

2016 White Paper on Small and Medium Enterprises in Japan (outline)

April 2016

**Research Office, Small and
Medium Enterprise Agency**

Outline

- Annual Report Based on Article 11 of the Small and Medium-sized Enterprise Basic Act (Statutory White Paper)
- It is obliged to compile a report on the developments among SMEs based on opinions of the Council for Small and Medium Enterprise Policy and submit it to the Diet every year.
- This is the 53rd annual report after the enactment of the Small and Medium-sized Enterprise Basic Act.

Small and Medium-sized Enterprise Basic Act (extract)

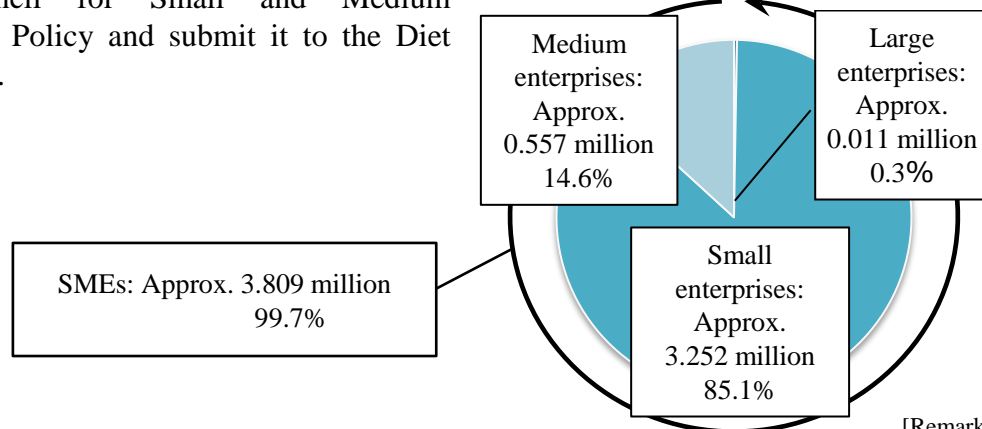
(Annual Report, etc.)

Article 11 (1) The Government must submit a report on the developments among small and medium-sized enterprises and measures it has taken therefor to the Diet every year.

(2) The Government must prepare a document clarifying measures it intends to take in consideration of the developments among small and medium-sized enterprises compiled in the report referred to in the preceding paragraph, based on opinions of the Council for Small and Medium Enterprise Policy and submit it to the Diet every year.

Definitions under the Small and Medium-sized Enterprise Basic Act and the Number of Enterprises and Employees

| | SMEs | | Small enterprises |
|-----------------------------------|--------------------------------------|--------------|---------------------|
| Business type | Stated capital or number of employee | | Number of employees |
| Manufacturing industry and others | 300 million yen or less | 300 or fewer | 20 or fewer |
| Wholesale trade industry | 100 million yen or less | 100 or fewer | 5 or fewer |
| Service industry | 50 million yen or less | 100 or fewer | 5 or fewer |
| Retail trade industry | 50 million yen or less | 50 or fewer | 5 or fewer |



| | Number of enterprises | Number of employees |
|-------------------|-----------------------|---------------------|
| Large enterprises | 0.011 million | 14.33 million |
| SMEs | 3.809 million | 33.61 million |
| Small enterprises | 3.252 million | 11.27 million |

2016 White Paper on Small and Medium Enterprises in Japan

- While businesses conditions of SMEs and Small Enterprises are moderately recovering, various environmental changes and challenges, such as shrinking domestic markets, labor shortages, and aging of facilities, have been identified.
- This White Paper analyzes efforts being made by SMEs struggling to achieve diverse and vigorous growth by strengthening earning power under such circumstances.

White Paper on Small and Medium Enterprises in Japan

1. Analysis of the Current Status

Economic Developments in Japan

Developments among SMEs and Small Enterprises

Productivity of SMEs

2. Efforts by SMEs with High Earning Power

Utilization of IT for Enhancing Productivity


Overseas Business Expansion for Increasing Sales

Risk Management to Support Earning Power

3. Finances Supporting SMEs

4. Earning Power of SMEs

Analysis of Characteristics of SMEs with High Earning Power



Management Power that Decides Earning Power of SMEs

1. Analysis of the Current Status (1) Corporate Earnings and Business Confidence

Ordinary profits of SMEs have achieved a record-high level and business confidence is improving, but growth in sales is stagnant.

Fig. 1 Changes in Ordinary Profits

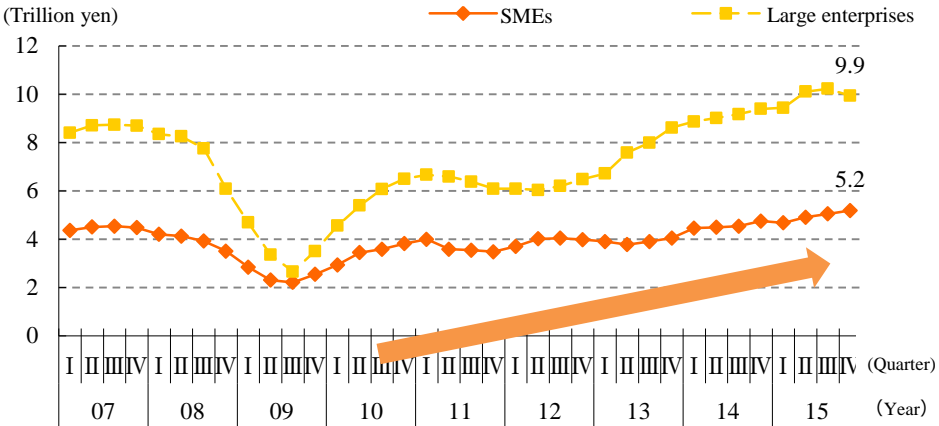


Fig. 2 Changes in Sales

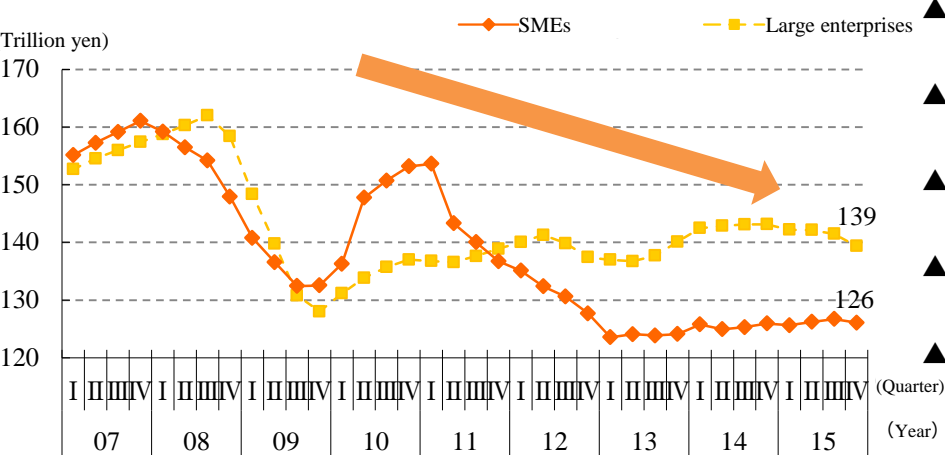
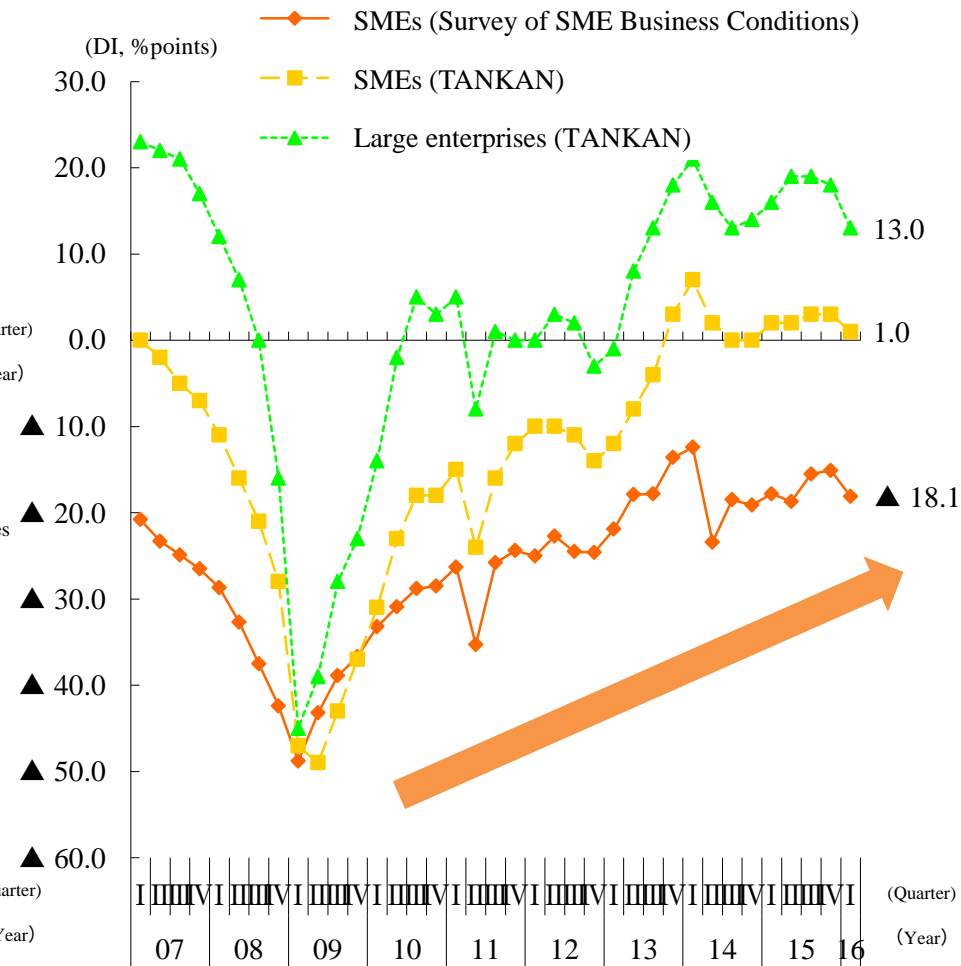


