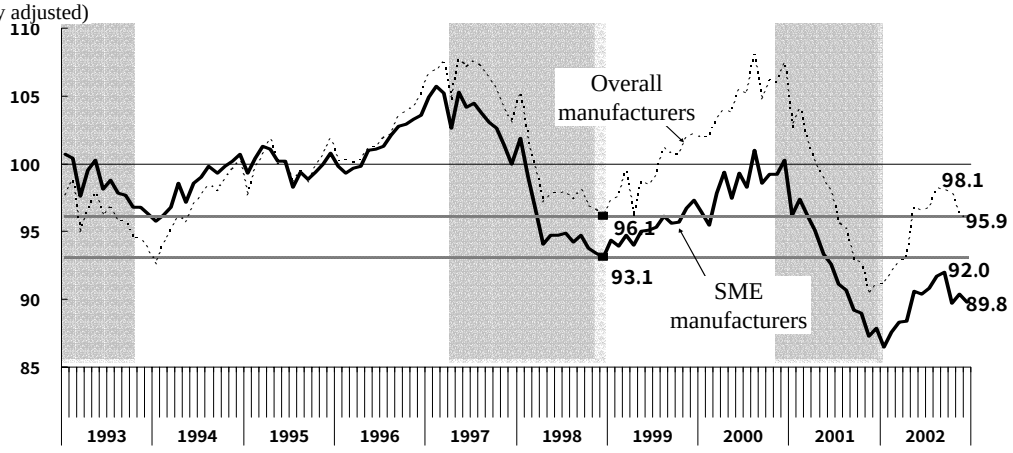



Source: SME Agency/JASMEC, *Survey of Business Conditions in the Small Business Sector*
(Notes) 1. Business conditions diffusion index = percentage for improvement - percentage for deterioration
2. Shaded parts in the figure indicate recession periods (the same for figures below).

- Production of SME manufacturers bottomed out in the beginning of 2002 and expanded on the back of robust electrical and transportation machinery production before slowing down from the autumn. **While overall production of Japan's manufacturing industries recovered from the previous trough of the economic cycle in December 1998, SME manufacturers' production remained below their trough level. A production gap thus has expanded between large and SME manufacturers.**

**Figure 1-2 Changes in Production of SME Manufacturers**
**- Production of SME manufacturers still remained below the late 1998 level -**

(100 for 1995, seasonally adjusted)

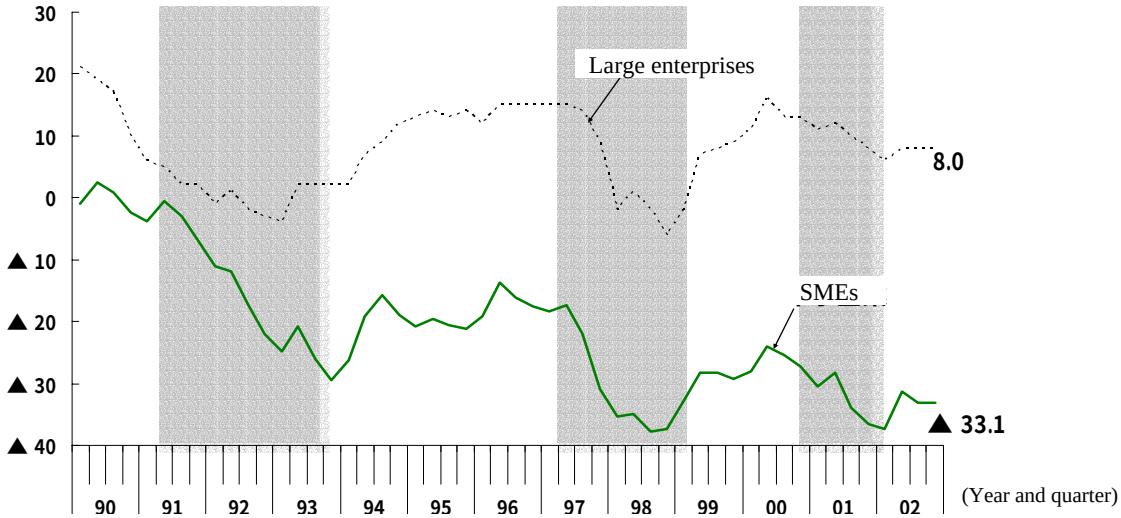



Sources: ME11, *Index of Industrial Production*, SME Agency, *Manufacturing Production Indices by Size of Firm*

## 2. Financial Environment Surrounding SMEs

- The financial position has **deteriorated for SMEs over the long term** while leveling off for large enterprises.

**Figure 1-3 SME Financial Position DI (All Industries)**
**- Deteriorating over the long term -**

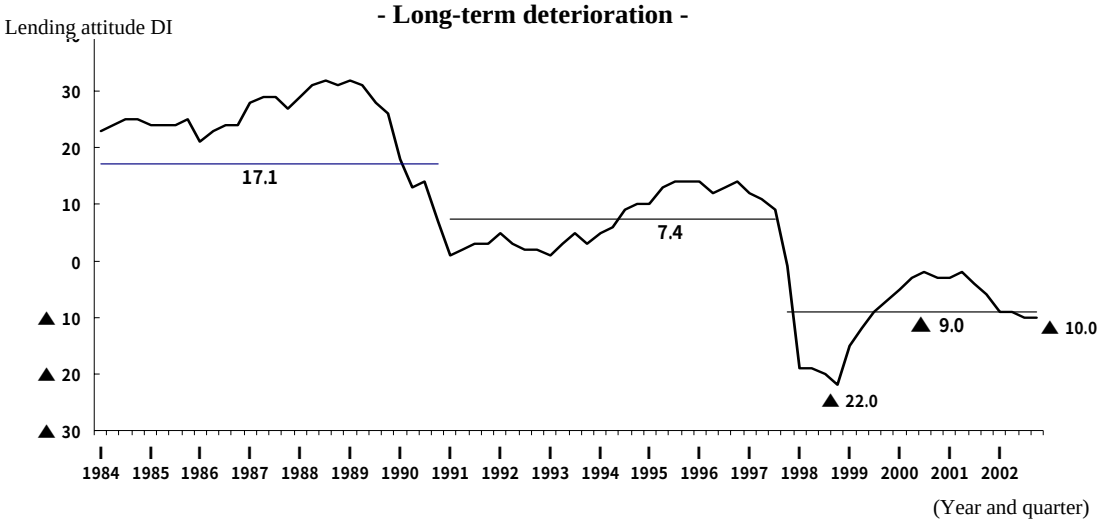



Sources: Bank of Japan, *Short-Term Economic Survey of Enterprises in Japan* for large enterprises; SME Agency/JASMEC, *Survey of Business Conditions in the Small Business Sector* for SMEs

(Notes) 1. DI for large enterprises = percentage for "easy"- percentage for "difficult"
DI for SMEs = percentage for "improvement" from a year earlier - percentage for "deterioration"
2. Shaded parts in the figure indicate recession periods

- The lending attitude Diffusion Index of financial institutions **has continued to deteriorate over the long term. When the business conditions DI improved briefly in 2002, the lending attitude DI remained low without any signal of the recovery.**

**Figure 1-4 Lending Attitude DI of Financial Institutions (for SMEs in all industries)**
**- Long-term deterioration -**

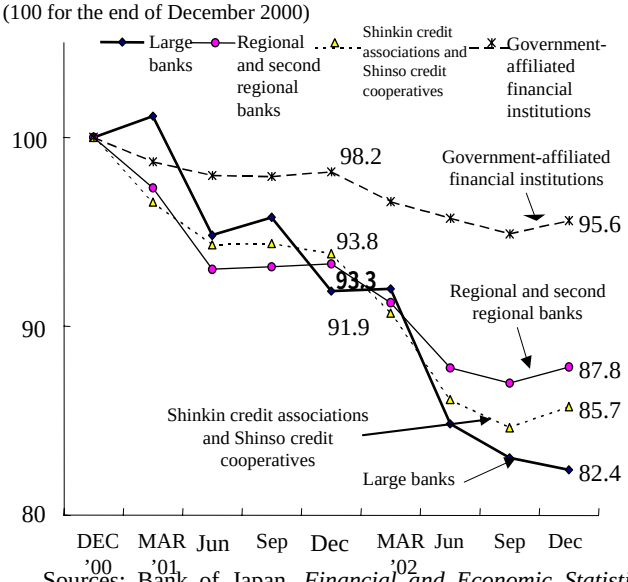



Source: Bank of Japan, *Short-Term Economic Survey of Enterprises in Japan*
(Note) Lending attitude DI of financial institutions = percentage for "easy" - percentage for "tight."

- Outstanding loans to SMEs **declined at large private financial banks.** On the other hand, those to SMEs **remained rather steady at government financial institutions.**

**Figure 1-5 Changes in Outstanding Loans to SMEs**

(100 for the end of December 2000)



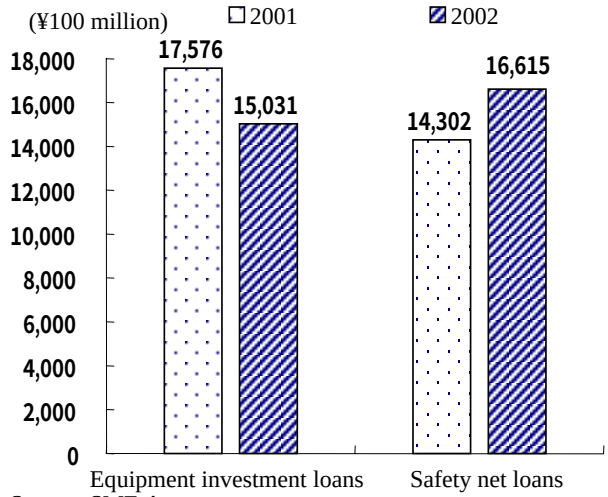

Sources: Bank of Japan, *Financial and Economic Statistics Monthly*; SME Agency, *Monthly SME Survey*

(Notes)

1. Large banks cover city, trust and long-term credit banks, and trust and overseas branch accounts of domestic banks.
2. Government financial institutions cover Shoko Chukin Bank, Japan Finance Corporation for Small Business and National Life Finance Corporation.

**Figure 1-6 Breakdown of Government Financial Institutions' Loans to SMEs**

**- Equipment investment loans declined while safety net loans increased -**




Source: SME Agency

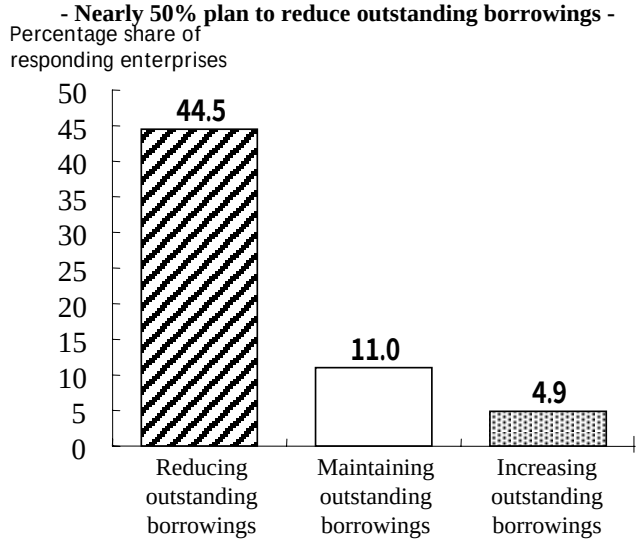
(Notes)

1. Changes in equipment investment and safety net loans provided by Japan Finance Corporation for Small Business, Shoko Chukin Bank (long-term loans alone) and National Life Finance Corporation.
2. Safety net loans were created in December 2000 to smoothly provide funds to SMEs faced with bankruptcies of trading partners or financial institutions.

-Nearly 50% of enterprises plan to reduce their outstanding borrowings. This tendency is promoted by the fact that **enterprises become more cautious about borrowing plans after having loan applications rejected by financial.** The rejections are assumed to invite a spiral of decline in loan applications.

**Figure 1-7 Enterprises' Borrowing Plans for Coming Year (All Industries)**

**- Nearly 50% plan to reduce outstanding borrowings -**



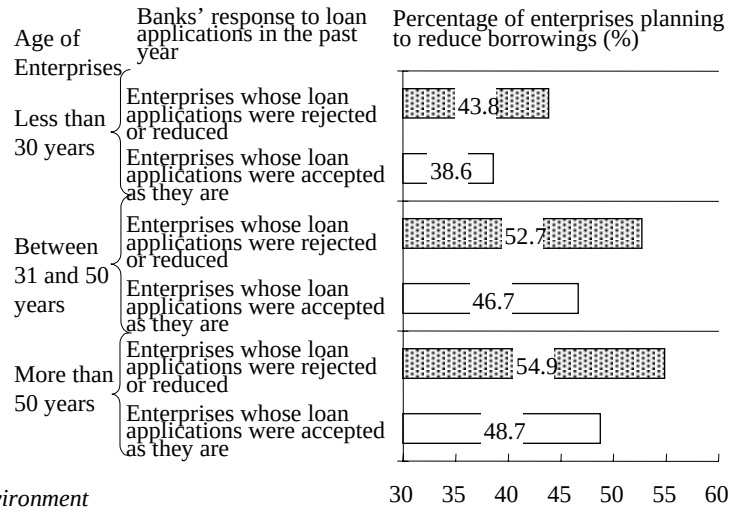

Source: SME Agency, *Survey of the Business Financing Environment (November 2002)*

(Note)

In addition, 39.7% said "Taking flexible actions in response to specific situations."

**Figure 1-6 Banks' Response to Loan Applications and Enterprises' Future Borrowings Plans (All Industries)**

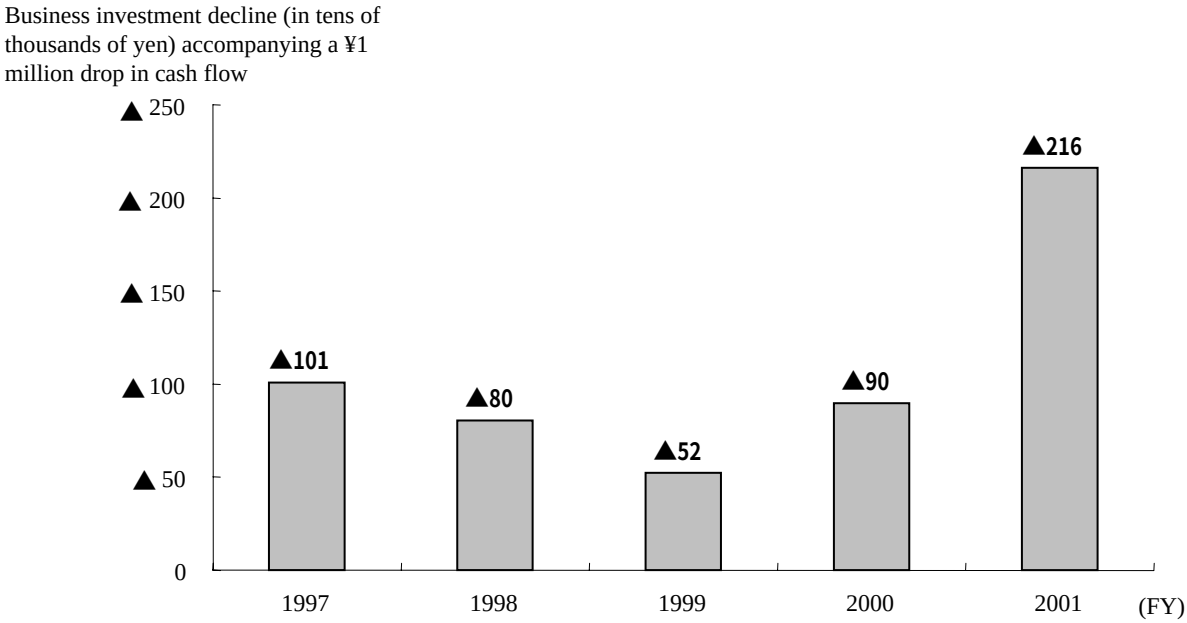
**(Enterprises' Borrowings Reduction Plans by Banks' Response to Loan Applications)**




Source: SME Agency, *Survey of the Business Financing Environment (November 2002)*

-Amid unforeseeability about the future, **investments by SME manufacturers have become more dependent on their cash flow levels, leading to lower investment**.

**Figure 1-9 Cash Flow's Impact on Business Investment (SME Manufacturers)**
**- Cash flow levels have had a growing impact on business investment levels -**

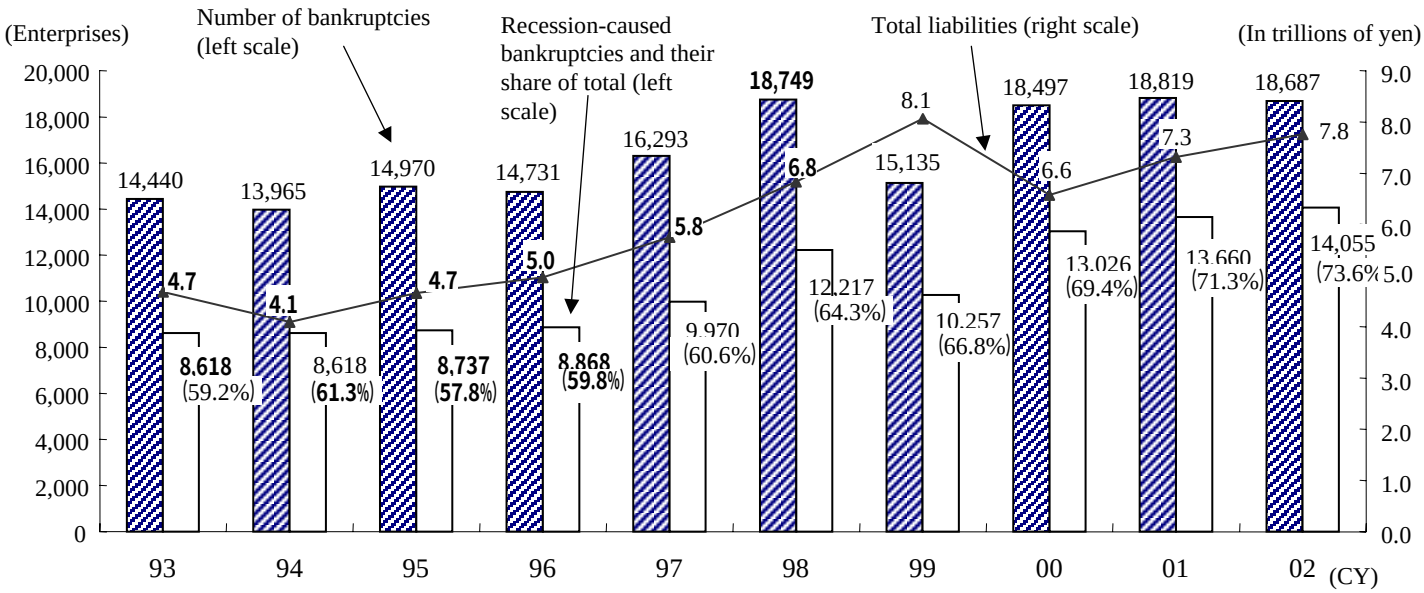



Source: METI, *Basic Survey of Japanese Business Structure and Activity (FY 1996-2001)*
(Note) Annual cash flow = (annual recurring profit) x 1/2 + (annual depreciation cost)

## 3. SME Bankruptcies

-The number of SME bankruptcies in FY2002 was at a high level, **above 18,000, which is the sixth highest in history.** Under the prolonged economic slowdown, **recession-type bankruptcies accounted for a greater share. The number of this type hit the worst level ever.**

**Figure 1-10 SME Bankruptcies and Their Liabilities**
**- Recent annual bankruptcies remained high -**

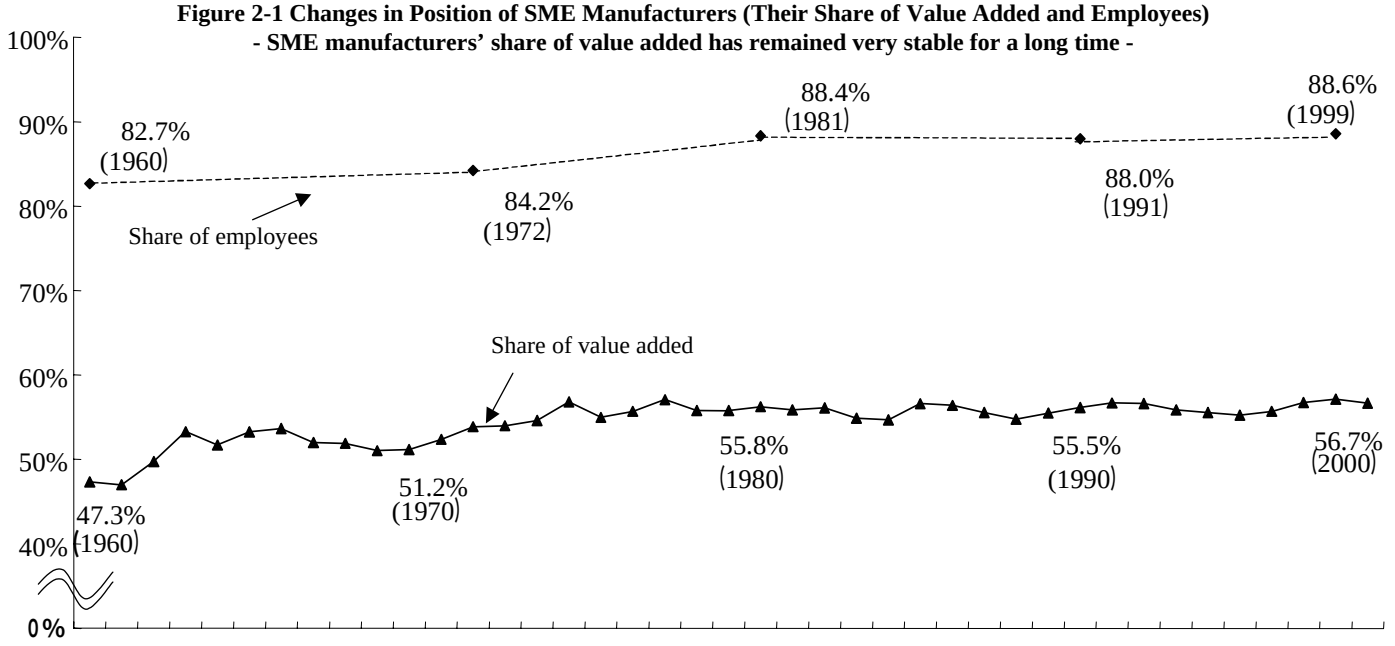



Source: Tokyo Shoko Research, Ltd., *Bankruptcy White Paper*
(Notes)
1. The number of bankruptcies covers bankrupt enterprises with liabilities of ¥10 million or more. SMEs are corporations and individuals with capital slipping below ¥100 million.
2. Figures in parentheses are recession-caused bankruptcies' percentage shares of total failures.

# <Strengths and Performances of SMEs>

-Industrial shipments jumped 20-fold from 1960 to 2000 in Japan. In spite of dramatic changes including high economic growth, two oil crises and the steep appreciation of the yen, the position of SME manufacturers, as measured by value added and the number of employees, has remained very stable for a long time. SMEs have thus contributed to Japan's economic development.

**Figure 2-1 Changes in Position of SME Manufacturers (Their Share of Value Added and Employees)**
**- SME manufacturers' share of value added has remained very stable for a long time -**



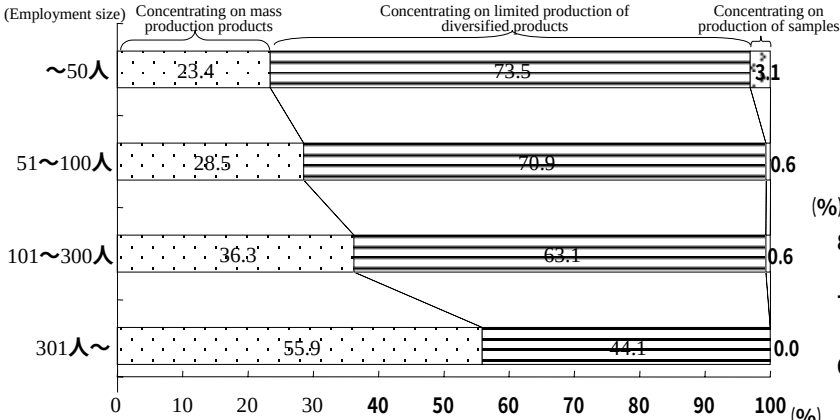

Sources: METI, Census of Manufactures *(Industries)*; Ministry of Public Management, Home Affairs, Posts and Telecommunications, *Establishment and Enterprise Census of Japan*
(Notes)
1. For the share of value added, business offices with four to 299 employees are classified as SMEs.
2. For the share of employees, business offices with one to 299 employees are classified as SMEs.

-SMEs have **performed better than large enterprises in areas of limited production of diversified products** and in areas **where demand fluctuates wildly. These areas** grow more important for improvement of national income**.** While large enterprises have undertaken primarily mass production, SMEs have focused on limited production of diversified products. This is one form of business division.

**Table 2-2 Cases Where SMEs Specialize in Limited Production of Diversified Products in Certain Industry or Product Categories**

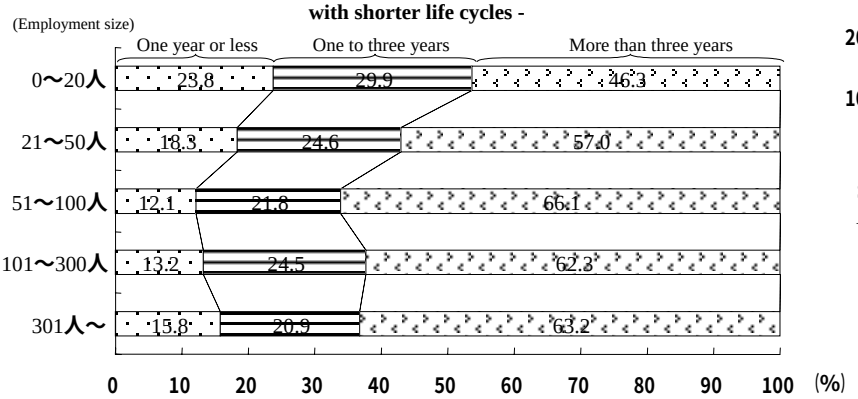
| | Large Enterprises | SMEs |
|---|---|---|
| Electrical audio machine and instrument manufacturing | Popular, low-priced and other general-purpose products for mass production and sales (minicomponent stereo sets, etc.) | High-value-added products featuring better-quality sound and other improvements for audio enthusiasts (More-than-one-million-yen luxury audio amplifiers, components, etc.) |
| Robot manufacturing | Robots for which certain levels of demand are expected for production lines in automobile, electronics and electrical machinery industries (welding, painting, assembling, mounting and other robots) | Special robots for research purposes (research robots, robot components, etc.) |
| Medical equipment manufacturing | Products whose development and improvement require massive funds and many experts (artificial organs, X-ray systems, etc.) | Custom-made products meeting various specifications as required by hospitals and other users (thermatological systems, low-frequency massage devices, electric potential treatment instruments, components, etc.) |
| Bond adhesive manufacturing | Products for which certain levels of demand are expected, including bonds for building material plywood (urea resin bonds) | Products that can be used in various ways depending on bonding purposes (packaging, bookbinding, woodworking, etc.), bonding strength and bonding forms (hot-melt bonds) |
| Waste disposal equipment manufacturing | Large machines for waste disposal plants of local governments (bulky waste disposal machines, sludge treatment machines, etc.) | Machines for diversified treatments for recycling purposes (PET bottle compression machines, garbage treatment machines, etc.) |

**Figure 2-3 Features of Products as Divided by Employment Size (Manufacturing)**
**- Enterprises with smaller employment sizes tend to undertake limited production of diversified products -**



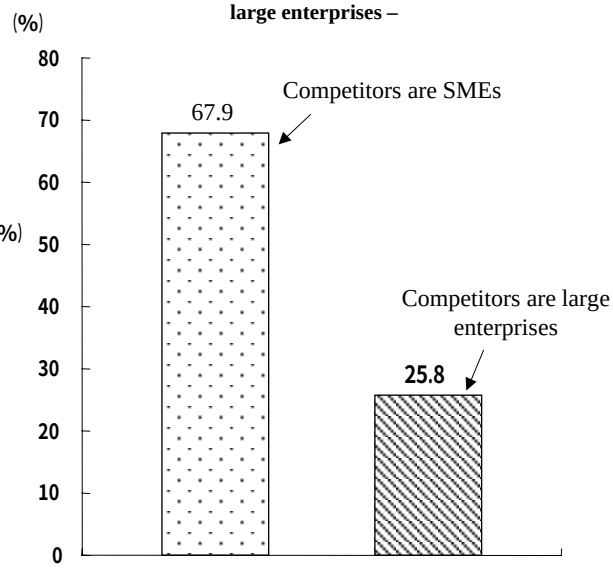

Source: Shoko Research Institute/Shoko Chukin Bank, "The 5th *Fact-finding Survey on Structural Changes of Machinery and Metal Industries (2000)*

**Figure 2-4 Life Cycles of Goods and Services as Divided by Employment Size (Manufacturing)**
**- Enterprises with smaller employment sizes tend to produce products and services with shorter life cycles -**




Source: SME Agency, *Fact-finding Survey on Business Management Strategy (November 2002)*

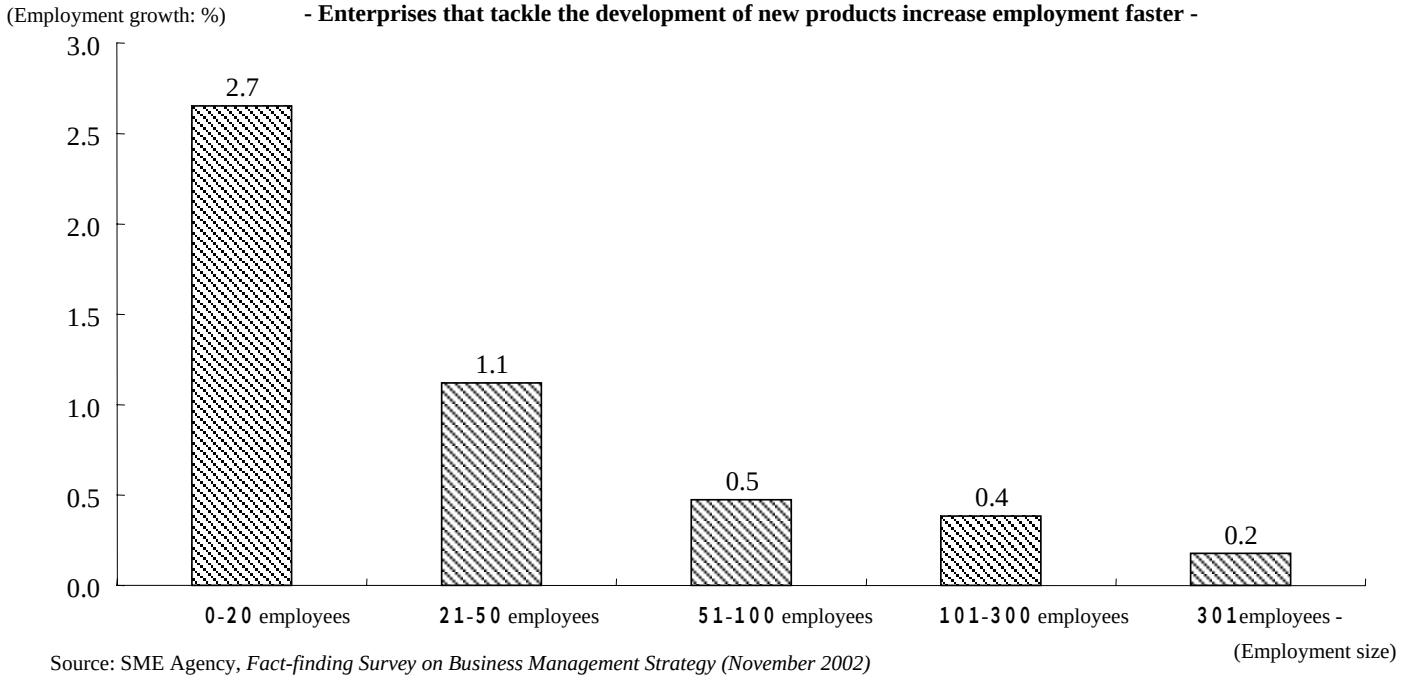
**Figure 2-5 SMEs' Major Competitors (Manufacturing)**
**– SMEs work well in areas that are different from those for large enterprises –**




Source: SME Agency, *Fact-finding Survey on Business Management Strategy (November 2002)*

-SMEs do not necessarily maintain the same size in the area of limited production of diversified products. They grow through the **development of new products.**

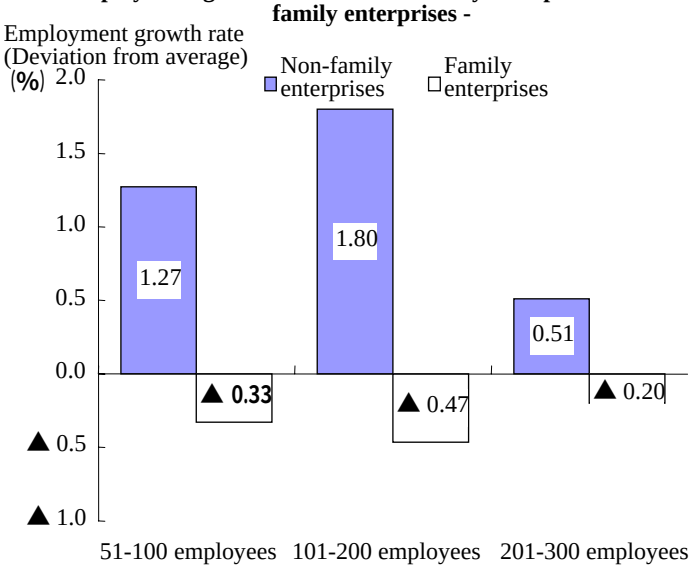
**Figure 2-6 New Product Development's Effect on Employment Growth (1998-2002) (Manufacturing)**
**- Enterprises that tackle the development of new products increase employment faster -**




Source: SME Agency, *Fact-finding Survey on Business Management Strategy (November 2002)*
(Note) The figure pays attention to a gap between an average employment increase for enterprises tackling new product development and that for all enterprises, as divided by employment size.

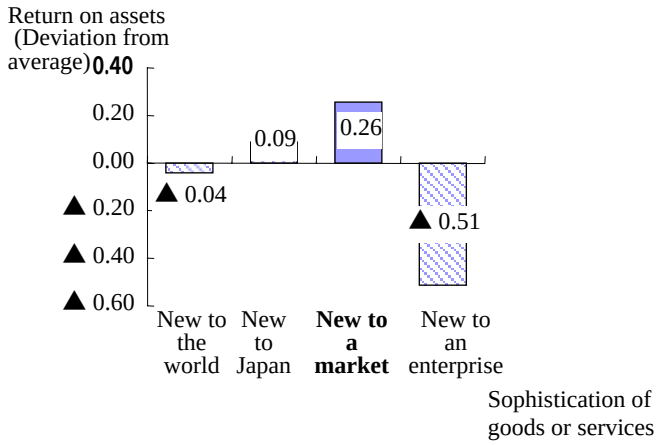
-Growing SMEs indicate that it is important a) **to employ external workers such as** shifting from **family enterprises to non-family enterprises**, and b) to develop **sophisticated technologies that meet their markets.**

**Figure 2-7 Employment Growth Rates for Family and Non-family Enterprises (Manufacturing, wholesale and retail industries)**
**- Employment grows faster for non-family enterprises than for family enterprises -**




Sources: METI, *Basic Survey of Commercial and Manufacturing Structure and Activity (2000)* (reedited and processed); SME Agency, *Fact-finding Survey on Business Management Strategy*

**Figure 2-8 Sophistication of Goods or Services, and Return on Assets (Manufacturing, wholesale and retail industries)**
**- Enterprise earnings indicate that goods or services do not necessarily have to be highly advanced -**




Source: SME Agency, *Fact-finding Survey on Business Management Strategy (November 2002)*
(Note) In the survey, responding enterprises were asked to choose from four alternatives-(1) New to the world, (2) New to Japan, (3) New to a market, and (4) New to an enterprise-regarding the sophistication of their mainstay goods or services.

-SMEs have provided lots of innovations to society through **the development of new products during their growth**.

<Examples of innovations by SMEs that have been widely applied>

- Shredder: Devised by then Meikoshokai Co. President Takagi in 1960, based on noodle-making machines.
- Fish finder: Invented by radio repair brothers Seiko and Seiken Furuno (Furuno Denki Shokai) in Nagasaki Prefecture in 1948.
- Integrated security service: Started by Makoto Iida of Secom Co. along with his friend Juichi Toda in 1961. Expanded business through security, etc. for construction site for Olympic Games.
- Karaoke (sing-along) machine: Invented by bandsman Daisuke Inoue in 1971.
- Mechanical pencil: Invented by Tokuji Hayakawa of Hayakawa Kyodai Shokai in 1915. After his company failed due to the occurrence of the Great Kanto Earthquake, Hayakawa launched an electrical appliance manufacturer that developed into Sharp Corp.