Fig. 3 Changes in Business Conditions DI



[Remarks] Fig. 1 and Fig. 2: “Financial Statements Statistics of Corporations by Industry (quarterly report)” (Ministry of Finance (MOF)); [Note] The four-quarter backward moving average; SMEs are enterprises whose stated capital is 10 million yen or more but less than 100 million yen, and large enterprises are those whose stated capital is 1 billion yen or more.; Fig. 3: “TANKAN (Short-Term Economic Survey of Enterprises in Japan)” (Bank of Japan) and “Survey of SME Business Conditions” (Small and Medium Enterprise Agency (SMEA) and SME Support, Japan); [Notes] 1. Business Conditions DI of the TANKAN is obtained by subtracting the percentage of enterprises that consider the recent business conditions are bad from the percentage of those that consider the recent business conditions are good.; 2. Business Conditions DI of the Survey of SME Business Conditions is obtained by subtracting the percentage of enterprises that consider the current business conditions to have worsened from the previous quarter from the percentage of those that consider the current business conditions to have improved from the previous quarter.; 3. In the TANKAN, large enterprises are those whose stated capital is 1 billion yen or more, and SMEs are those whose stated capital is 20 million yen or more but less than 100 million yen.

1. Analysis of the Current Status (2) Number of SMEs

The number of SMEs is 3.81 million, made up of .56 million medium-sized enterprises and 3.25 million small enterprises. The decline in the number of SMEs has slowed.

Fig. 1 Changes in the Number of SMEs

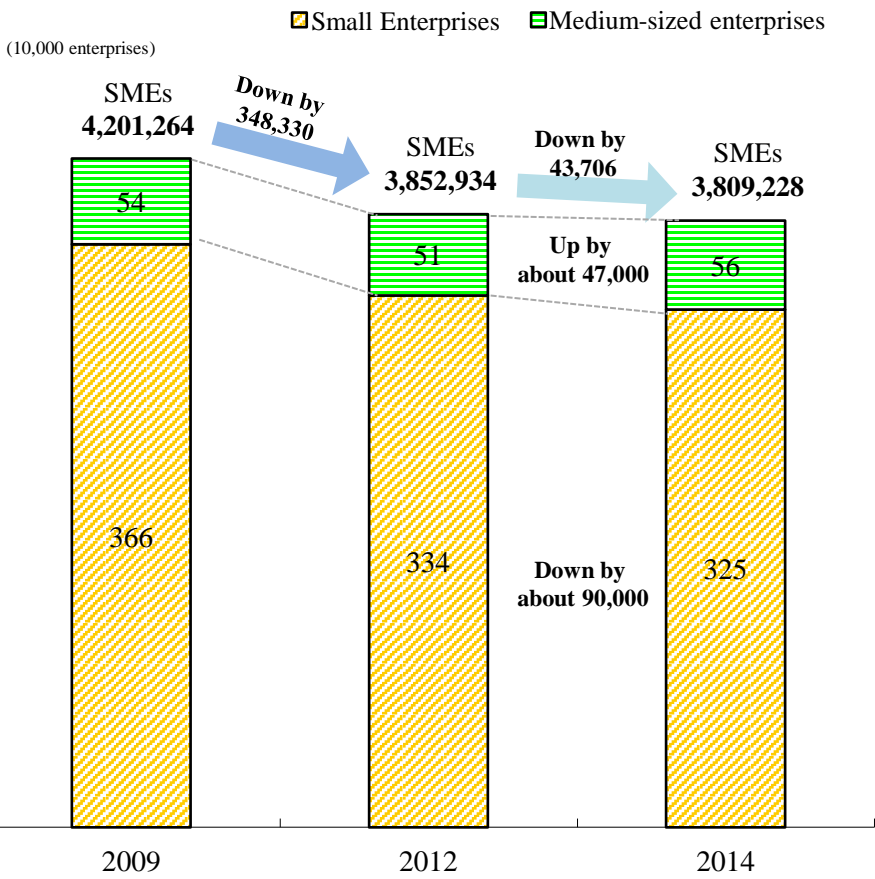
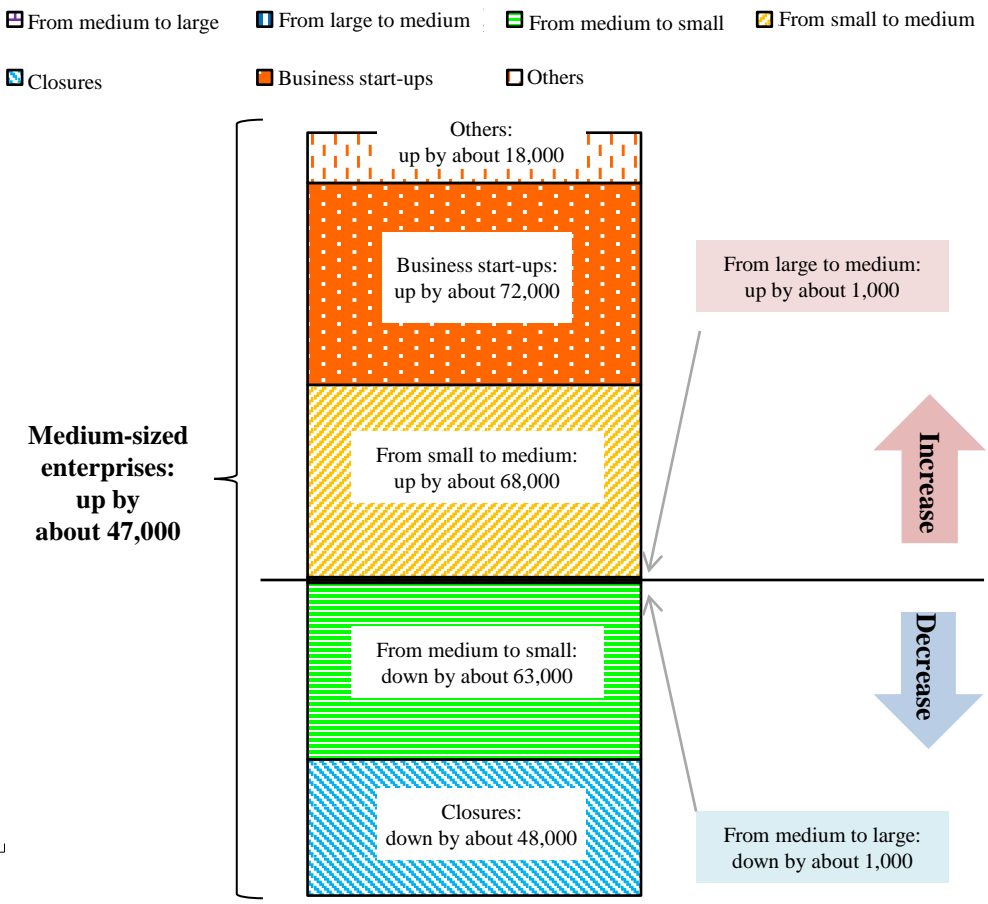


Fig. 2 Breakdown of Changes in Number (from 2012 to 2014)



[Remarks] Fig. 1 and Fig. 2: “Economic Census for Business Frame” (Ministry of Internal Affairs and Communications (MIC)), and “FY2012 Economic Census for Business Activity” (MIC and Ministry of Economy, Trade and Industry (METI)) (rearranged and processed); [Note] Number of enterprises = Number of companies + Number of individual proprietors (single business establishments and headquarters or main business establishments); [Notes] 1. Based on Economic Censuses for 2014 and 2012, out of enterprises whose data are confirmed in either of these censuses, those whose business establishments are considered to be all closed are categorized into “Closures.” Enterprises that fall under neither of them are categorized into “Others.”; 2. Upon tabulation, the number of business counted as start-ups and closures may be larger than the actual number due to such reasons as relocation.

1. Analysis of the Current Status (3) Background of the Increase in Earnings

Changes in ordinary profits of SMEs from 2009 to 2015 were brought about mainly by the following factors: (i) decreased sales; (ii) decreased variable costs (partly due to declines in prices of raw materials and energy); and (iii) decreased personnel costs (partly due to decreases in the number of enterprises and employees). As a whole, ordinary profits increased by 2.5 trillion yen.