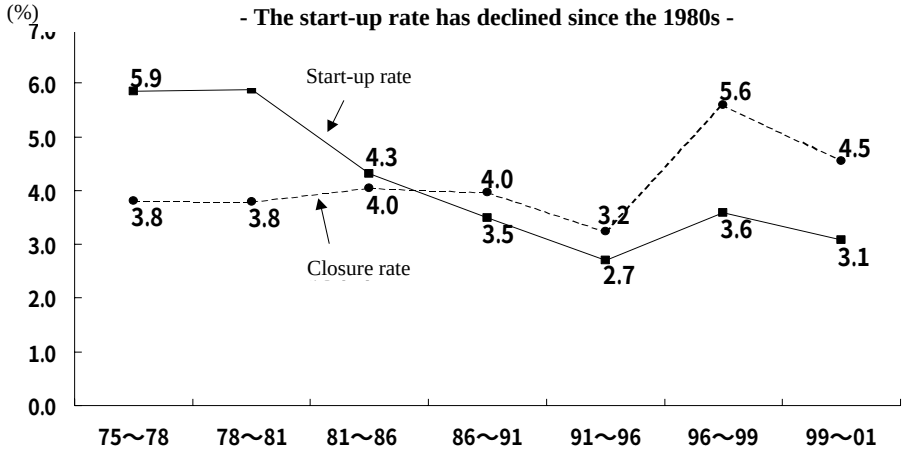
-SMEs with such strengths have been and will be expected to **lead the revitalization of the Japanese economy through the creation of innovations and jobs**.

# <Building an economy where businesses can be started-up, closed, revitalized with ease>

## 1. Current Start-up Trend and Relevant Problems in Japan

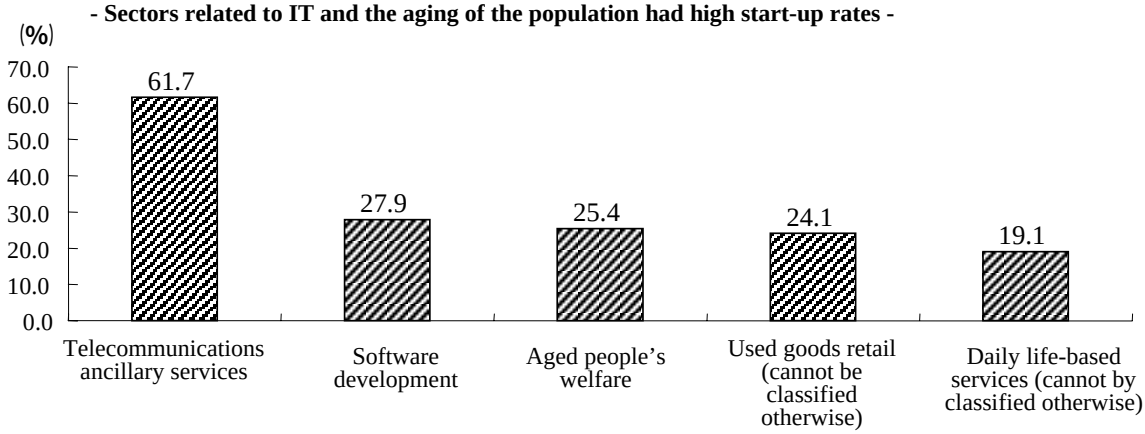
-Start-up rate is still in a slump in Japan. Compared to other areas, the rate is **higher not only in the IT sector and other advanced areas, but also in daily life- and community-based sectors such as nursing care and recycling.**

**Figure 3-1 Changes in Start-ups and Closure Rates**
**(non-primary industries, annual average)**
**- The start-up rate has declined since the 1980s -**




Source: Ministry of Public Management, Home Affairs, Posts and Telecommunications, *Establishment and Enterprise Census of Japan*

**Figure 3-2 Top Five Sectors in terms of Start-up Rate (yearly average, 1999-2001)**
**- Sectors related to IT and the aging of the population had high start-up rates -**



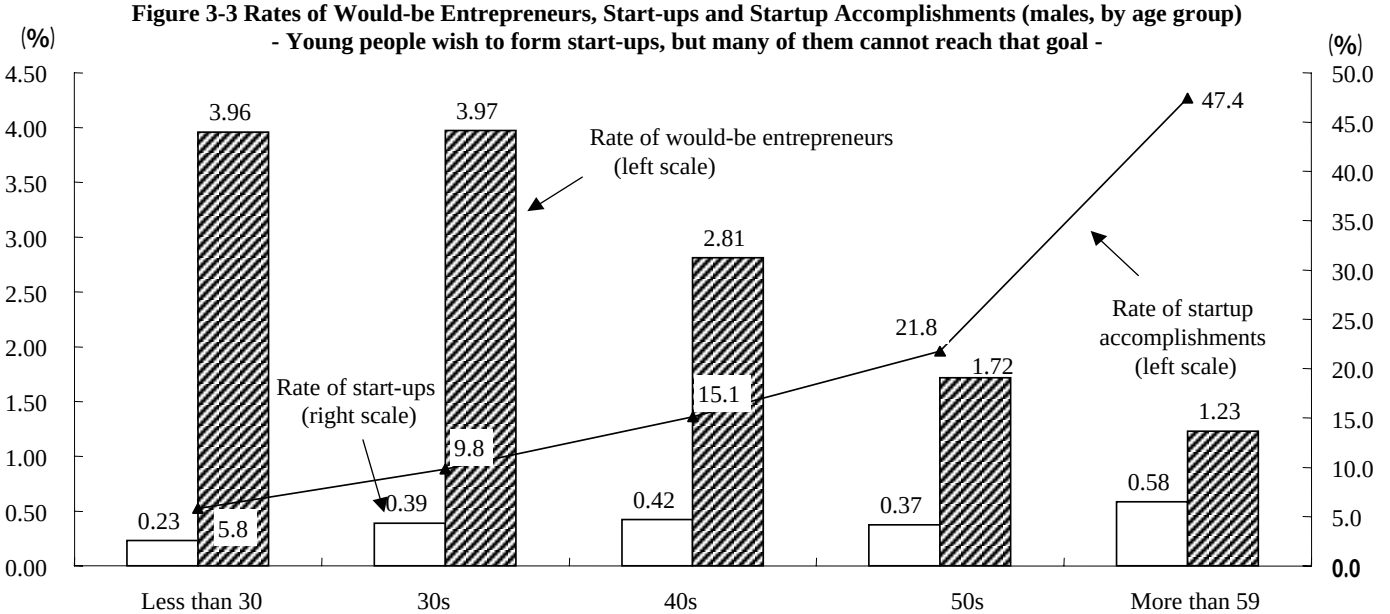

Source: Ministry of Public Management, Home Affairs, Posts and Telecommunications, *Establishment and Enterprise Census of Japan* (reedited and processed)
(Notes)
1. Business initiation rate = Number of annual average initiations / Number of business establishments in the 1999 survey x 100 (%)
2. The calculations here covered sectors that had 10,000 or more business establishments each at the time of the 2001 census.

(Descriptions of sectors)

| | |
|---|---|
| Telecommunication ancillary services | Mobile telecommunication centers (cellular phone shops, etc.), etc. |
| Software development | Commissioned software development, package software development |
| Aged people's welfare | Nursery homes for aged people, day-service centers for aged people |
| Used goods retail (cannot be classified otherwise) | Retailers of used clothing, furniture, etc. |
| Daily life-related services (cannot by classified otherwise) | Food processing, marriage agencies, tourist information providers, chauffeur services, etc. |

-The rates of would-be entrepreneurs are higher in the 20s and 30s age groups and lower in older age groups. On the other hand, the higher the age, the higher the rate of start-up. As a result, the rates of start-up accomplishments are lower at younger ages. There is a large gap between wishes and realities among young people.

**Figure 3-3 Rates of Would-be Entrepreneurs, Start-ups and Startup Accomplishments (males, by age group)**
**- Young people wish to form start-ups, but many of them cannot reach that goal -**

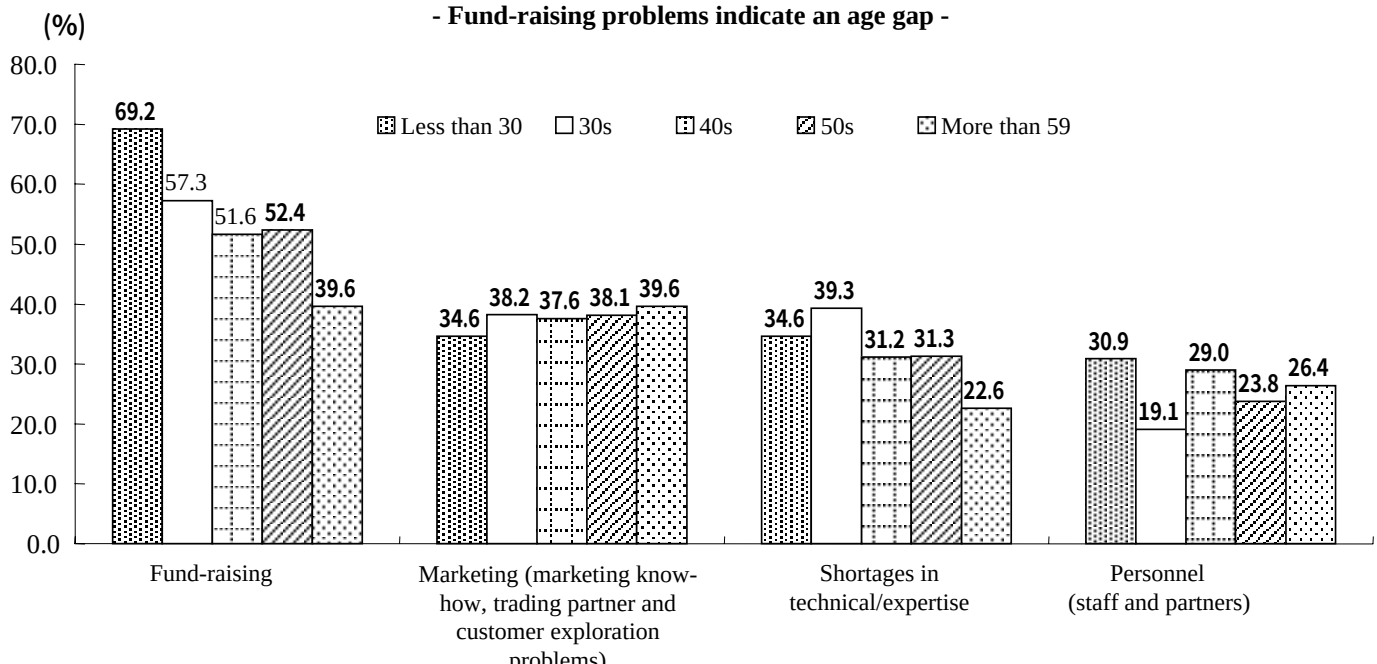



Source: Ministry of Public Management, Home Affairs, Posts and Telecommunications, *Employment Status Survey (1997)* (reedited and processed)

(Notes)
1. Start-ups are limited to those who had earlier been permanent employees. Would-be entrepreneurs are limited to those who are permanent employees.
2. Rate of start-up (would-be) entrepreneurs = number of start-up (would-be) entrepreneurs / number of permanent employees x 100
3. Rate of startup accomplishments = number of start-up entrepreneurs / number of would-be entrepreneurs x 100

-Obstacles to start-up of would-be entrepreneurs include the issues of finance, marketing and technical/expertise knowledge. Young people especially face financial problems and shortages of technical/expertise knowledge.

**Figure 3-4. Problems of Would-be Entrepreneurs' Start-up (by age group)**
**- Fund-raising problems indicate an age gap -**

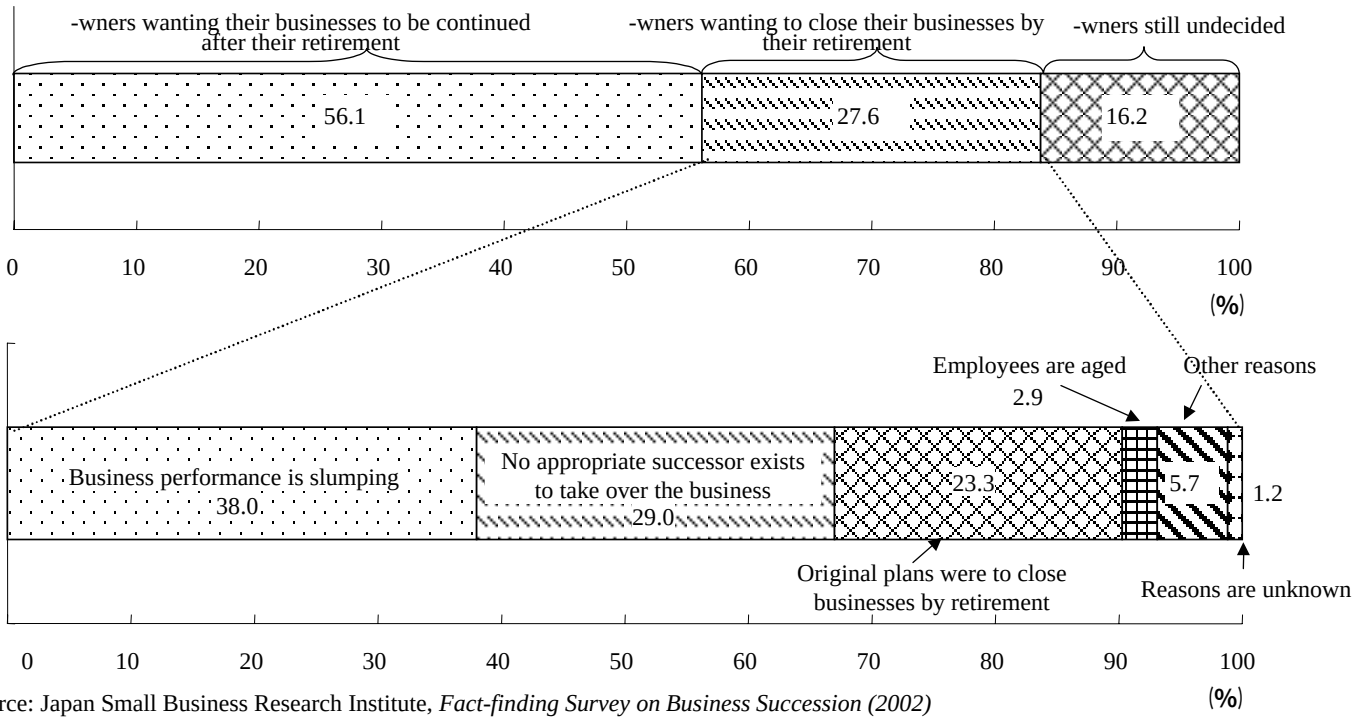



Source: Japan Chamber of Commerce and Industry, Central Federation of Societies of Commerce and Industry, *Follow-up Survey of Business Initiation Training Participants in Fiscal 2000 and 2001 (June 2002)* (reedited and processed)
(Note) The percentage total may exceed 100 since each respondent was allowed to choose plural alternatives.

## 2. Business Closure Trend in Japan

-The number of self-employed people has declined in recent years. Some 30% of owners are thinking of closing **their businesses. One of the reasons is the absence of successors, as well as the slump in business performance.**

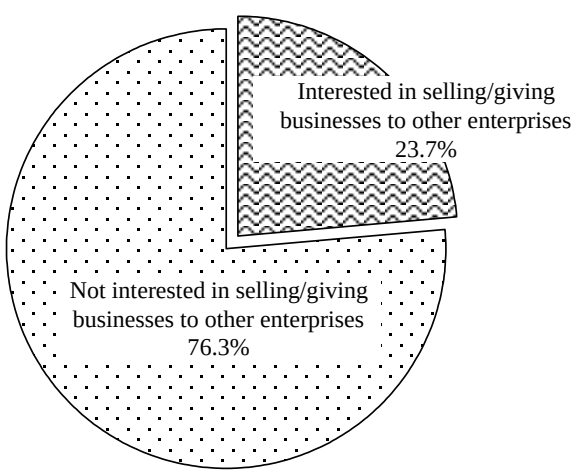
**Figure 3-5 Managers Willing to Continue Business and Reasons for Business Closure**
**- Some 30% of owners are thinking of closing their businesses and their main reason is the business performance slump -**




Source: Japan Small Business Research Institute, *Fact-finding Survey on Business Succession (2002)*
(Note) The questionnaire survey was conducted in December 2002, covering about 10,000 manufacturing enterprises in Tokyo's Ota Ward and Higashi Osaka City in order to grasp problems regarding business succession.

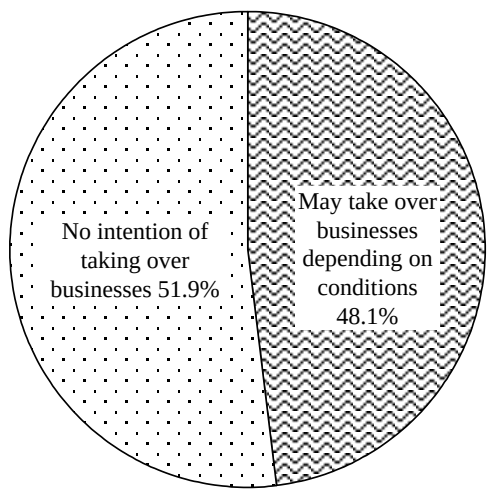
-Although SME owners are said to be united with their enterprises, **a considerable number of owners are thinking of selling/giving their enterprises or taking over others. Measures to facilitate business transfers** can contribute to the revival of enterprises.

**Figure 3-6 Interest in Selling/Giving Businesses**
**- A quarter of owners are interested in selling/giving businesses to other enterprises -**




Source: Japan Small Business Research Institute, *Fact-finding Survey on Business Succession (2002)*
(Note) Included in this figure are SME owners who have yet to decide on their successors or are willing to close enterprises by their retirement.