Fig. 1 Increases in Ordinary Profits in 2015 Compared to Those in 2009 (by factor)

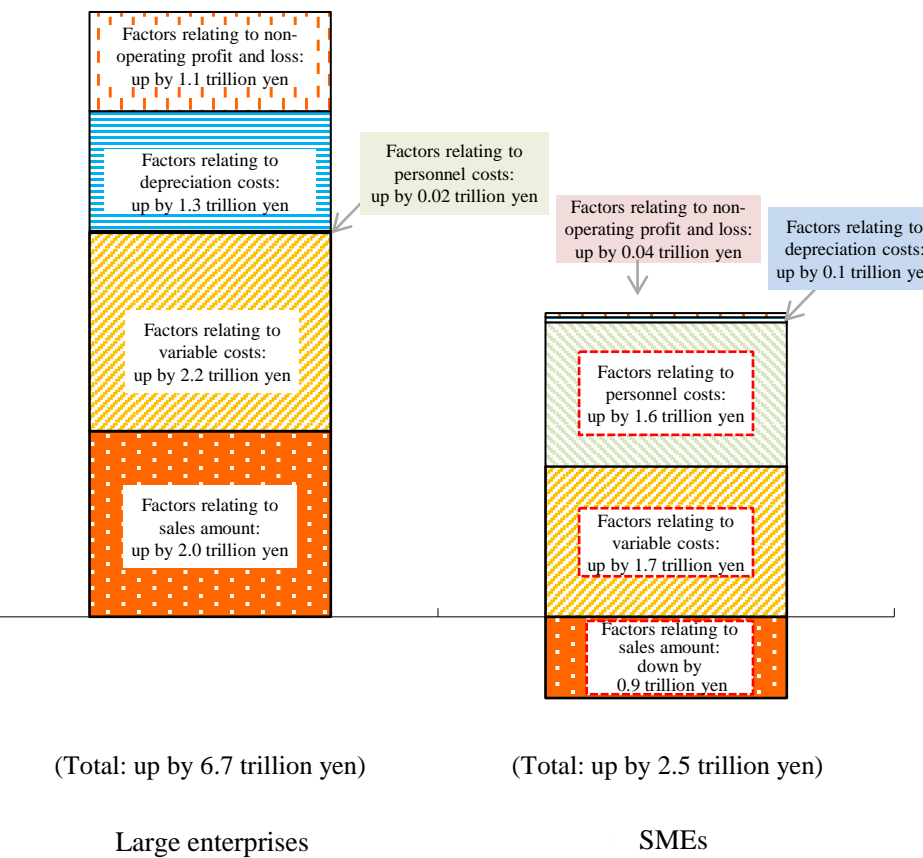


Fig. 2 Changes in Prices of Primary Commodities

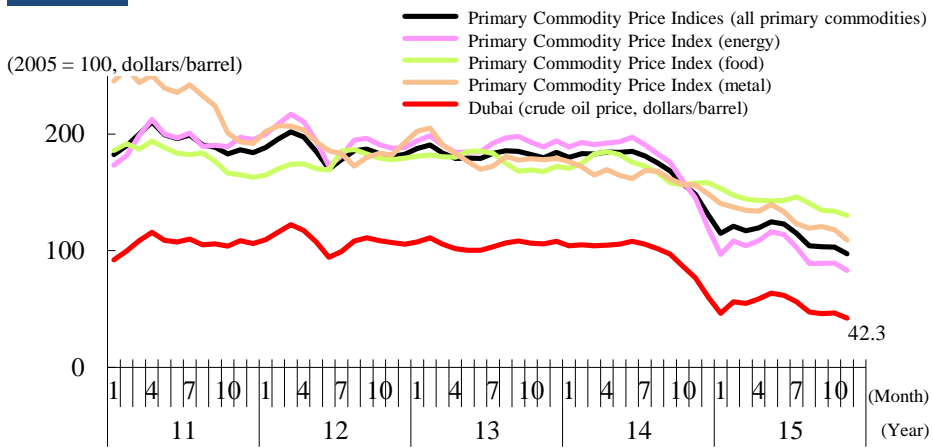
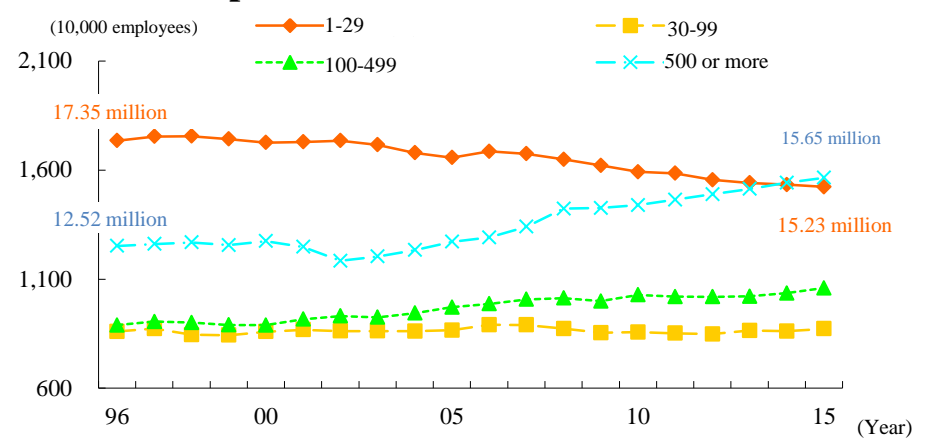


Fig. 3 Changes in the Number of Employees by Enterprise Size



[Remarks] Fig. 1: "Financial Statements Statistics of Corporations by Industry (annual report)" (MOF); [Note] Large enterprises are those whose stated capital is 1 billion yen or more, and SMEs are those whose stated capital is 10 million yen or more but less than 100 million yen.; Fig. 2: "Primary Commodity Prices" (IMF); [Notes] 1. Primary Commodity Price Indices are indexed prices of commodities, such as food, metal, energy (oil), weighted with the average export amount from 2002 to 2004.; 2. Food includes cereal, plant oil, meat, sugar, fruits, etc.; 3. Metal includes copper, aluminum, iron, tin, nickel, lead, etc.; 4. Energy includes crude oil, natural gas and coal.; Fig. 3: "Labor Force Survey" (MIC)

1. Analysis of the Current Status (4) Labor Shortage and Aging of Facilities

Wages are being raised also among SMEs but labor shortages are becoming more and more serious. Capital investment remains sluggish and SMEs face the problem of aging facilities. Given these circumstances and considering that ordinary profits are at a record-high level, now is the time to enhance earning power through efforts to streamline business and increase sales.

Fig. 1 Wage Increase (percentage of average increase per person)

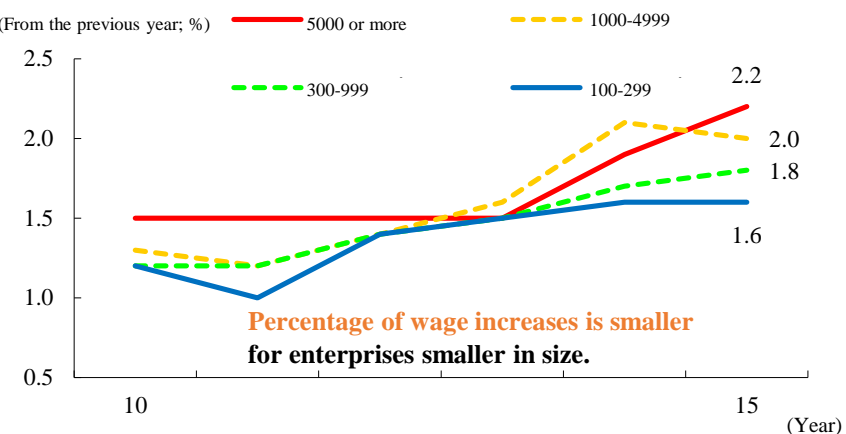


Fig. 2 Employee Overcapacity and Insufficiency DI

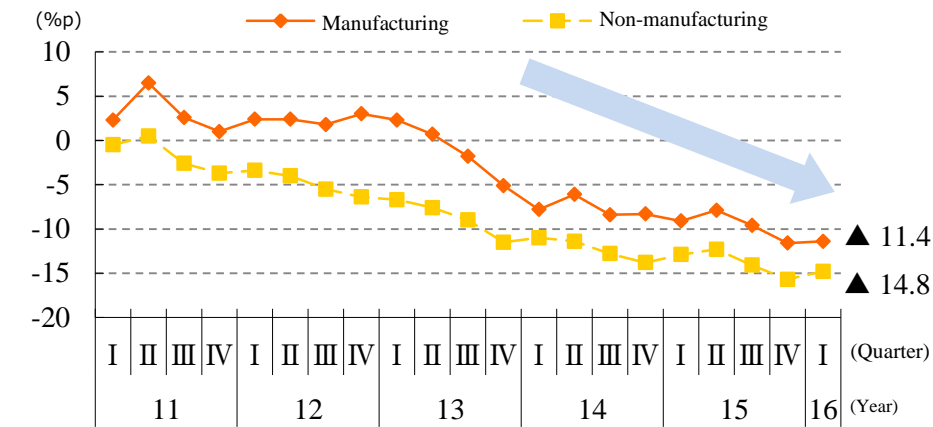


Fig. 3 Changes in Capital Investment

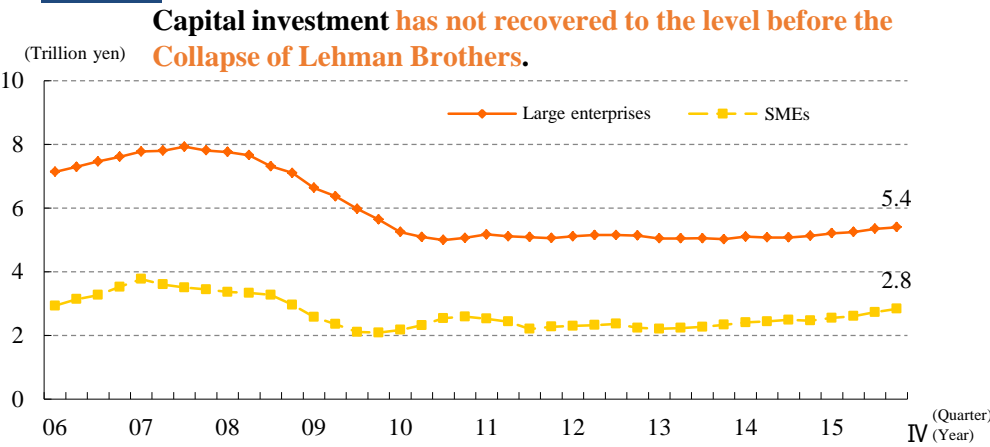
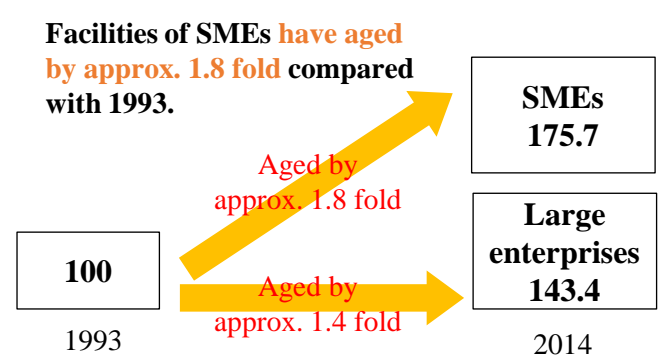


Fig. 4 Changes in Facility Age (by size, 1993=100)



[Remarks] Fig. 1: "Survey on Wage Increase" (Ministry of Health, Labour and Welfare (MHLW)); [Note] Meaning annual wage hike, increase in base pay, or other changes of various allowances targeting all or part of regular employees and including decreases in base pay, regular wage, etc.; Fig. 2: "Survey of SME Business Conditions" (SME Support, Japan); Fig. 3: "Financial Statements Statistics of Corporations by Industry" (MOF); [Note] Here, large enterprises are those whose stated capital is 1 billion yen or more, and SMEs are those whose stated capital is 10 million yen or more but less than 100 million yen.; Fig. 4: Prepared based on "SMEs' Competitiveness and Capital Investment" (Shoko Research Institute) in "Financial Statements Statistics of Corporations by Industry (annual report)" (MOF)

1. Analysis of the Current Status (5) Productivity of SMEs

Some SMEs have high productivity and earning power. Such SMEs seem to take a positive stance toward growth investment. We will analyze the characteristics of their investment and funding behavior.

Fig. 1 Cumulative Distribution of Labor Productivity

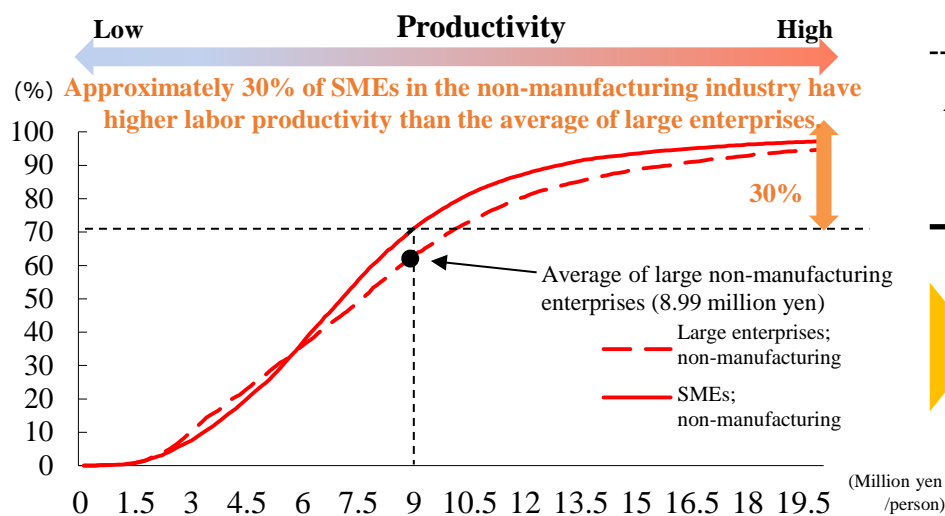
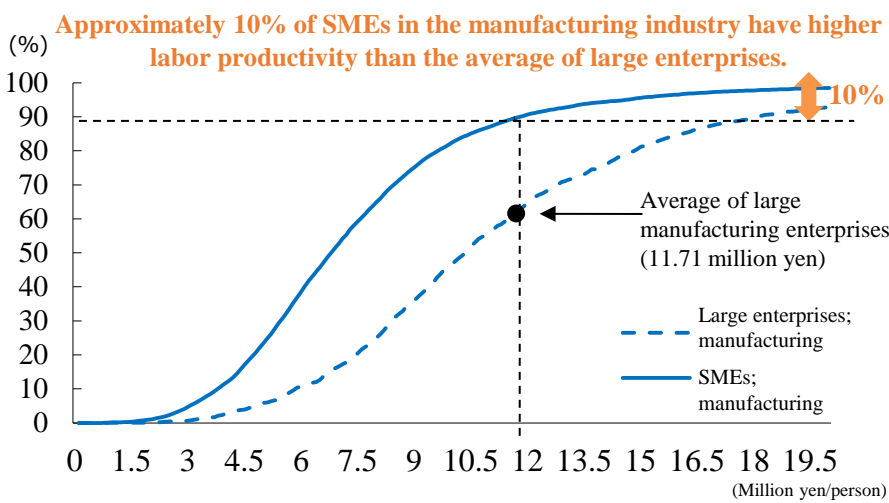


Fig. 2 Characteristics of SMEs with High Labor Productivity (average) (in the case of the retail industry)

| | Distribution ratio (%) | Stated capital (million yen) | Employees (persons) | Capital investment (million yen) | Information processing and communications costs (million yen) | Personnel cost/person (million yen) | Capital equipment ratio (million yen/person) |
|--|------------------------|------------------------------|---------------------|----------------------------------|---|-------------------------------------|--|
| SMEs with labor productivity higher than the average of large retailers (n=383) | 25.9 | 43.0 | 224.3 | 338.6 | 34.6 | 5.1 | 26.7 |
| SMEs with labor productivity lower than the average of large retailers (n=1,095) | 74.1 | 42.2 | 350.0 | 97.8 | 17.4 | 2.4 | 15.2 |
| All SMEs in the retail industry (n=1,478) | 100 | 42.5 | 306.0 | 182.0 | 23.4 | 3.7 | 19.2 |

There is a tendency for SMEs with high productivity to be **positive about capital and IT investment, etc.,** and **wages per person are higher.**

Therefore, we will analyze how such SMEs with high earning power are making investment for growth.

[Remarks] Fig. 1 and Fig. 2: "Basic Survey of Japanese Business Structure and Activities" (rearranged and processed); [Notes] 1. Excluding enterprises with less than 50 employees or those for which the stated capital or contribution is less than 30 million yen; 2. Distribution ratios of labor productivity (added value per employee) were tabulated on the basis of 100,000 yen per person and the results were cumulated.

2. Efforts by SMEs with High Earning Power (1) IT Investment (i)

Some of the challenges facing SMEs, such as obtaining an accurate self-understanding of business conditions, are addressable through the utilization of IT, but IT investment is not active among many SMEs due to lack of personnel and uncertainties regarding its effectiveness. However, high-profit enterprises have been successfully enjoying the positive effects of IT investment, such as strengthened sales capabilities and increased sales.

Fig. 1 Accounting Management of SMEs

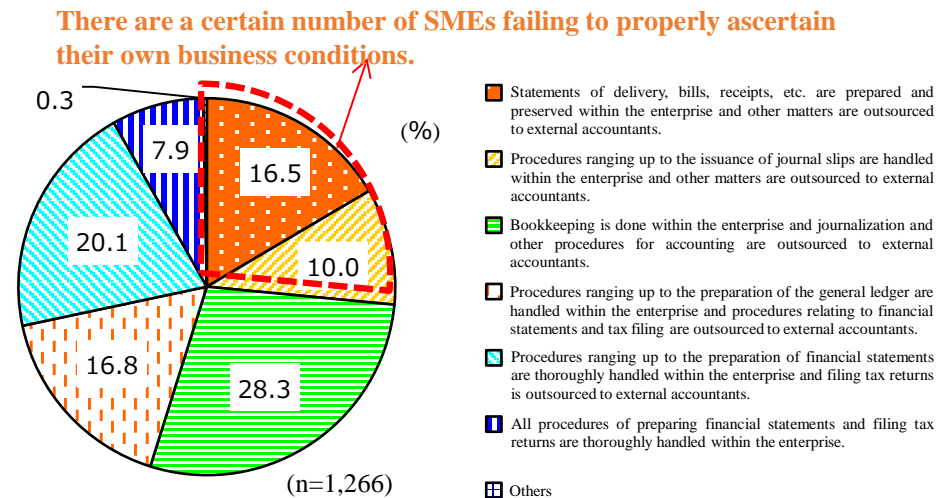
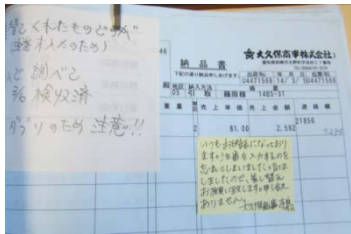


Fig. 2 Picture of SMEs failing to fully utilize IT



At SMEs failing to fully utilize IT, PCs are not allocated to each staff member and there are heaps of slips on desks...



... Information is transmitted by writing it on memo pads, which causes lots of errors. It is often the case that errors need to be checked by searching through stacks of such memos.