**Figure 3-7 Willingness to Take over Business**
**- Almost half of owners say they may take over businesses from other enterprises depending on conditions -**

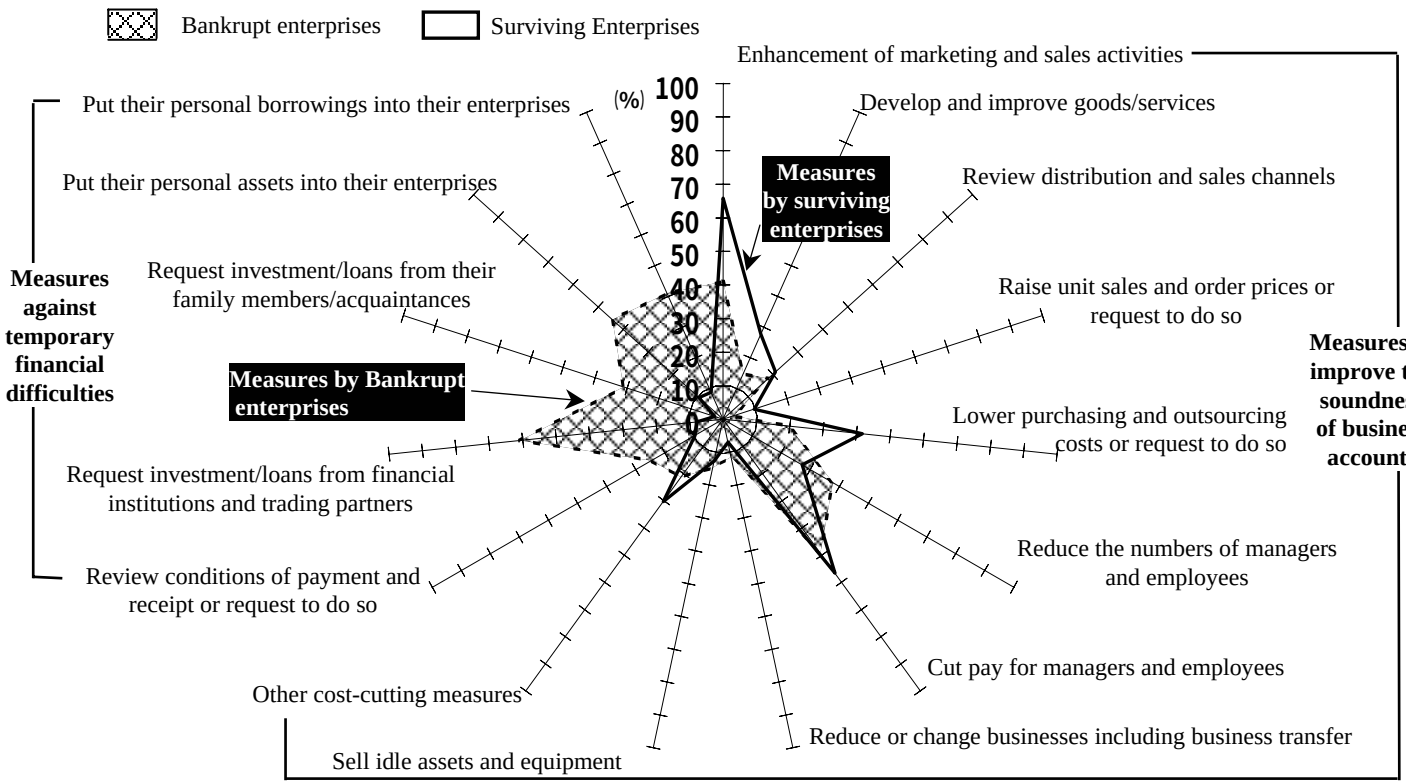



Source: Japan Small Business Research Institute, *Fact-finding Survey on Business Succession (2002)*
(Note) All respondents in the survey are included in this figure.

# 3. Bankruptcies and Revival (from a Poll of 1,500 Owners of Bankrupt Enterprises)

**-Enterprises bankrupted tend to take stopgap measures against temporary financial difficulties and refrain from taking more important measures which aim to improve the soundness of their business accounts.**

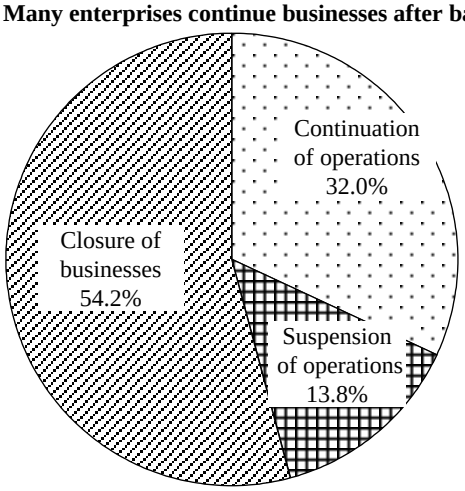
**Figure 3-8 Bankruptcy-avoiding Measures of Bankrupt and Surviving Enterprises**
**(Comparison of enterprises with recurring profit and excess liabilities for the latest fiscal year)**
**- Bankrupt enterprises focus on tentative financing more than surviving enterprises -**




Sources: Small Business Institute, *Fact-finding Survey on Business Rechallenge (2002), Fact-finding Survey on Overcoming Difficulties (2002)*
(Note) The total exceeds 100 as respondents were allowed to select plural alternatives.

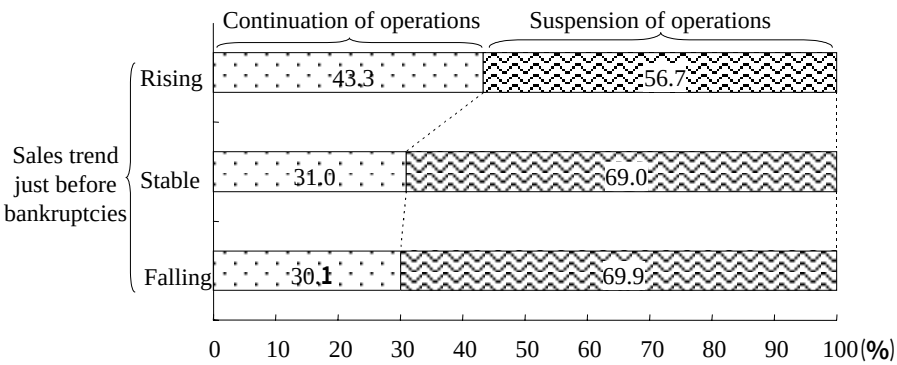
**-Thirty two % of bankrupt enterprises continue their operations.** Companies that find it easiest to continue business are those that had expanding business and high turnover before bankruptcy. On the other hand, companies that find it easiest to produce profits after bankruptcy are those that did so before bankruptcy. Conditions for business continuation and profitability are not the same.

**Figure 3-9 Business continuation by Bankrupt Enterprises**
**- Many enterprises continue businesses after bankruptcy -**




Source: Small Business Institute,
*Fact-finding Survey on Business Rechallenge (2002)*

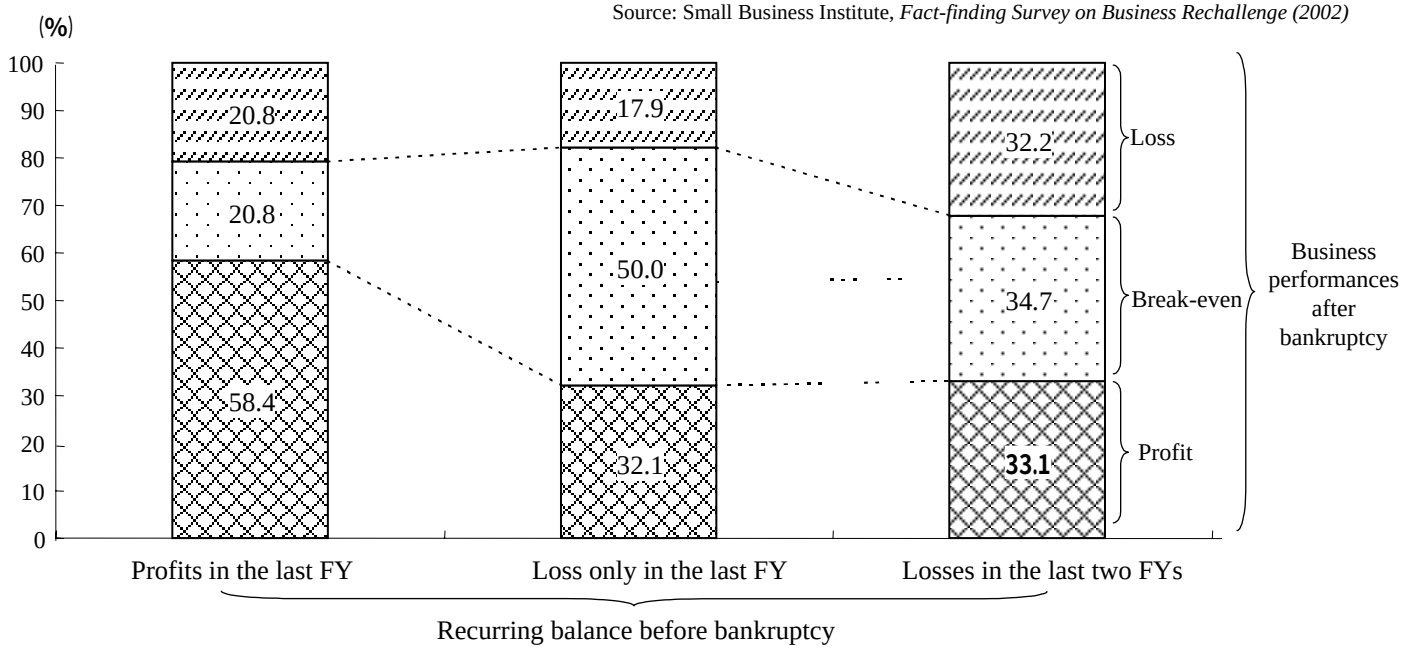
**Figure 3-10 Sales just before Bankruptcy and Continuation of Business Operations**
**- The proportion of businesses with rising turnovers that continue operations after bankruptcy is high -**




Source: Small Business Institute,
*Fact-finding Survey on Business Rechallenge (2002)*

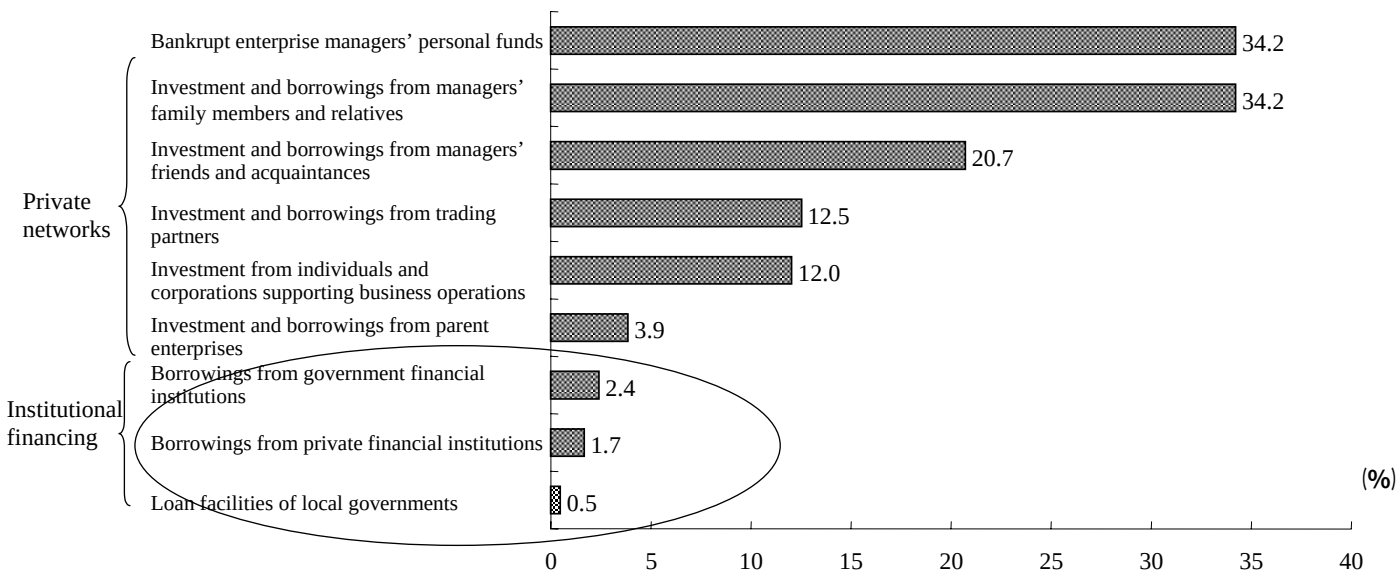
**Figure 3-11 Business Performances of Enterprises Continuing Operations after Bankruptcy**
**- Enterprises that had made profits before bankruptcy tend to do so after it -**

Source: Small Business Institute, *Fact-finding Survey on Business Rechallenge (2002)*




-Owners cannot ask for financial support from anyone except their family members or acquaintances after bankruptcy. Facilitation of **flexible responses by financial institutions** is as a policy issue**.**

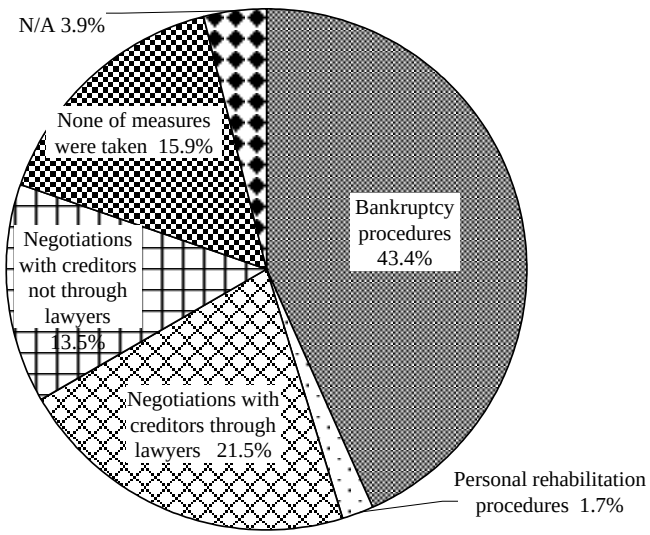
**Figure 3-12 Means to Raise Funds for Continuation of Business Operations after Bankruptcy**
**- Continuation of operations after bankruptcy depends on private networks -**




Source: Small Business Institute, *Fact-finding Survey on Business Rechallenge (2002)*
(Note) The total exceeds 100 as respondents were allowed to select plural alternatives.

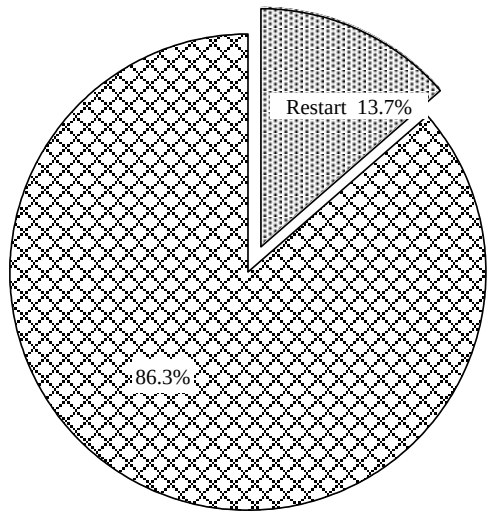
**-Forty three % of owners of failed enterprises are bankrupt. But about 14% of them have restarted enterprises.**

**Figure 3-13 Measures Taken by Bankrupt Enterprise Owners to Liquidate Personal Liabilities**
**– More than 40% go bankrupt –**




Source: Small Business Institute,
*Fact-finding Survey on Business Rechallenge (2002)*
(Note) Included in this figure are all respondents in the survey.

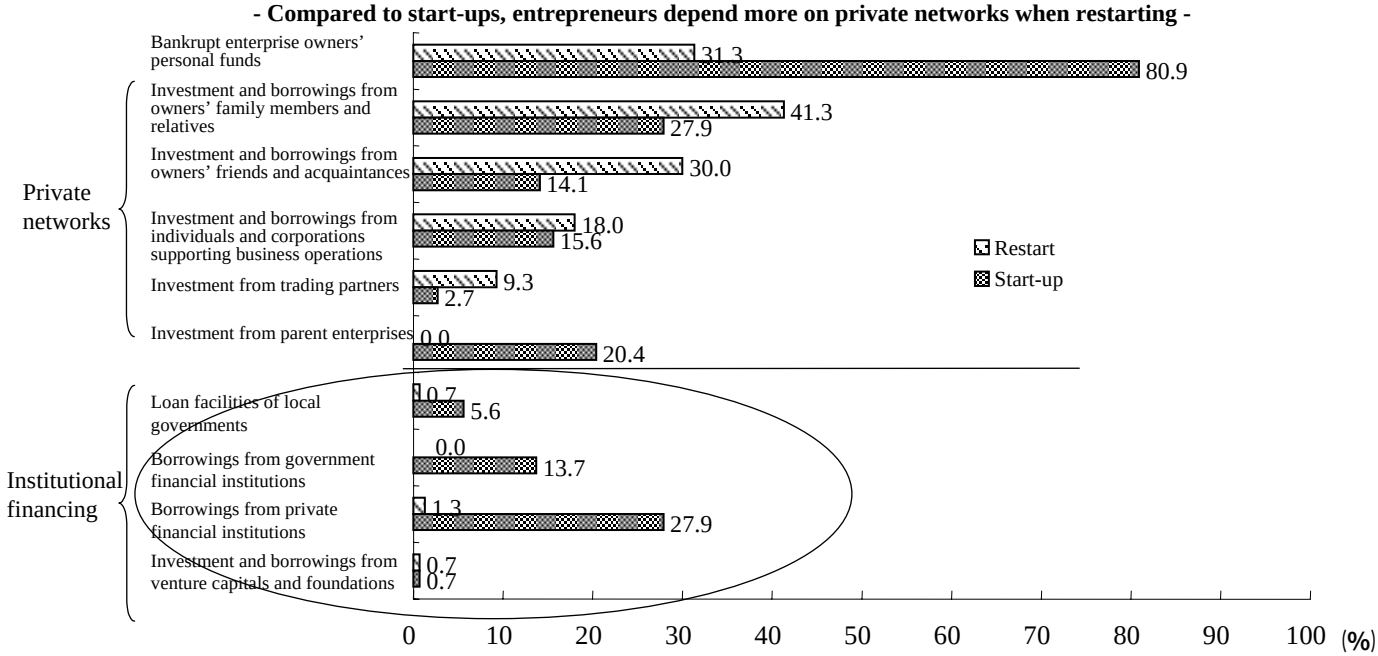
**Figure 3-14 Bankrupt Owners' Restart of Enterprises**
**- Of bankrupt enterprise owners who personally went bankrupt, 13.7% have restarted -**




Source: Small Business Institute,
*Fact-finding Survey on Business Rechallenge (2002)*
(Note)Included in this figure are bankrupt enterprise managers who said they had gone bankrupt personally.

-Bankrupt enterprise owners depend more on family members, friends and acquaintances for financing when restarting enterprises than when starting-up. **Expansion of institutional financing for restarts is a policy issue.**

**Figure 3-15 Fund-raising Means for Start-ups and Restarts**
**- Compared to start-ups, entrepreneurs depend more on private networks when restarting -**

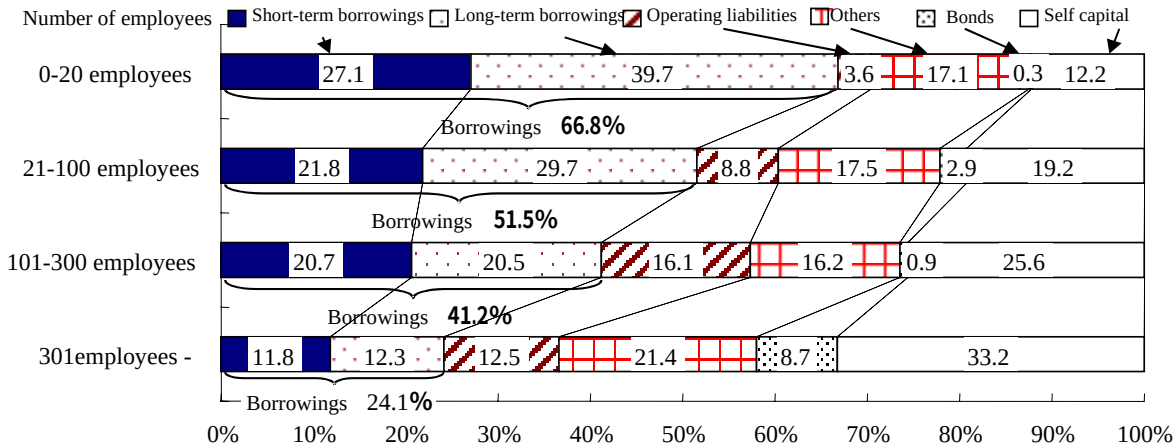



Sources: SME Agency, *Survey on Environment for Start-ups (December 2001)*
Small Business Institute, *Fact-finding Survey on Business Rechallenge (2002)*
(Note) The total exceeds 100 as respondents were allowed to select plural altnernatives.
Included in restarts are bankrupt enterprise managers who have successfully restarted enterprises.

# <Accounting Methods that Consider Enterprise Qualities that Cannot Be Measured by Financial Data Alone>

-SMEs **depend on borrowing** more than large enterprises.

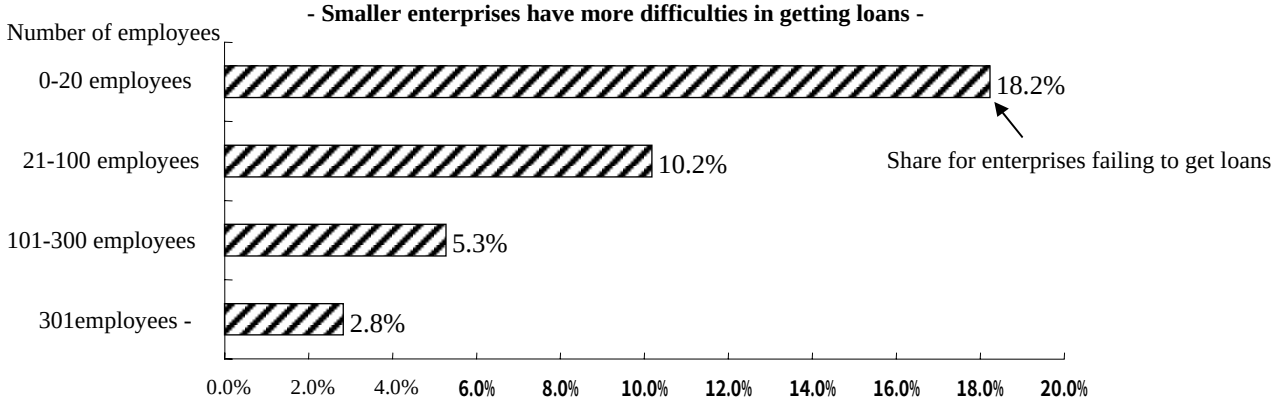
**Figure 4-1 Fund-raising Structure (FY 2001, by employment size, non-primary industries (the same applies below))**
**– Larger enterprises have less borrowing and more equity capital –**




Source: Ministry of Finance, *FY 2001 Financial Statements Statistics of Corporations* (reedited and processed)
(Notes)
1. Each fund-raising category was divided by "liabilities, capital and outstanding discount bills" to determine its share.
2. Operating liabilities (inter-business credits) cover bills payable and trade accounts payable. "Others" include outstanding discount bills and reserves.

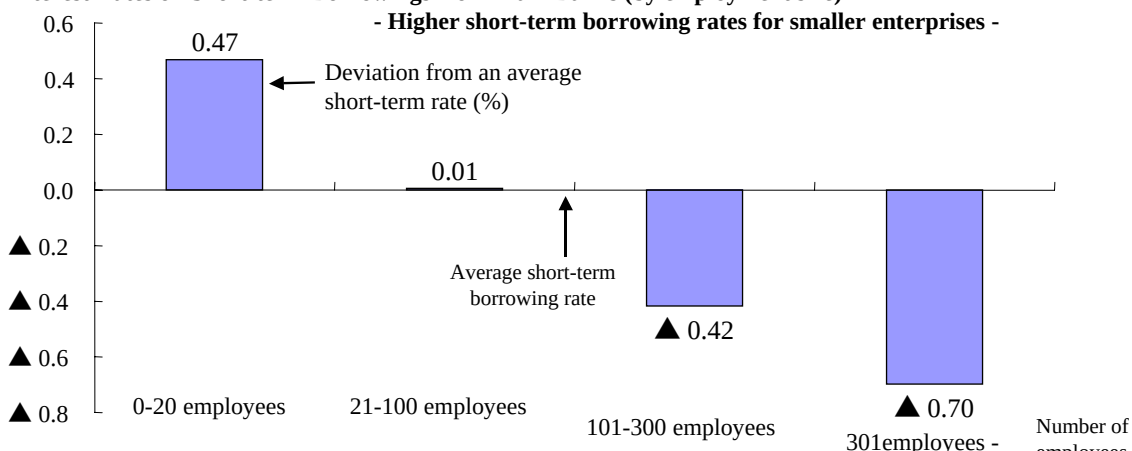
**-On the other hand, the smaller the enterprise, the more difficult it is to borrow the requested amount from banks and the higher the interest rate is.**

**Figure 4-2 Percentage Shares for Enterprises Failing to Get Loans from Their Respective Main Banks (By employment size)**
**- Smaller enterprises have more difficulties in getting loans -**




Source: SME Agency, *Survey on Business Financing Environment (November 2002)*
(Note) "Enterprises failing to get loans" are those who selected "rejection or reduction of loan requests" when they were asked to select main banks' most frequent response to their loan requests in the past year.

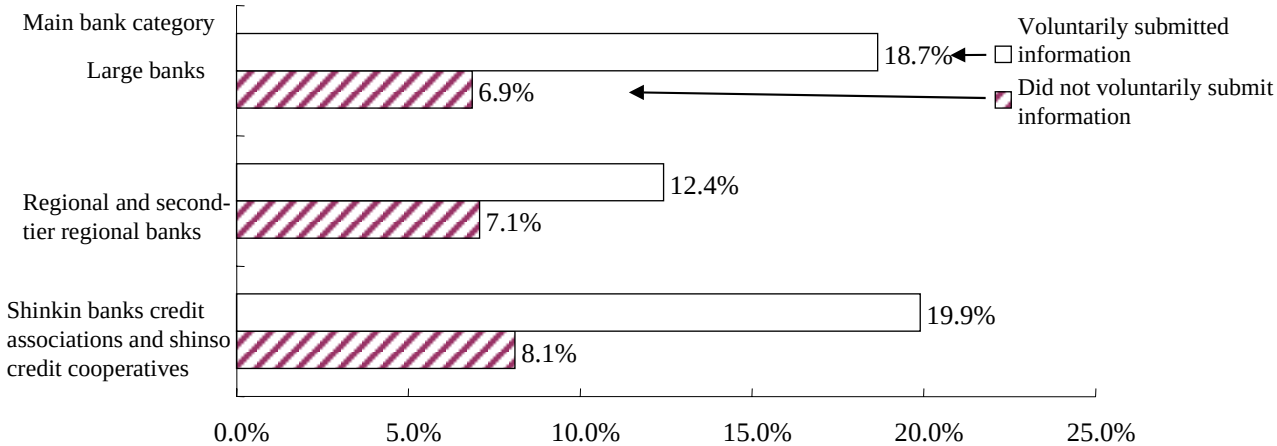
**Figure 4-3 Interest Rates on Short-term Borrowings from Main Banks (by employment size)**
**- Higher short-term borrowing rates for smaller enterprises -**




Source: SME Agency, *Survey on Business Financing Environment (November 2002)*
(Notes) 1. Deviation of interest rates on short-term main-bank loans from the average short-term loan rate at the end of October 2002.
2. For any enterprise that had no short-term borrowings at the end of October 2002, the latest short-term borrowing rate was used.
For any enterprise that had plural short-term borrowing rates, the highest rate was used.

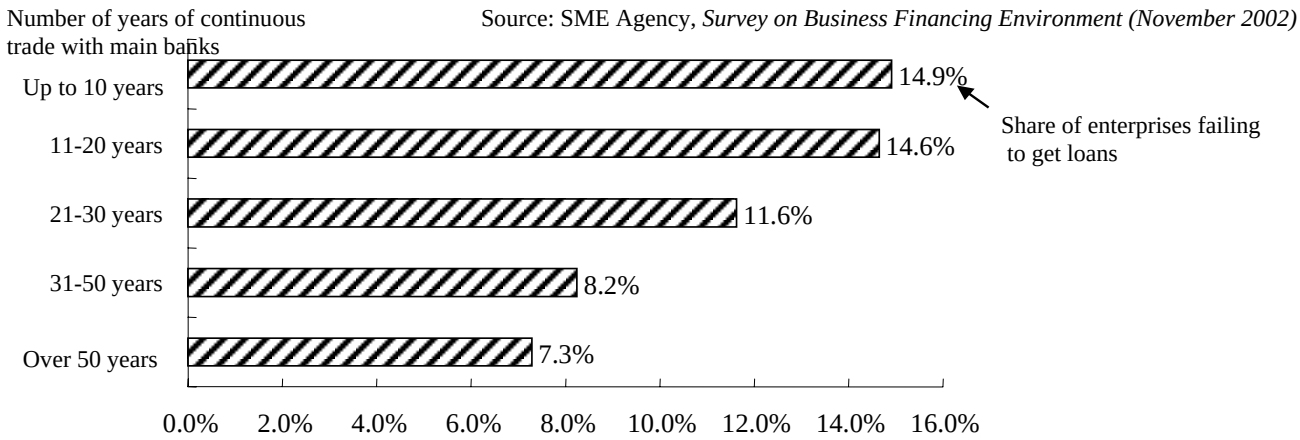
-Keys for SMEs to borrow money smoothly are a) to actively disclose corporate information and b) to build continuous long term relationships where SMEs can communicate **more than just financial data to their banks.**

**Figure 4-4 Shares for Enterprises Failing to Get Loans (in the presence and absence of voluntary information submission)**
**Enterprises that voluntarily submit information to banks can get loans more easily -**



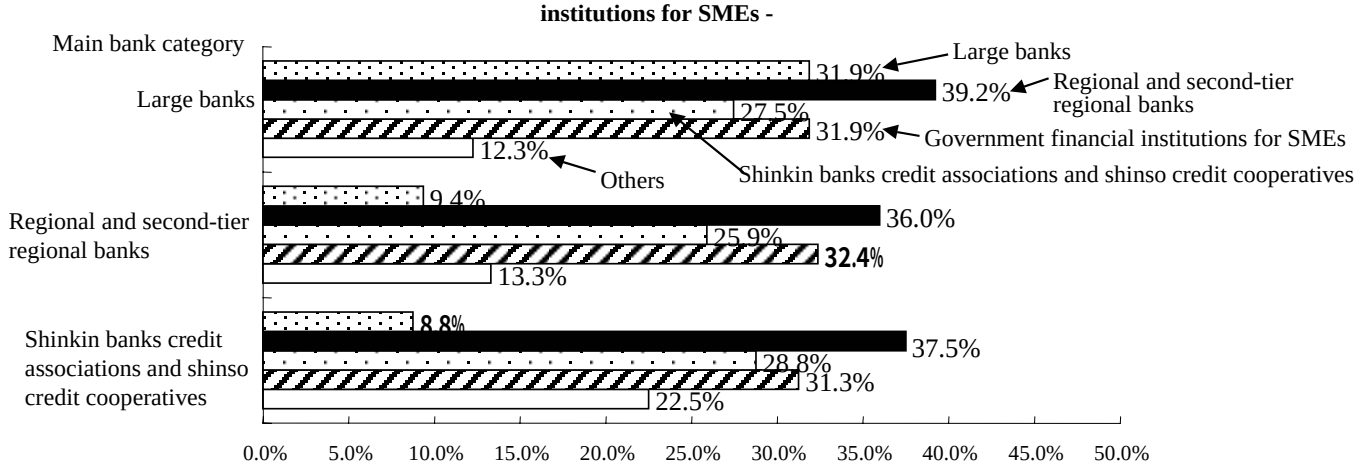

Source: SME Agency, *Survey on Business Financing Environment (November 2002)*

**Figure 4-5 Share of Enterprises Failing to Get Loans (by the number of years of continuous trade with main banks)**




-It is also important for SMEs to **diversify partner banks** in order to prepare for the case that they fail to get loans from main banks. In such cases, regional banks and government financial institutions could play unique roles.

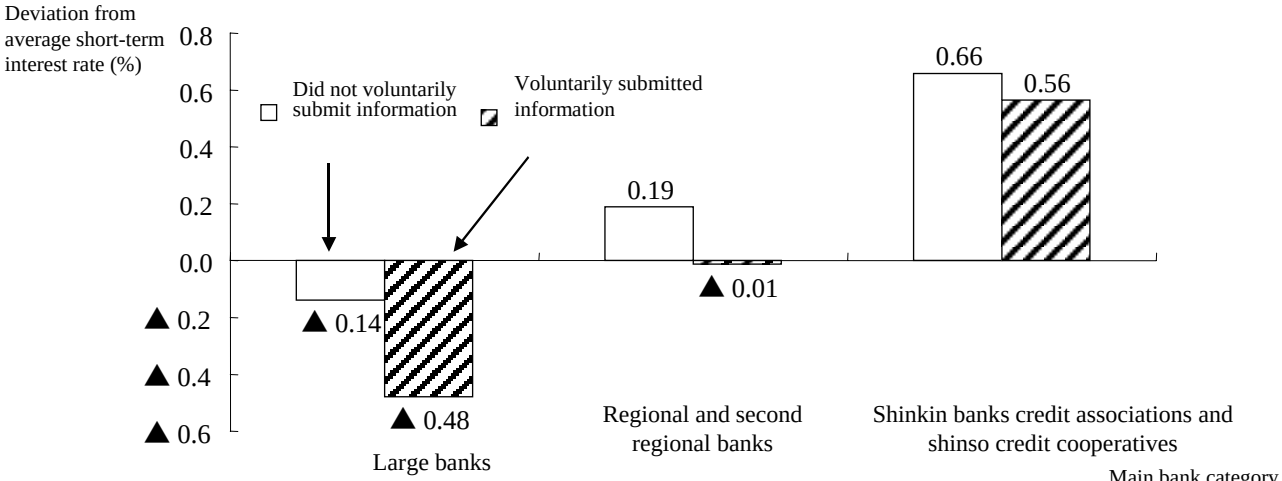
**Figure 4-6 Alternative Banks for Enterprises Failing to Get Loans from Main Banks (by main bank category)**
**- Alternative banks for these enterprises include regional and second-tier regional banks, and government financial institutions for SMEs -**




Source: SME Agency, *Survey on Business Financing Environment (November 2002)*

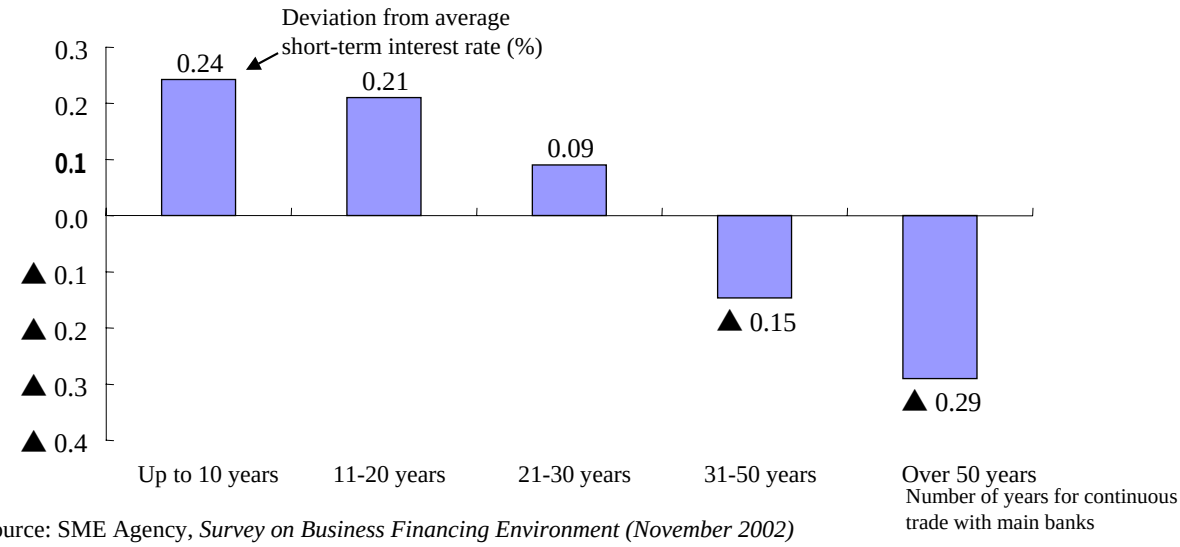
-As for interest rates, SMEs that **voluntarily submit information to main banks and build long-term business relationships can get lower interest rates on borrowings** than those that do not do so. **Knowledge of interest rates** is also important for SMEs.