Fig. 3 Reasons for Not Making IT Investment

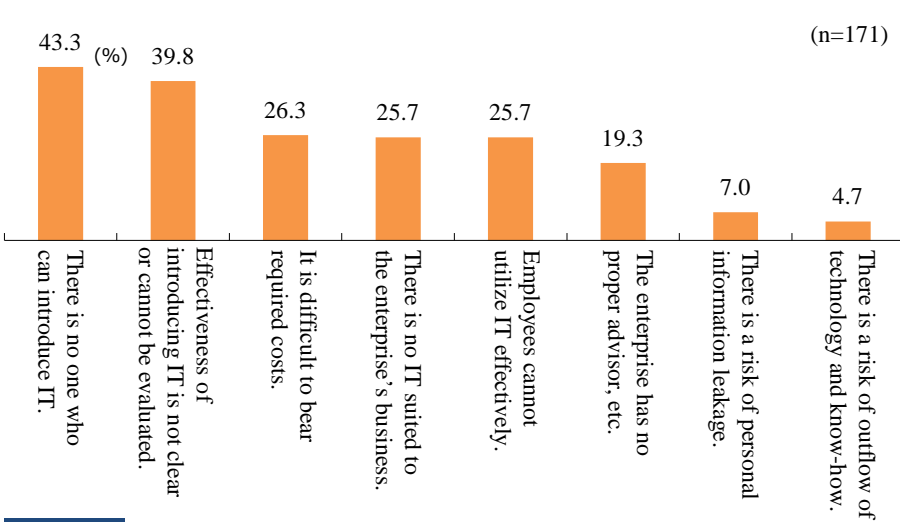
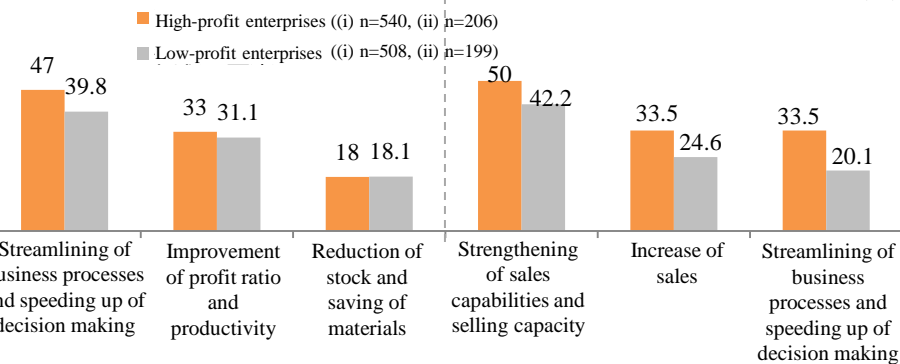


Fig. 4 Effectiveness of IT Investment

In particular, gaps are notable in the effectiveness of aggressive IT investment.

(i) Effectiveness of defensive IT investment (%) (ii) Effectiveness of aggressive IT investment (%)



[Remarks] Fig.1: "FY2012 Survey on Accounting of SMEs" (Teikoku Databank, Ltd.) under contract from the SMEA; Fig.2: Photos are from Material 3 of the 4th FinTech Meetup; Fig. 3 and Fig. 4: "Questionnaire Survey on Growth and Investment Behavior of SMEs" (December 2015; Teikoku Databank, Ltd.) under contract from the SMEA

2. Efforts by SMEs with High Earning Power (1) IT Investment (ii)

High-profit enterprises generally listen to opinions of each department, provide training to employees, continuously strive to enhance business processes, and make IT investment in a strategic manner, while properly utilizing external organizations amid labor shortages.

Fig. 1 Introduction of IT by Earning Capacity

No notable gaps are observed in the status of introduction of IT among enterprises fully utilizing IT.

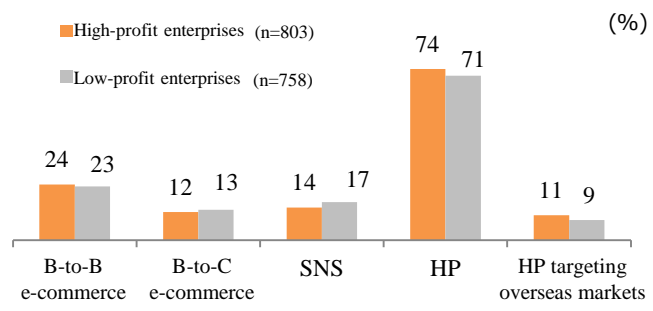
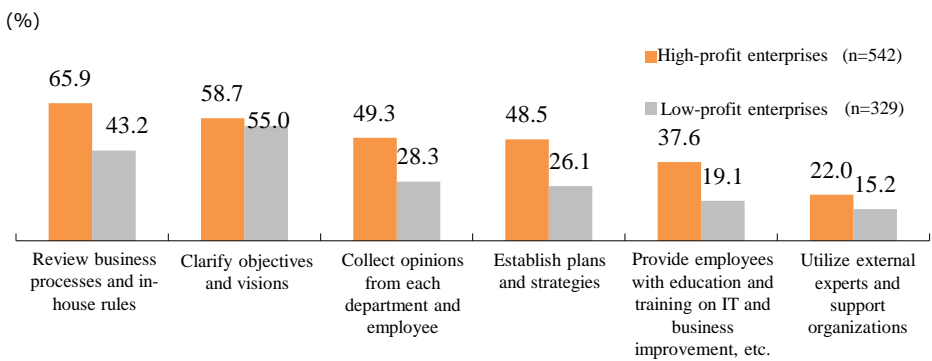


Fig. 2 Efforts to Increase Earnings through the Introduction of IT

A high percentage of enterprises with high earning power have **communication with employees** and **review business processes** upon introducing IT.



[Example] Ohkushi Corporation (Chiba-shi, Chiba)

The company has successfully enhanced the percentage of repeat customers and increased sales through collection and analysis of customer data using the POS system and human resources development.

- The company has a total of 39 shops mainly in Chiba prefecture. The POS system is introduced in all shops, and various data, including information on employees and customers, are managed and analyzed.
- The analysis of various data, such as sales, business fluctuations, and percentages of repeat customers of each shop, has led to the discovery of issues, making them visible and ascertainable. At the same time, the company has actively taken measures to foster personnel with the aim of enhancing their skills, thereby successfully improving customer satisfaction.
- Aiming to develop an open working environment to prevent numerical achievement goals from pushing employees too hard, the company formulates annual policies every year and shares its Management philosophy with all employees through meetings.
- Through the introduction of the POS system, the company achieved a high percentage of repeat customers (approximately 85% on average for all shops), two-digit growth in sales for over 10 years, and a retention rate of 96%.



A barbershop of the company

[Remarks] Fig. 1 and Fig. 2: "Questionnaire Survey on Growth and Investment Behavior of SMEs" (December 2015; Teikoku Databank, Ltd.) under contract from the SMEA

2. Efforts by SMEs with High Earning Power (2) Overseas Business Expansion (i)

As domestic markets are shrinking while the number of middle-class and wealthy-class people is increasing overseas, it is important to attract overseas demand. In the medium run, the number of SMEs expanding business overseas is on the rise. Such SMEs have achieved productivity enhancement and an increase of domestic employees.

Fig. 1 Number of Direct Exporters among Manufacturing SMEs

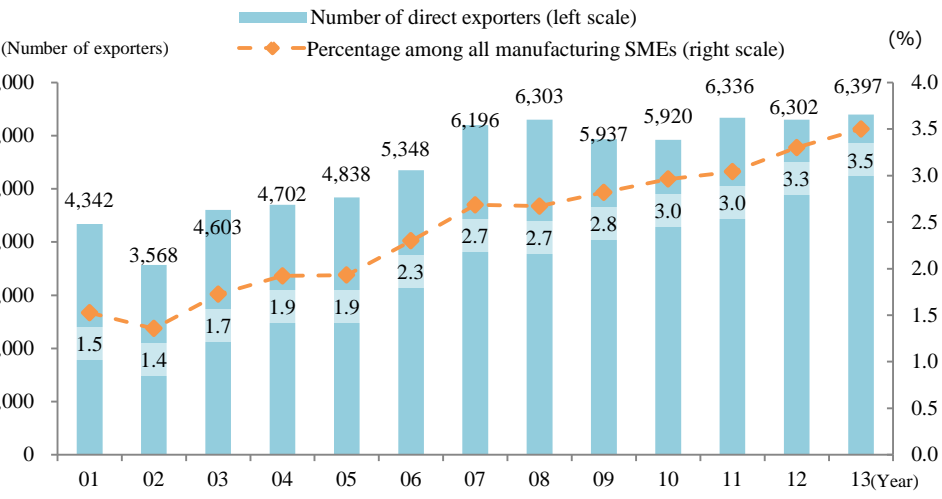


Fig. 2 Labor Productivity of Exporting SMEs and Non-exporting SMEs (manufacturing)

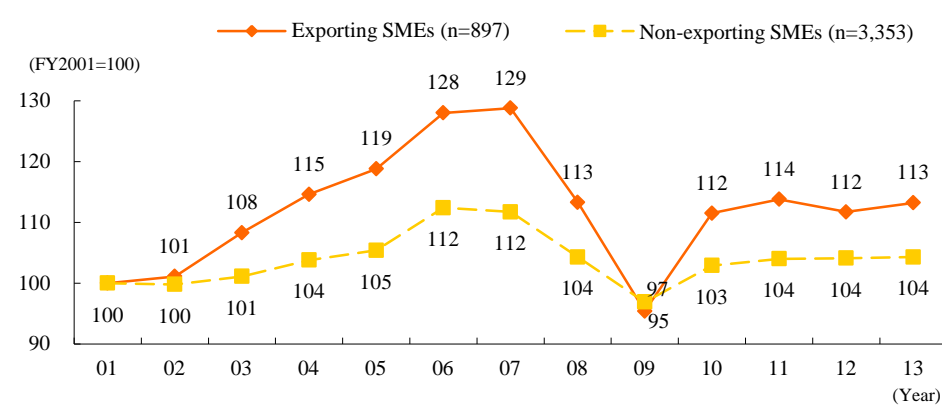


Fig. 3 Direct Investors by Enterprise Size and Business Type

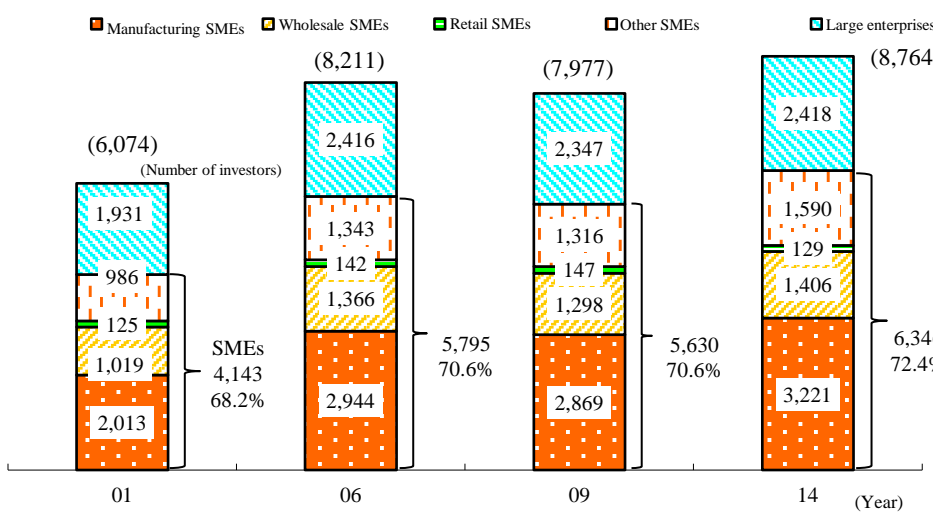
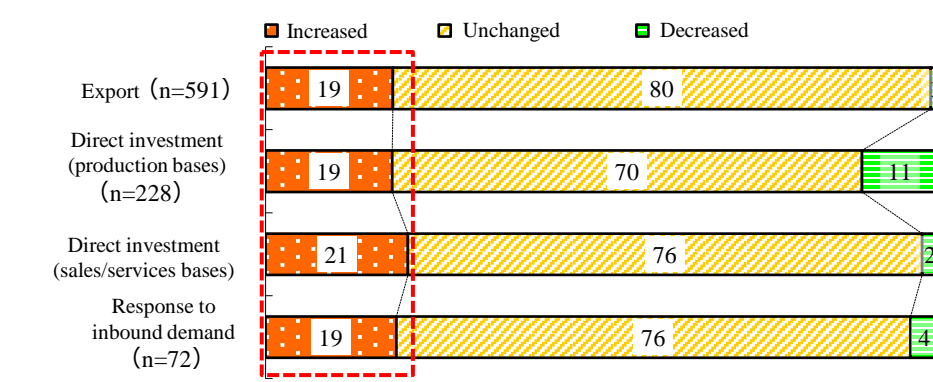


Fig. 4 Changes in the Number of Domestic Employees by the Status of Investment for Overseas Business Expansion

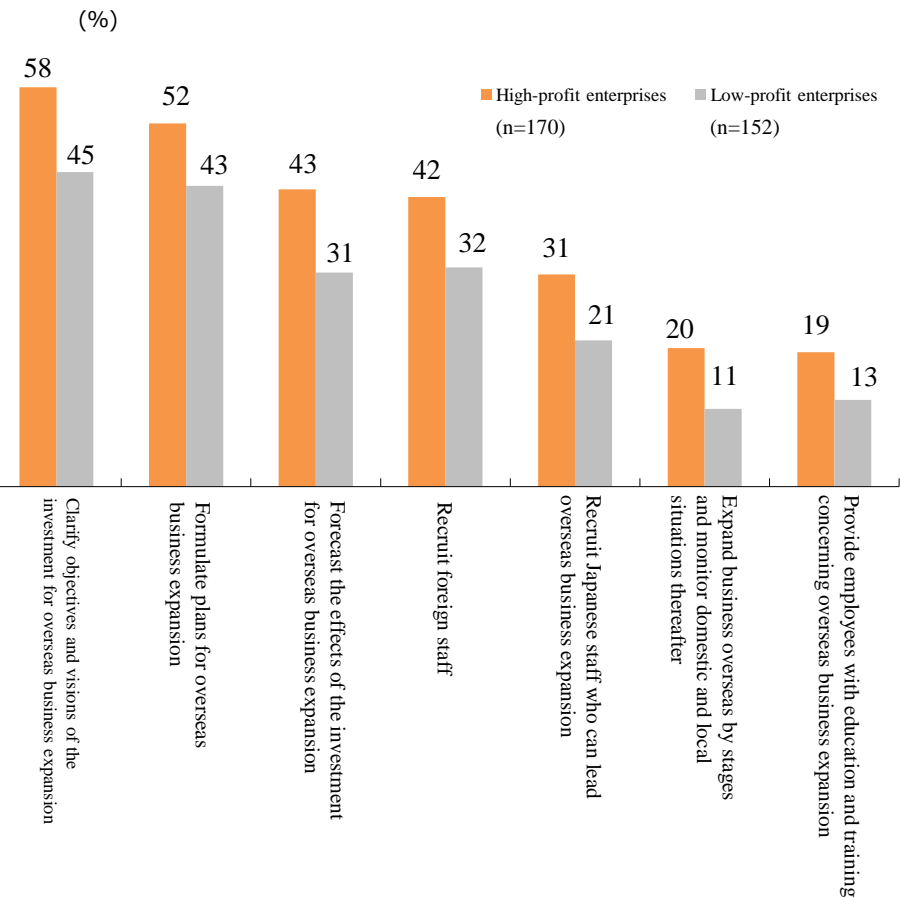


[Remarks] Fig. 1: “Census of Manufacture” (METI), “2014 Economic Census for Business Frame” (MIC and METI) (rearranged and processed); Fig. 2: “Establishment and Enterprise Census” (MIC), “2009 and 2014 Economic Census for Business Frame” (rearranged and processed); Fig. 3 “Basic Survey of Japanese Business Structure and Activities” (METI) (rearranged and processed); [Note] Exporting SMEs refer to enterprises that continuously exported products from FY2001 to FY2013 and non-exporting SMEs refer to those that had never exported products during the same period.; Fig. 4: “Questionnaire Survey on Growth and Investment Behavior of SMEs” (December 2015; Teikoku Databank, Ltd.) under contract from the SMEA

2. Efforts by SMEs with High Earning Power (2) Overseas Business Expansion (ii)

High-profit enterprises generally promote marketing and planning, secure and foster personnel including foreign staff, make preparation for risks through monitoring, and have achieved increased sales, etc. by way of overseas business expansion.

Fig. 1 Efforts to Increase Earnings through Overseas Business Expansion



[Example] WILLER TRAVEL Inc. (Osaka-shi, Osaka)

The company has successfully obtained inbound demand and increased sales through the designing of products and marketing activities targeting foreign visitors to Japan.

- The company, which belongs to the WILLER ALLIANCE group that provides travel services using highway buses, etc., operates the group's portal site that mainly offers online booking services and the web marketing.
- Since 2009, when foreign visitors started to increase, the company commenced the building of IT capabilities able to meet the changing demand environment. The company has developed tour packages dedicated to foreign visitors, promoted multilingualization of its booking site, introduced an online credit settlement system, started multilingual announcements at bus terminals and within the company, and hired foreign staff. The company conducts business mainly via the Internet, thereby significantly reducing costs ordinarily required for travel agencies, such as those for establishing a call center.
- Upon carrying out these measures, the company formulated visions and business plans for responding to foreign visitors. The visions are disseminated and shared among all employees and business plans have been reviewed on a monthly basis to properly respond to inbound demand.
- As a result, the number of customers increased from 70,000 in 2014 to 150,000 in 2015, and further growth is expected.



A highway bus of the company

[Remark] "Questionnaire Survey on Growth and Investment Behavior of SMEs" (December 2015; Teikoku Databank, Ltd.) under contract from the SMEA

2. Efforts by SMEs with High Earning Power (3) Risk Management (i)

As natural disasters have come to occur frequently and the need for information security has grown due to the evolution of IT, large enterprises have proactively taken measures for risk management, but the percentage of SMEs that have formulated a BCP is as low as 15% and their efforts have been slow.

* Business Continuity Plan (BCP): A plan that an enterprise formulates in advance with regard to activities to be carried out at normal times and responses in an emergency so that the enterprise can minimize the damage in the event of a natural disaster, terror attack or any other emergency and can continue or restore business at an early stage.