**Figure 4-7 Short-term Borrowings Rates (in the presence and absence of voluntary information submission)**
**- Interest rates on borrowings are lower for enterprises that voluntarily submit information to banks -**



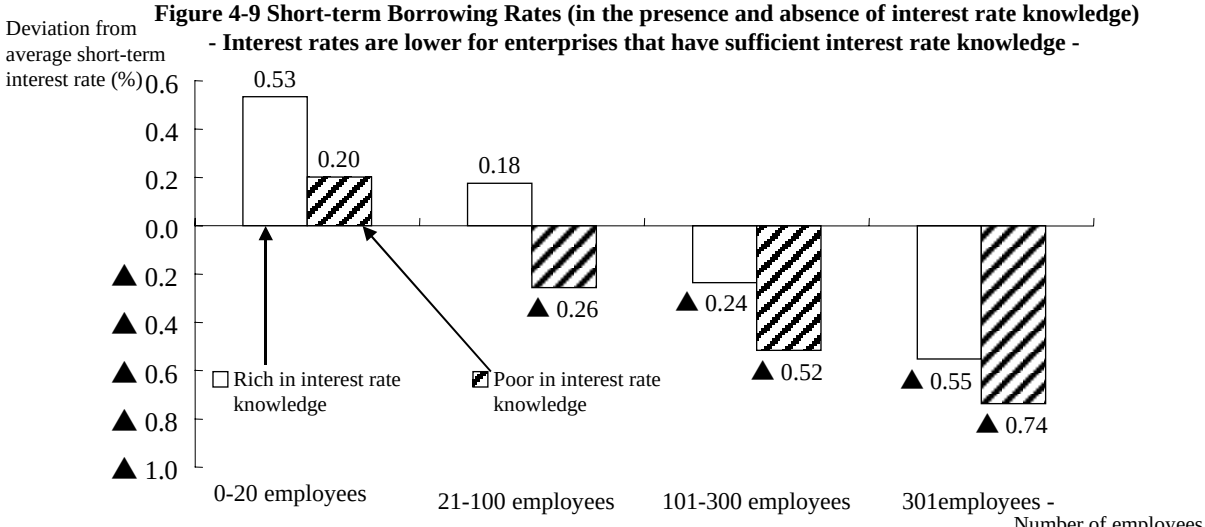

Source: SME Agency, *Survey on Business Financing Environment (November 2002)*

**Figure 4-8 Short-term Borrowing Rates (by number of years ofcontinuous trade with main banks)**
**- Interest rates are lower for enterprises that have longer trading relations with main banks -**




Source: SME Agency, *Survey on Business Financing Environment (November 2002)*

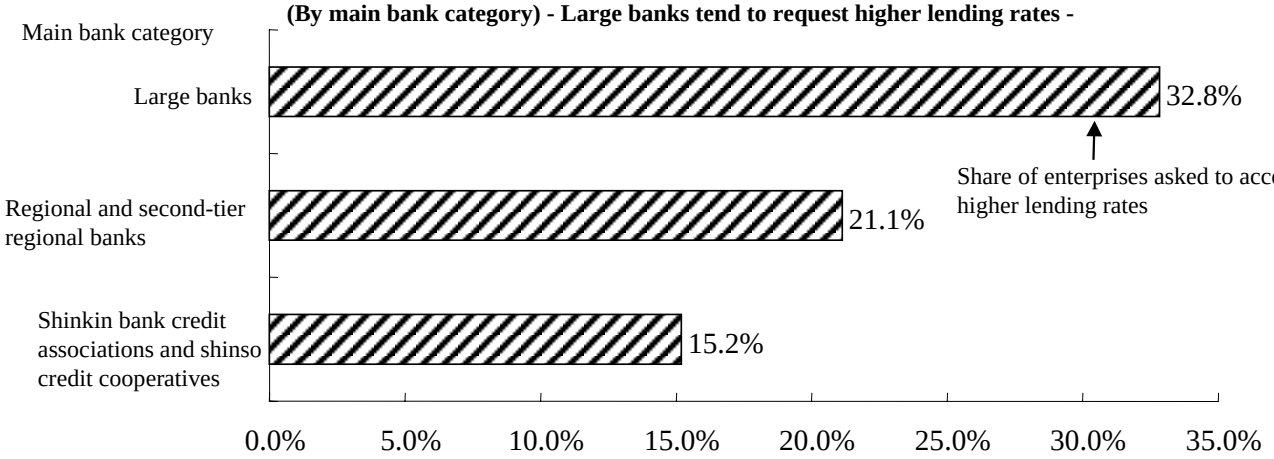
**Figure 4-9 Short-term Borrowing Rates (in the presence and absence of interest rate knowledge)**
**- Interest rates are lower for enterprises that have sufficient interest rate knowledge -**




Source: SME Agency, *Survey on Business Financing Environment (November 2002)*
(Note) Enterprises that are "rich in interest rate knowledge" are those that know the deviation of their short-term borrowings rates from bank-fixed short-term prime lending rates.

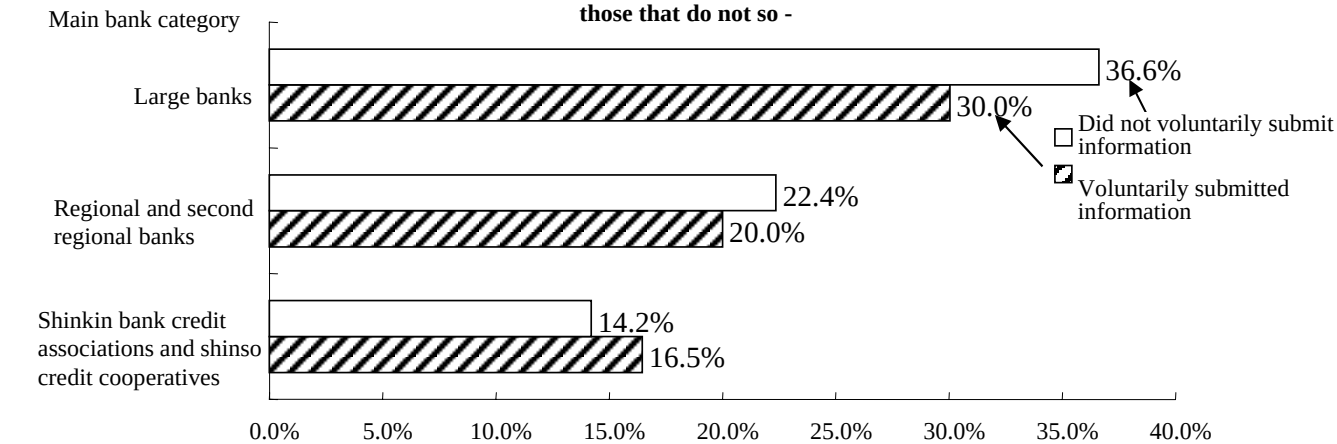
-Some SMEs were requested by banks to accept higher interest rates in 2002. They tend to **a) deal with large banks as main banks and b) do not submit corporate information to the banks.**

**Figure 4-10 Share of Enterprises Asked to Accept Higher Lending Rates**
**(By main bank category) - Large banks tend to request higher lending rates -**




Source: SME Agency, *Survey on Business Financing Environment (November 2002)*

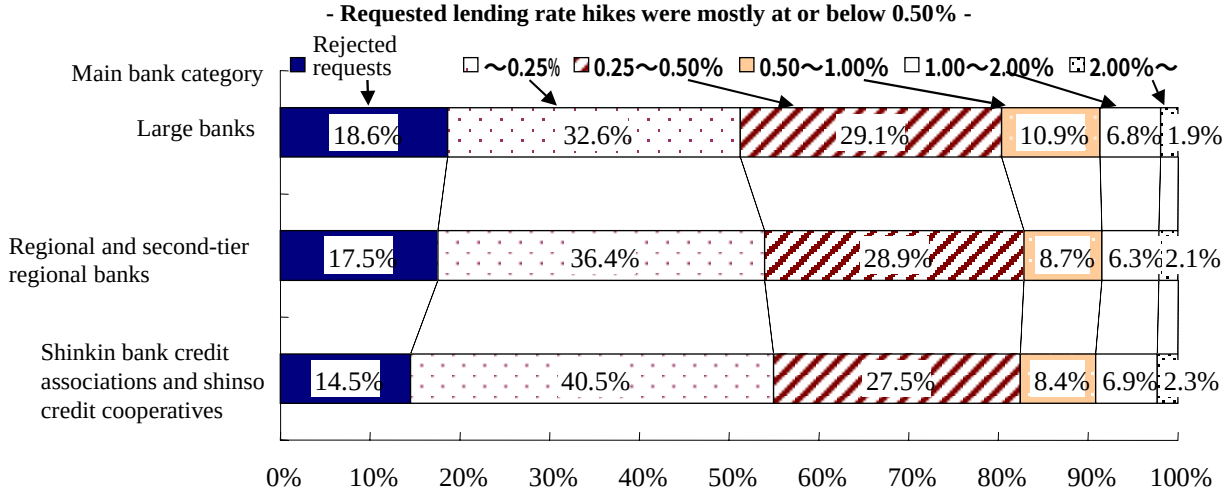
**Figure 4-11 Shares of Enterprises Asked to Accept Higher Lending Rates (With and without voluntary information submission)**
**- Enterprises that voluntarily submit information to banks have a smaller chance to receive requests for lending rate hikes than those that do not so -**




Source: SME Agency, *Survey on Business Financing Environment (November 2002)*
(Note) Note that the number of enterprises that received requests for lending rate hikes from shinkin bank credit associations and shinso credit cooperatives as main banks is far smaller than the number of enterprises that received such requests from other banks as main banks. Those that received such requests from shinkin and shinso banks included 54 that failed to voluntarily submit information and 56 that voluntarily submitted information. (From other banks, 300 to 400 enterprises received such requests.)

**-10% to 20% of SMEs reject requests to increase interest rate.**

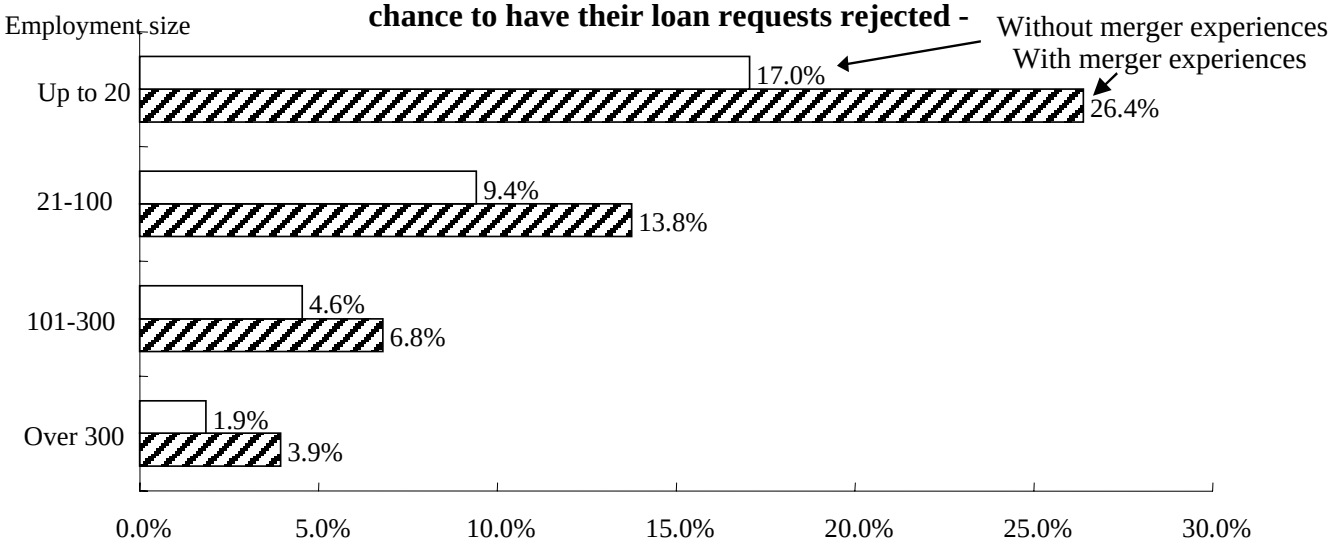
**Figure 4-12 Responses to Requests for Lending Rate Hikes (by main bank category)**
**- Requested lending rate hikes were mostly at or below 0.50% -**




Source: SME Agency, *Survey on Business Financing Environment (November 2002)*
(Note) The figure covers enterprises that actually received requests from their main banks for lending rate hikes.

- **Main banks which have experienced mergers** tend to tighten their lending attitudes. For enterprises, it is **more difficult to borrow money from such banks** than from other banks. SME policy is necessary in respect of bank mergers.

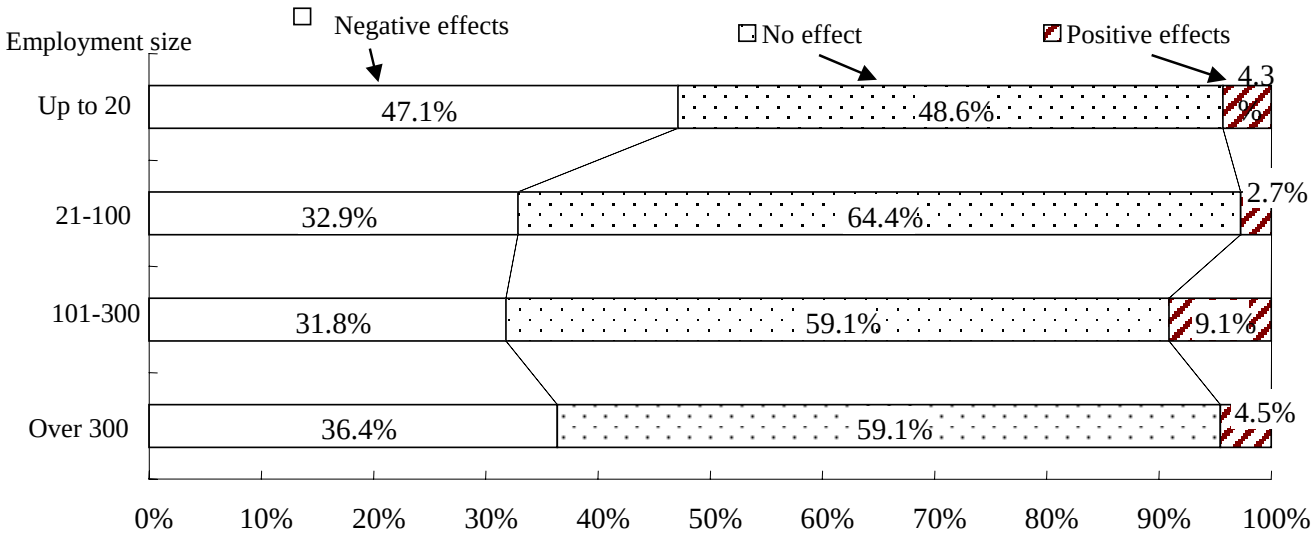
**Figure 4-13 Shares of Enterprises Failing to Procure Loans (from main banks with and without merger experiences)**
**- Enterprises whose main banks have experienced mergers have a greater chance to have their loan requests rejected -**




Source: *SME Agency, Survey on Business Financing Environment (November 2002)*
(Note) Merger experiences are those since 1997.

- **A failure of a main bank has especially negative effects** on small enterprises.

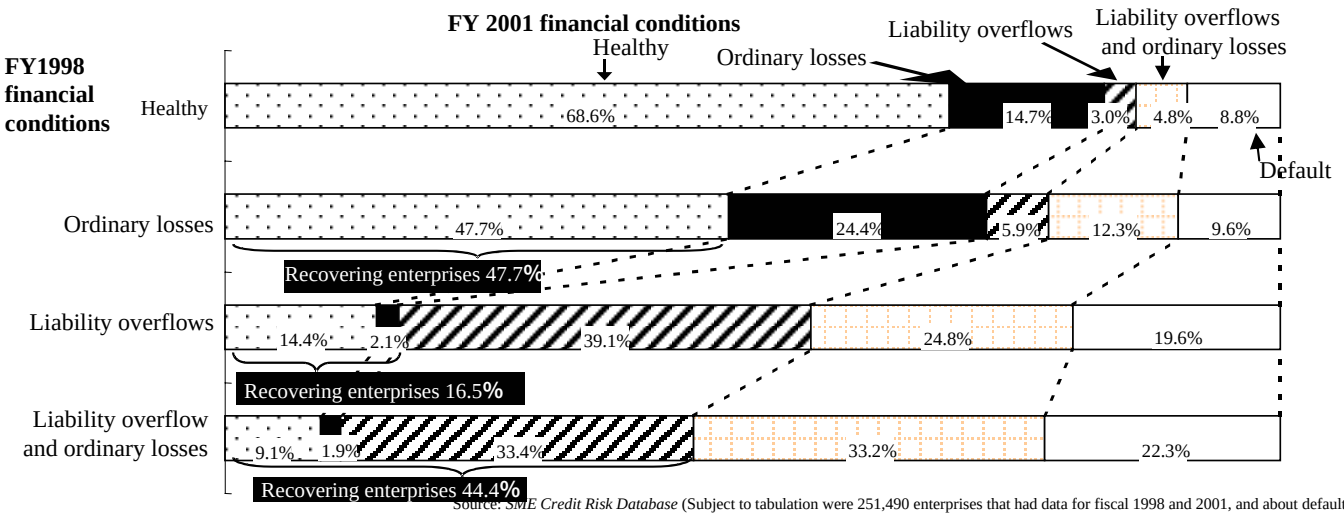
**Figure 4-14 Effects of Main Bank Failures on Borrowers (by employment size)**
- Main bank failures have negative effects on many enterprises -




Source: SME Agency, *Survey on Business Financing Environment (November 2002)*
(Note) Negative effects mean tighter lending attitudes and terms by failed main banks, and disadvantages and inconveniences for borrowers. Positive effects mean the opposite.