Fig. 1 Frequencies and Damage of Natural Disasters in Japan

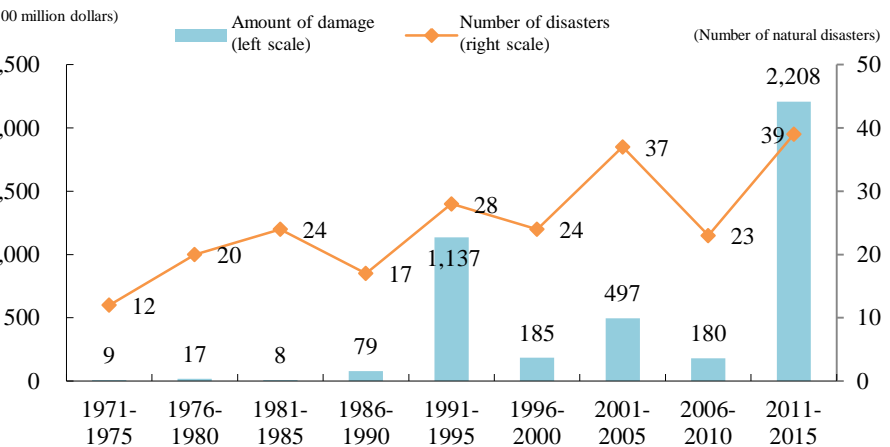


Fig. 2 Formulation of BCPs (SMEs, by number of employees)

The percentage of SMEs that have formulated a BCP is as low as 15%, and the percentage is even smaller at 8% for SMEs with no more than 100 employees.

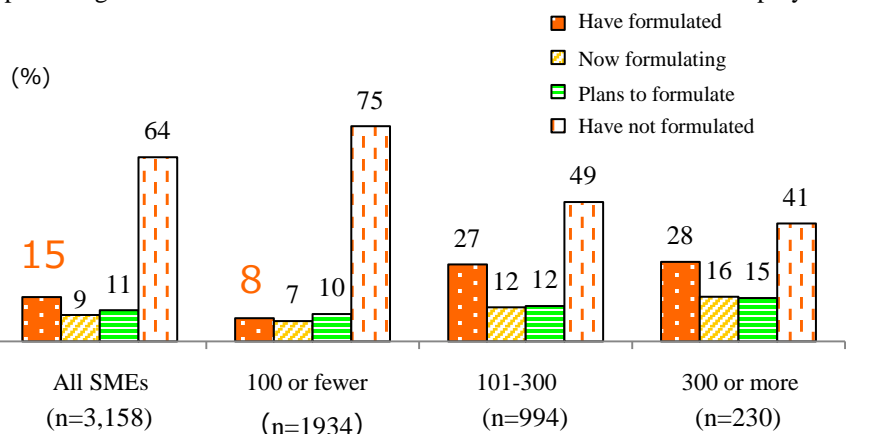
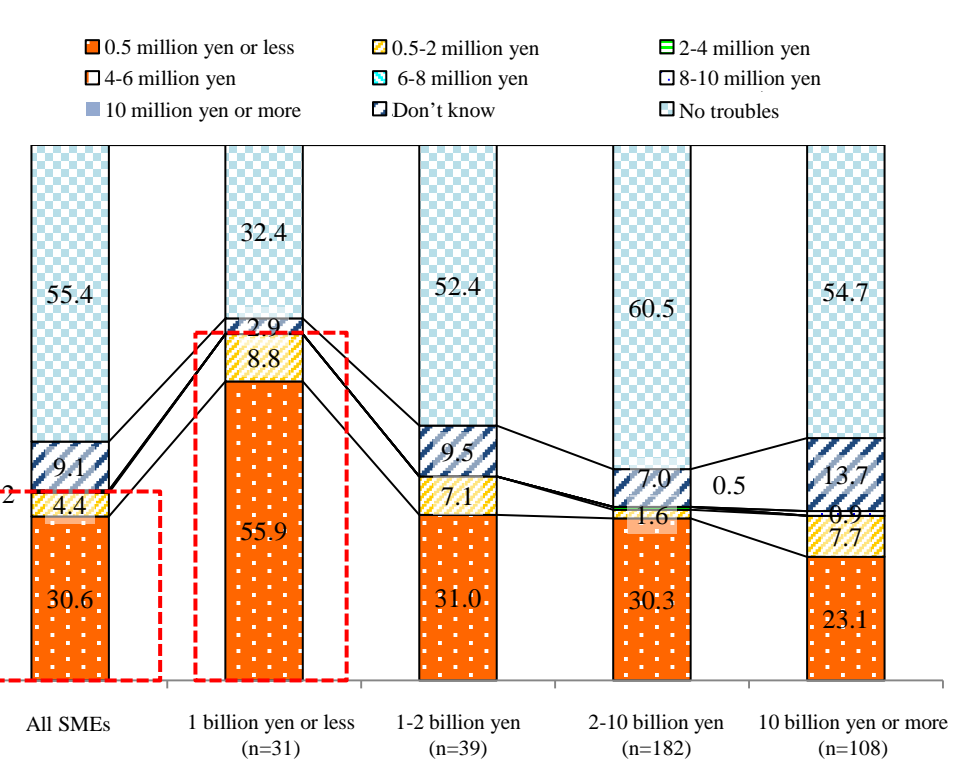


Fig. 3 Amount of Damage due to Information Security-related Troubles (SMEs, by sales)

Approximately 35% of SMEs have faced some information security-related troubles. Among enterprises smaller in size in particular, approximately 65% have sustained damage due to information security-related troubles.



[Remarks] Fig. 1: Prepared by the SMEA based on "Disaster Database (EM-DAT)" (Centre for Research on the Epidemiology of Disasters, Université catholique de Louvain); Fig. 2: "Survey on SMEs' Efforts for Risk Management" (December 2015; Mizuho Research Institute) under contract from the SMEA; Fig. 3: "Survey on Current Status of Information Processing" (METI) (rearranged and processed)

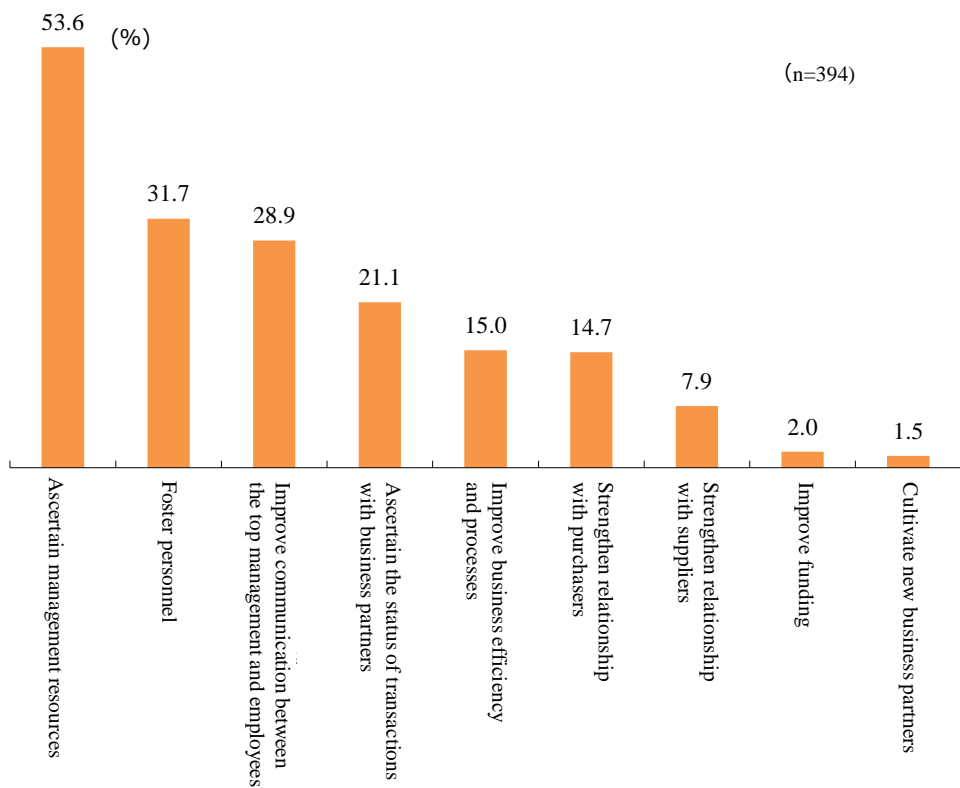
2. Efforts by SMEs with High Earning Power (3) Risk Management (ii)

SMEs with high earning power generally take measures against risks and thereby improve business efficiency, foster personnel and increase sales. It is necessary to actively engage in risk management as part of efforts for business improvement during normal times.

* Business Continuity Management (BCM): A mechanism for activities and management to be operated continuously by formulating a BCP

Fig. 1 Effects of BCM during Normal Times

If efforts are made, **significant results can be expected in improving business at normal times.**



[Example] Taisei Fine Chemical Co., Ltd. (Asahi-shi, Chiba)

The company has successfully reduced costs at normal times through BCM.

- The company is a manufacturer of acrylic resin solutions. It designs custom-made resin and supports clients from the development of prototypes to the production of mass-produced products.
- The company had long promoted formulation of BCPs but was forced to suspend operation for one month after the Great East Japan Earthquake. In order to fulfil its responsibilities as a supplier, the company received guidance from a private consulting firm under a support program of the Tokyo metropolitan government and formulated a new BCP.
- As measures to ensure business continuity, the company has dispersed warehouses, has come to hold inventory for one and a half months, and has introduced private electric generators. Furthermore, in order to reduce possible damage, the company relocated its network management server and file server to external facilities resilient against level 7 earthquakes on the Japanese scale and outsourced their operation to an external data center, thereby at the same time achieving the reduction of operation costs by approximately 1 million yen annually.
- Their efforts for BCM were covered by the media and attracted people's attention, leading to higher evaluation by financial institutions and insurance companies and resulting in increases in orders received.