-An analysis of financial data from 250,000 SMEs shows that, even if SMEs had been experiencing ordinary losses or liability overflows, many of them achieved profits in a few years or solved liability overflows by their sales efforts in a severe situation. **Financial institutions should develop their capacity to identify capabilities that do not appear in financial statements of SMEs.**

**Figure 4-15 Financial Data in FY 1998 and 2001** -Many SMEs recover from losses to and return to healthy -

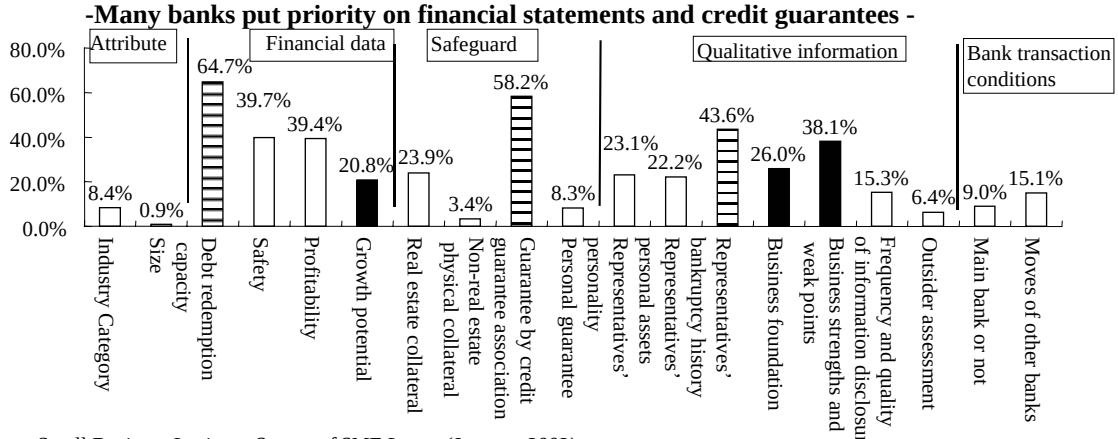



Source: *SME Credit Risk Database* (Subject to tabulation were 251,490 enterprises that had data for fiscal 1998 and 2001, and about default)

(Notes) 1. Healthy operation means without ordinary losses and liability overflows. 2.Default means SMEs with debt repayments in arrears for more than three months in principle, those assessed as de-facto or clearly bankrupt by banks, or those subjected to subrogation by credit guarantee associations.

-Banks put priority on **outward criteria such as financial statements and security packages. On the other hand, they are reluctant to look into business strengths and weaknesses of SMEs, growth potential and other aspects.** Therefore, financial institutions need to enhance their capacities as "connoisseurs" who place value on aspects which do not appear on the financial statements in order to facilitate financial supply to various SMEs.

**Figure 4-16 Priority Aspects for Banks in Screening SME Loan Requests**
**-Many banks put priority on financial statements and credit guarantees -**

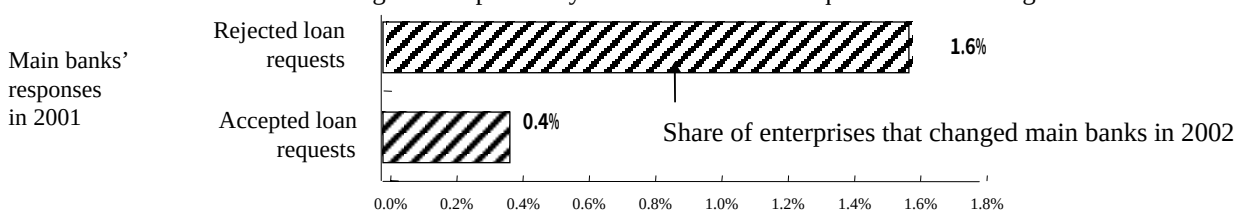



Source: Small Business Institute, *Survey of SME Loans (January 2003)*
(Note) The total exceeds 100 as respondents were allowed to select plural alternatives.

-Rigid lending attitudes by financial institutions can lead them to lose **SMEs that can be promising customers.** This might be a key loss to the institutions.

**Figure 4-17 Main Banks' Responses and Share of Enterprises that Changed Main Banks**

-SMEs that were confronted with negative responses by main banks to loan requests tend to change main banks -

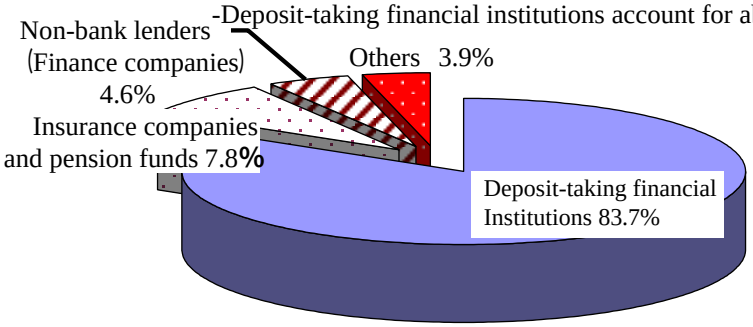



Sources: SME Agency, *Survey on Fund-Raising Environment for Enterprises (December 2001), Survey on Business Financing Environment (November 2002)*
(Note) The gap is sufficiently significant in terms of statistics.

**-More than 80% of enterprise financing is conducted by deposit-taking financial institutions such as banks**. Insurance companies, pension funds and non-banks are also used. Although bank loans are mainly backed by land collateral, SMEs have trade accounts receivable and notes in equivalent amounts to land assets.

**Figure 4-18 Breakdown of Outstanding Loans to Enterprises by Category of Financial Institutions (As of the end of September 2002)**

-Deposit-taking financial institutions account for about 80% of loans to enterprises-



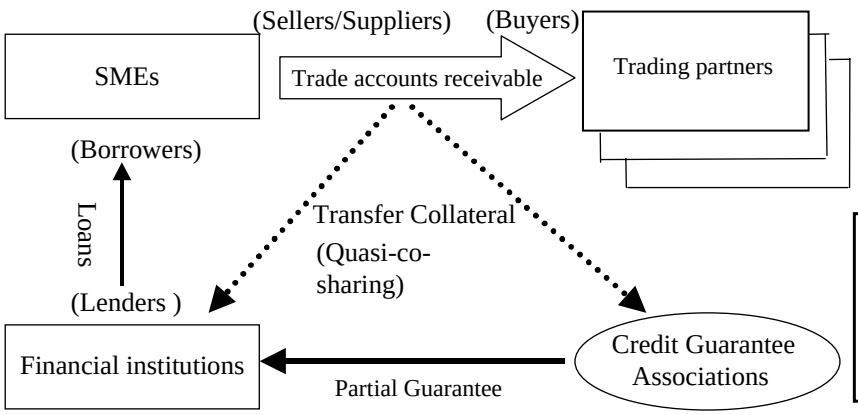

Assets owned by SMEs
(capitalized at 100 million JPY or less)

Cash and deposits 77.2 trillio
Trade accounts receivable and notes 85.3 tr
Land 74.1 t

Source: Bank of Japan, *Flow of Funds*

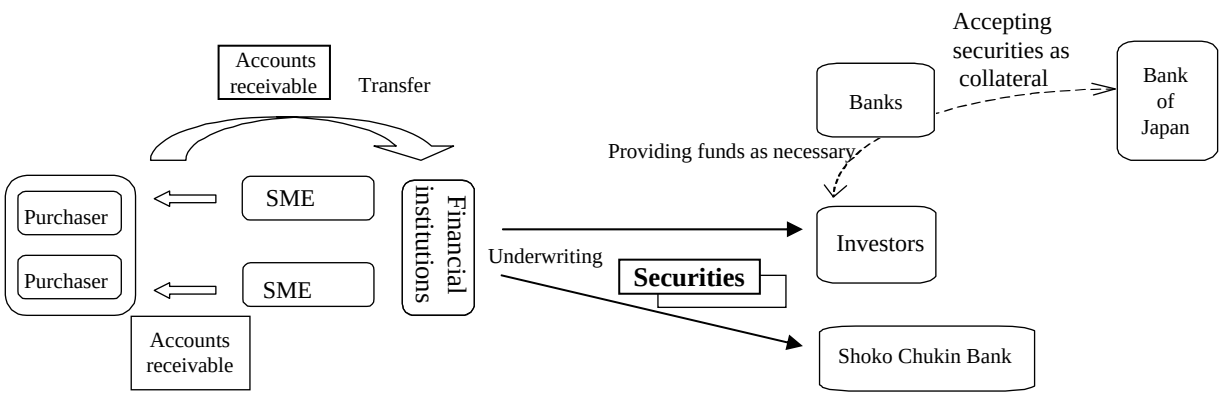
-The SME Agency has tackled the diversification of financing for SMEs. It has implemented the **guarantee system for loans backed by trade accounts receivable** since December 2001. Also, it has supported the **securitization of accounts receivable** in cooperation with government financial institutions since February 2003. It is important for SMEs to make use of such new financing methods.

**Figure 4-19 Outline of Guarantee System for Loans backed by Trade Accounts Receivable**




The Credit Guarantee Association guarantees the loan that a financial institution provides to an SME which transfers trade accounts receivable as collateral to the Association and the institution.

**Figure 4-20 Outline of Support for Securitization of Trade Accounts Receivable**




1. An SME transfers/entrusts accounts receivable to a financial institution for financing.
2. The institution issues securities backed by the accounts receivable.
3. Shoko Chukin Bank underwrites a part of the securities.
4. Bank of Japan accepts a part of the securities as eligible collateral.

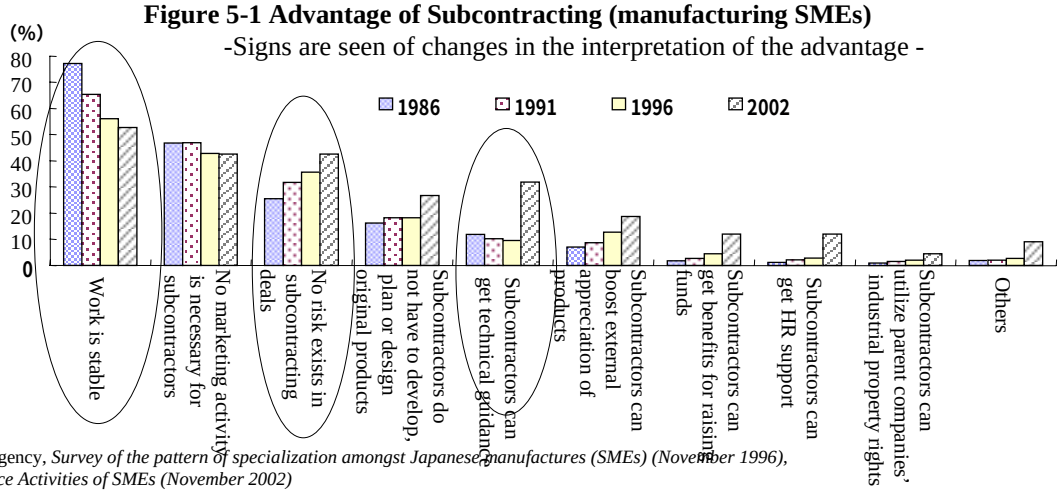
(This process makes it easier for investors to get funds by securities.)

# <Business Innovation through Business Partnership>

-As economic globalization progresses, **the advantage of a vertical subcontracting alliance among enterprises shifts from stability of work to the elimination of risks.**

**Figure 5-1 Advantage of Subcontracting (manufacturing SMEs)**

-Signs are seen of changes in the interpretation of the advantage -




Sources: SME Agency, *Survey of the pattern of specialization amongst Japanese manufactures (SMEs) (November 1996), Survey on Alliance Activities of SMEs (November 2002)*

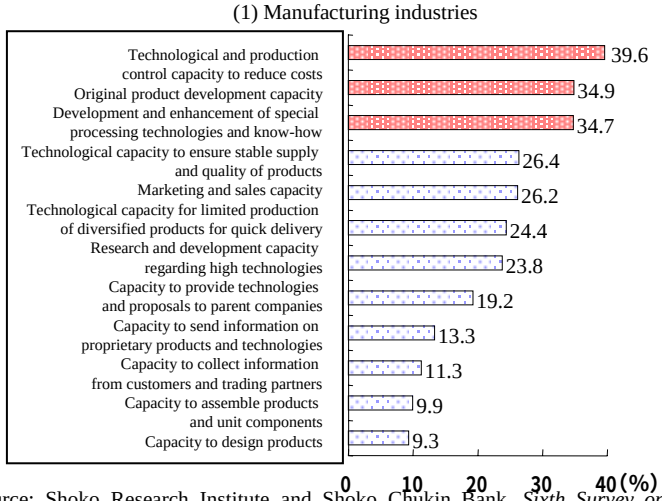
(Notes) 1. There is no continuity between figures in the 1996 and 2002 surveys as their targets are different.
2. The total exceeds 100 as respondents were allowed to select plural alternatives.

**-SME subcontractors are giving priority to the development of higher-value-added products and cutting product costs** under the changes of business environment. They are getting good results from these efforts.

**Figure 5-2 Planned Priorities for Future**

-SMEs give priority to cost reductions and the development of products and services -

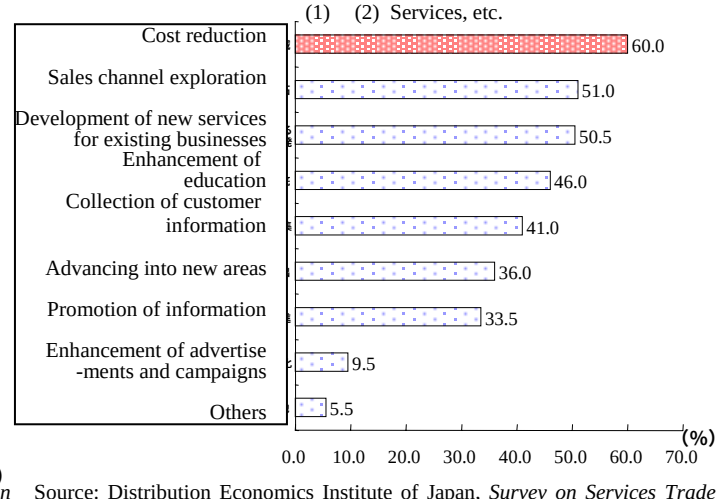
(1) Manufacturing industries




Source: Shoko Research Institute and Shoko Chukin Bank, *Sixth Survey on Structural Changes in SMEs in Machinery and Metal Industries (2001)* (Reedited and processed)

(Note) The total exceeds 100 as respondents were allowed to select plural alternatives.

(1) (2) Services, etc.



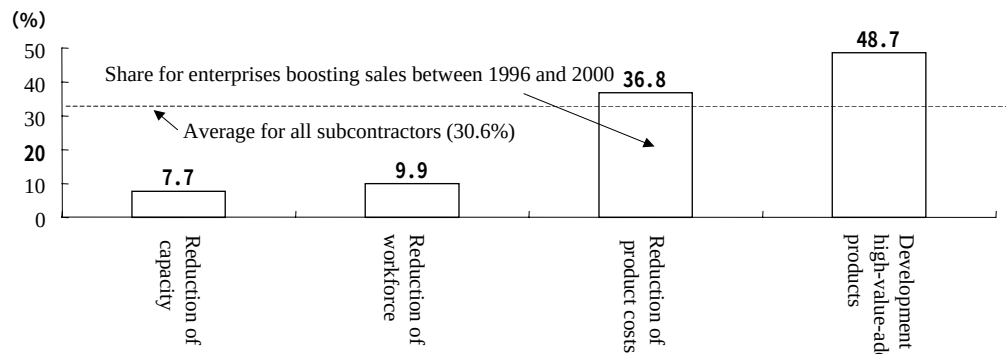

Source: Distribution Economics Institute of Japan, *Survey on Services Trade between Business Operators (2002)* (Reedited and processed)

(Note) The total exceeds 100 as respondents were allowed to select plural alternatives.

**Figure 5-3 Effects of Subcontracting SMEs' Strategies Responding to Parents' Overseas Expansion**

(Manufacturing SMEs)

-Efforts to lower product costs and develop higher-value-added products have led to good results -



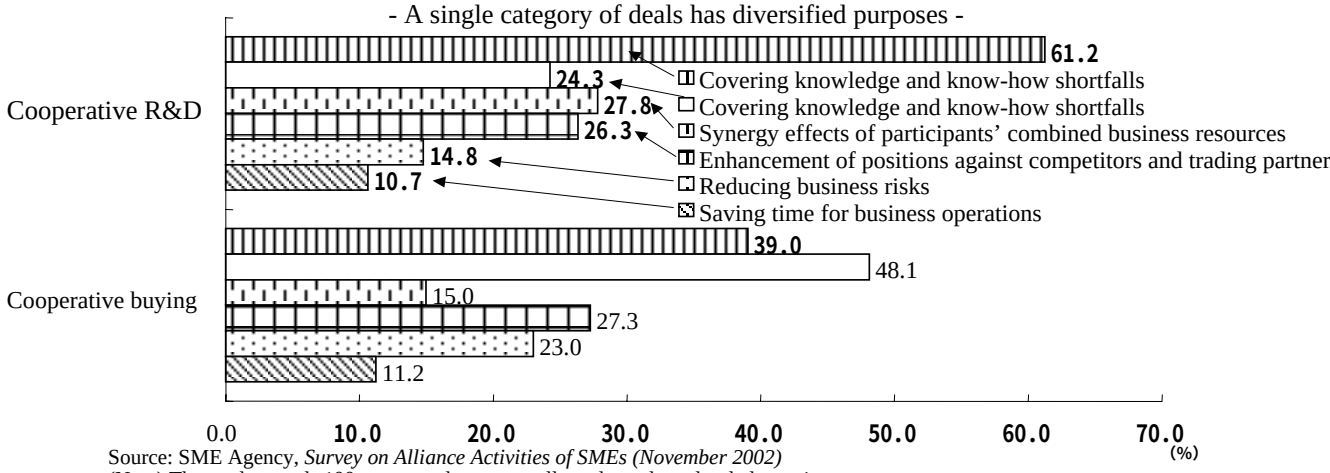

Source: National Association for Subcontracting Enterprises Promotion, *Survey on Effects on Subcontractors of Industrial Hollowing-out (2002)* (Reedited and processed)

-Business cooperation activities in the form of horizontal partnership among enterprises have **various purposes. Cooperative purchasing and cooperative R&D** can improve the performance of SMEs.

**Figure 5-4 Purposes of Category-wise Business Cooperation Deals**

(Manufacturing, wholesale and retail SMEs)

- A single category of deals has diversified purposes -

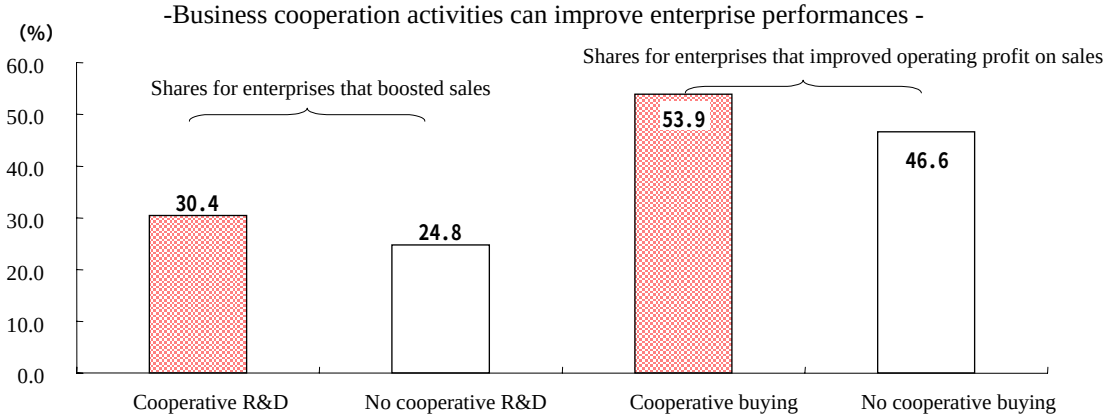



Source: SME Agency, *Survey on Alliance Activities of SMEs (November 2002)*

(Note) The total exceeds 100 as respondents were allowed to select plural alternatives.

**Figure 5-5 Effects of Business Cooperation Activities (Manufacturing, wholesale and retail SMEs)**

-Business cooperation activities can improve enterprise performances -




Source: SME Agency, *Survey on Alliance Activities of SMEs (November 2002)*

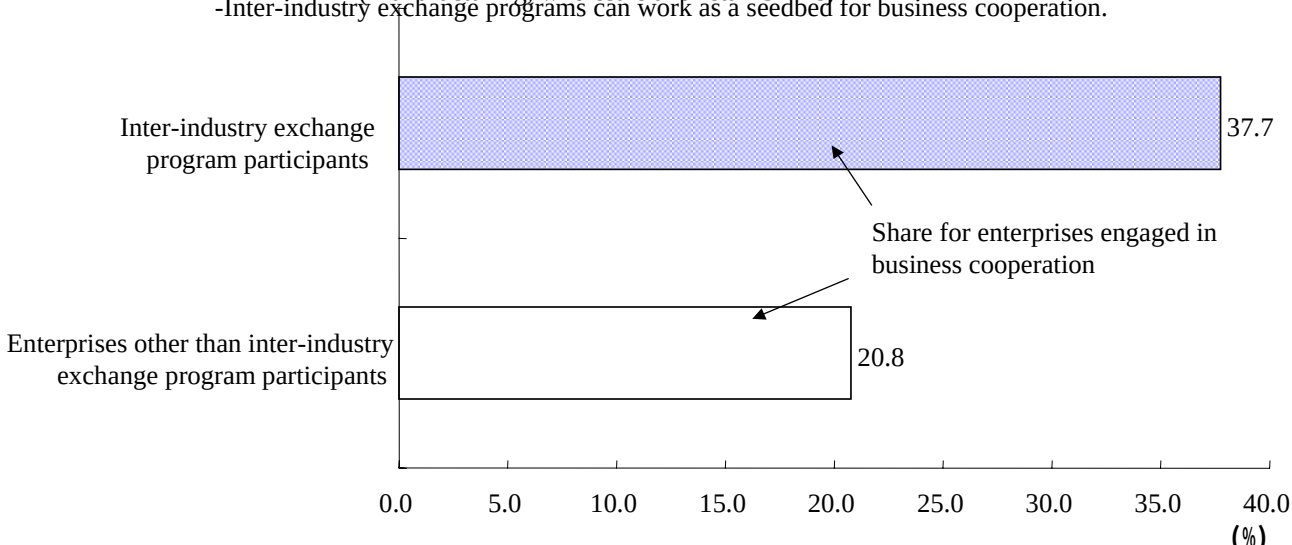
(Note) Enterprises that boosted sales are those whose sales increased from fiscal 1997 to 2001. Enterprises that improved operating profit on sales are those whose operating profit improved during the same period (including those whose operating loss narrowed).

-SMEs that participated in inter-industry exchange programs tend to try business cooperation activities. In this sense, **inter-industry exchange programs can work as a seedbed for business cooperation.**

**Figure 5-6 Share for Inter-industry Exchange Program Participants engaged in Business Cooperation**

(Manufacturing, wholesale and retail SMEs)

-Inter-industry exchange programs can work as a seedbed for business cooperation.

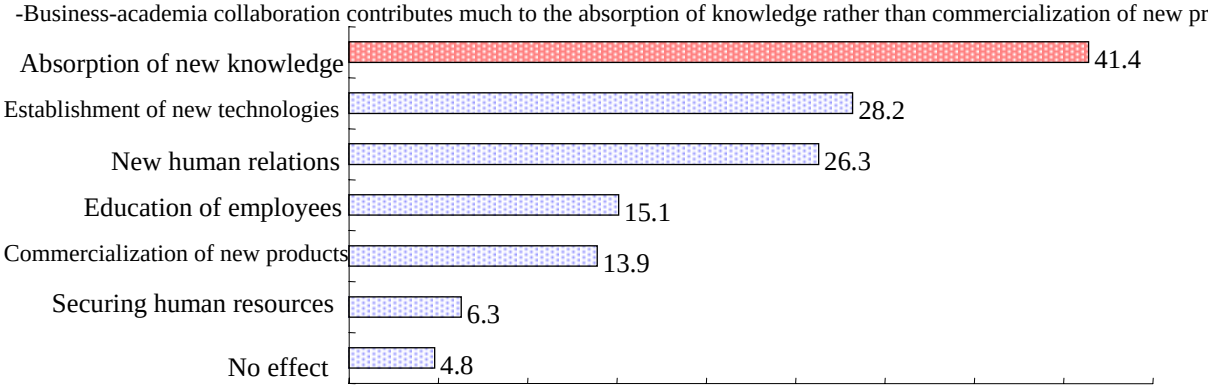



Source: SME Agency, *Survey on Alliance Activities of SME (November 2002)*

-Business-academia collaboration is highly effective in the absorption of knowledge and the establishment of new technologies for SMEs.

**Figure 5-7 Effects of Business-Academia Collaboration (Manufacturing SMEs)**

-Business-academia collaboration contributes much to the absorption of knowledge rather than commercialization of new products for SMEs -



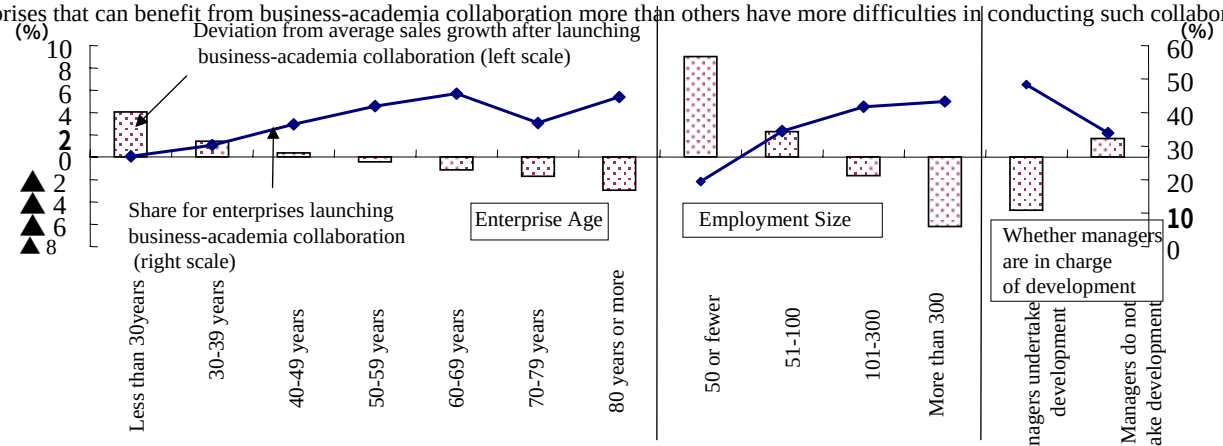

Source: SME Agency, *Survey on Business Management Strategies (November 2002)*

**-Smaller enterprises tend to get better effects from business-academia collaboration, but they lag behind larger firms in collaborating.** Relevant staff such as technology transfer experts from Technology Licensing Organizations, etc. should be empowered to solve this issue.

**Figure 5-8 Difference in Nature between Enterprises That Conduct Business-Academia Collaboration and Those That Effectively Benefit from Such Collaboration**

(Manufacturing SMEs)

—Enterprises that can benefit from business-academia collaboration more than others have more difficulties in conducting such collaboration –

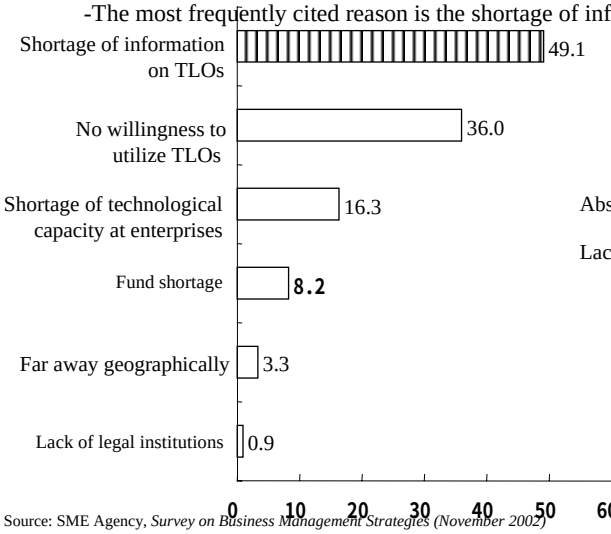



Sources: METI, *Basic Survey of Japanese Business Structure and Activities (1998)* (Reedited and processed); METI and SME Agency, *Basic Survey of Commercial and Manufacturing Structure and Activity (1998)* (Reedited and processed); *Survey on Business Management Strategies (November 2002)*

(Note) The deviation from average sales growth is the gap between the average sales growth for all enterprises conducting business-academia collaboration and the average for enterprises in each category.

**Figure 5-9 Reasons for SMEs' Failure to Utilize TLOs (Manufacturing SMEs)**

-The most frequently cited reason is the shortage of information on TLOs -

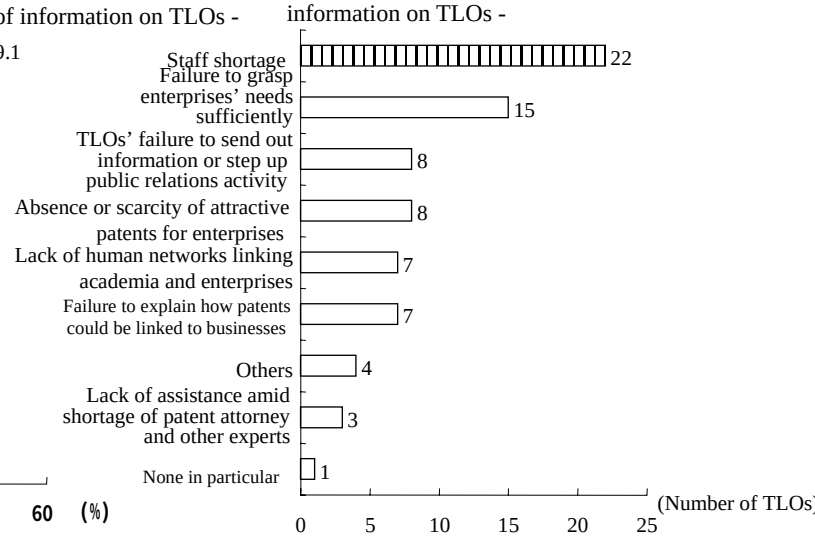



Source: SME Agency, *Survey on Business Management Strategies (November 2002)*

(Note) The total exceeds 100 since respondents were allowed to select plural alternatives.

**Figure 5-10 Problems Facing TLOs**

-The most frequently cited reason is the shortage of information on TLOs -



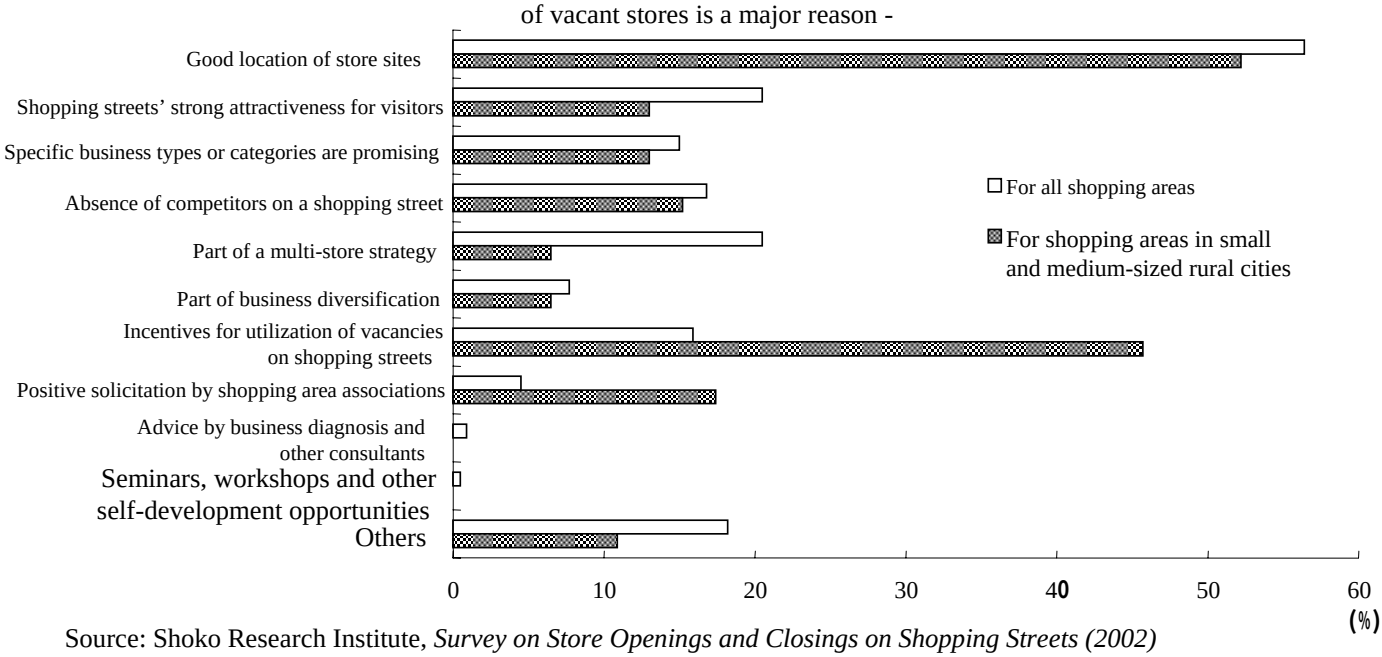

Source: Mitsubishi Research Institute, Inc., *Survey on SME Business Strategies and Business-Academia Collaboration (2002)*

(Note) The survey covered 24 certified TLOs. Each number above is the actual number of respondent TLOs.

**-One of the major reasons for opening shops is the availability of incentives for utilization of vacancies** in shopping areas in small and medium-sized rural cities**.**

**Figure 5-11 New Market Participants' Reasons for Opening Stores**

-In shopping areas in small and medium-sized rural cities, the availability of incentives for utilization of vacant stores is a major reason -




Source: Shoko Research Institute, *Survey on Store Openings and Closings on Shopping Streets (2002)*

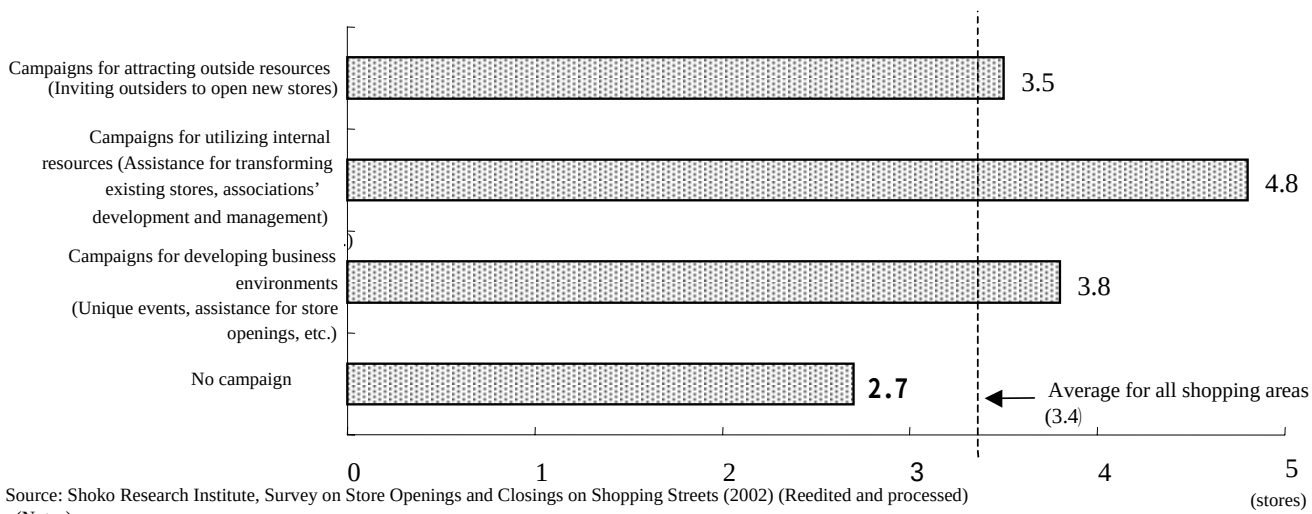
(Notes) 1. Small and medium-sized rural cities are cities with population of less than 200,000.

2. The total exceeds 100 since respondents were allowed to select plural alternatives.

-The combination of utilization of internal resources and the facilitation of business environments **promotes vitalization of shopping areas.**

**Figure 5-12 New Store Openings by Categories of Activity**

- Activities for the utilization of internal resources and the facilitation of business environments vitalize shopping areas -




Source: Shoko Research Institute, Survey on Store Openings and Closings on Shopping Streets (2002) (Reedited and processed)

(Notes)

1. For each shopping street, the number of new store openings in the past five years is converted into a number per 100 stores. Then, an average is calculated for each campaign category.
2. Since respondents were allowed to select plural alternative categories, the above figures fail to specify if respondents conducting campaigns for attracting outside resources implemented campaigns for utilizing internal resources.

## (Conclusion)

### Road to Revitalization and "Entrepreneur Society"

- SMEs are diversified and change dynamically. Even in the severe business environment, some SMEs can quickly revive their performance. However, not all SMEs have necessarily achieved this. Only SMEs that steadily implement innovations and enhance their profitability can survive and revive. The establishment of an "entrepreneur society," which produces a large number of such SMEs, will lead to the revitalization of the Japanese economy.