< A private electric generator introduced after the earthquake >



3. Finances Supporting Growth of SMEs (1) Loans from Financial Institutions

Funding supply is indispensable for SMEs to promote growth investment. At present, cash management of SMEs and financial institutions' lending attitude toward SMEs are improving, but loans to SMEs have not been increasing relative to those offered to large enterprises.

Fig. 1 Changes in Difficulties in Financing and Borrowing Funds from Financial Institutions

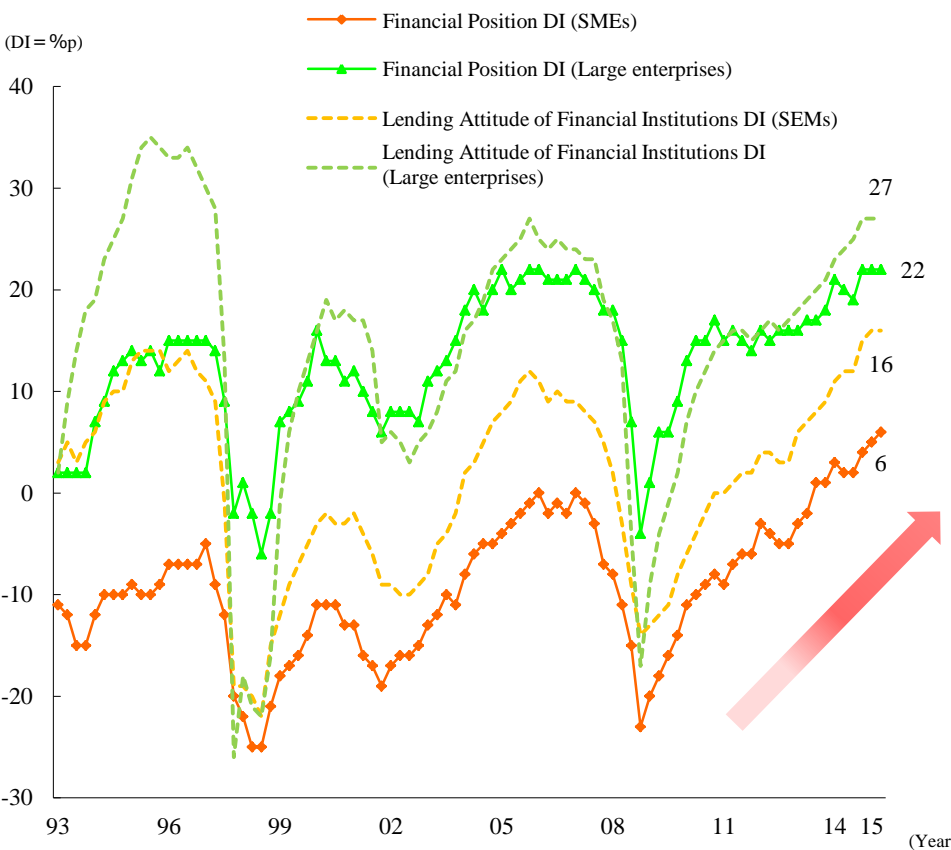


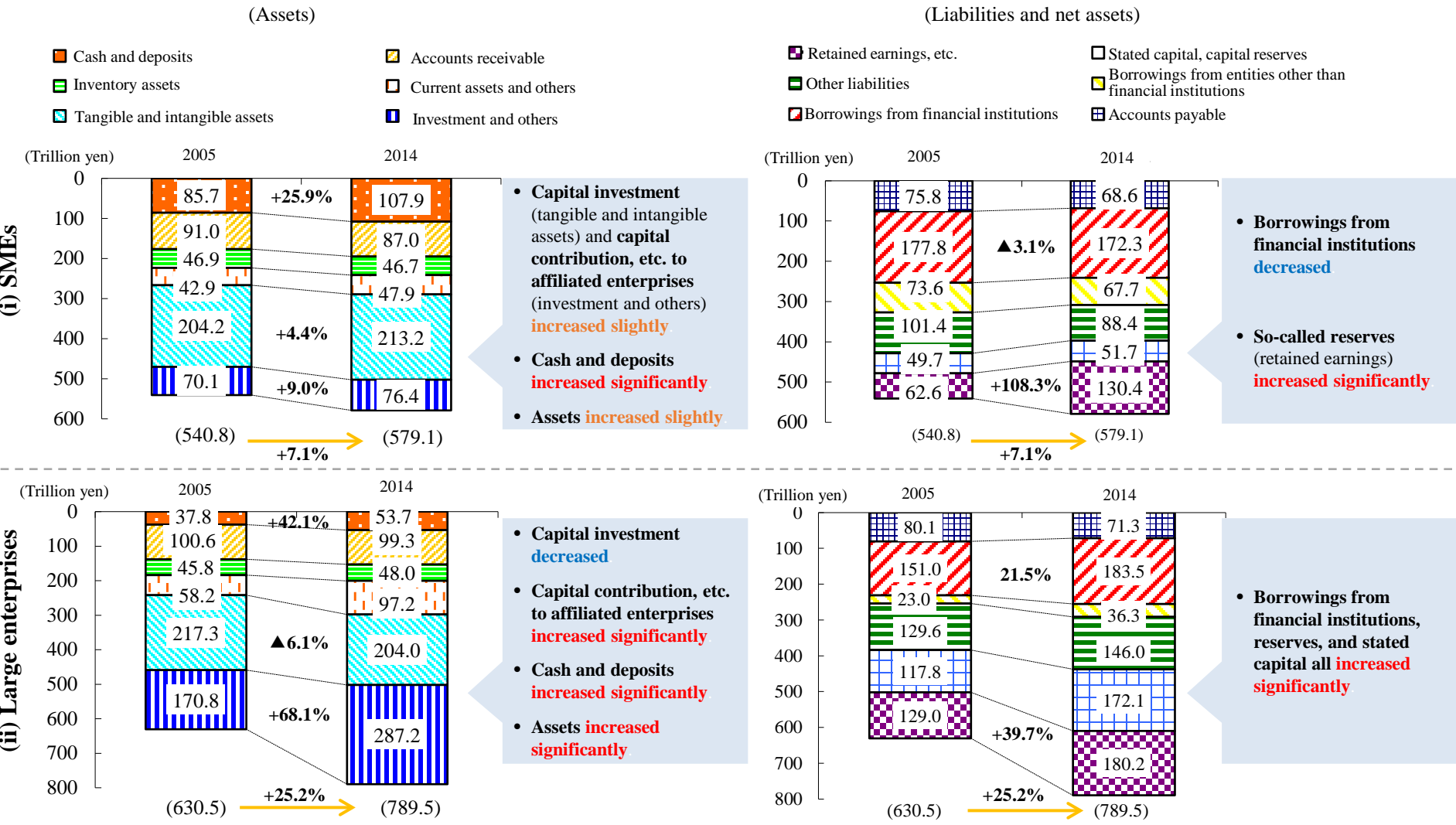
Fig. 2 Changes in Loans from Financial Institutions by Enterprise Size



[Remarks] Fig. 1: "TANKAN (Short-Term Economic Survey of Enterprises in Japan)" (Bank of Japan); [Notes] 1. Large enterprises here refer to those whose stated capital is 1 billion yen or more, and SMEs are those whose stated capital is 20 million yen or more but less than 100 million yen.; 2. Financial Position DI is obtained by subtracting the percentage of enterprises that replied their financial position is unfavorable from the percentage of those that replied their financial position is favorable.; 3. Lending Attitude of Financial Institutions DI is obtained by subtracting the percentage of enterprises that replied financial institutions' lending attitude is unfavorable from the percentage of those that replied financial institutions' lending attitude is favorable.; Fig. 2: "Monthly Report of Recent Economic and Financial Developments" (Bank of Japan); [Notes] 1. Loans include those from trust accounts and accounts of overseas branches.; 2. Only data for domestic banks are tabulated.

3. Finances Supporting Growth of SMEs (2) Background of Sluggish Borrowings from Financial Institutions

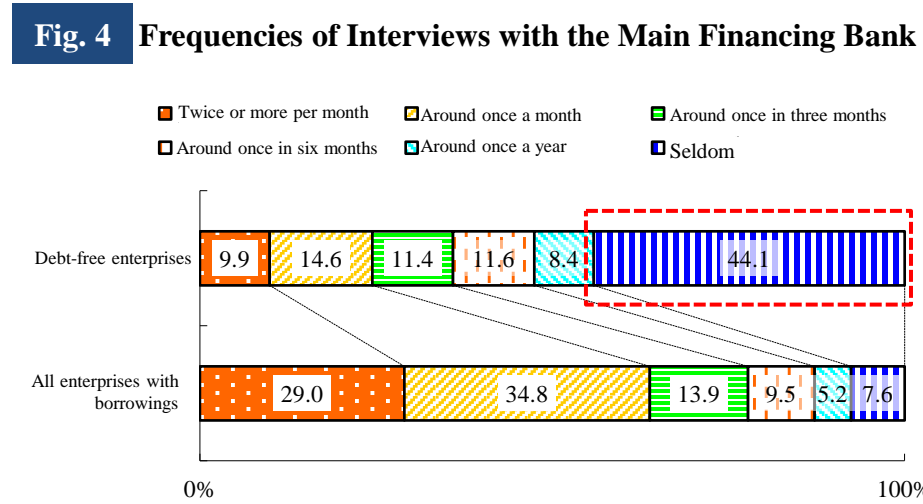
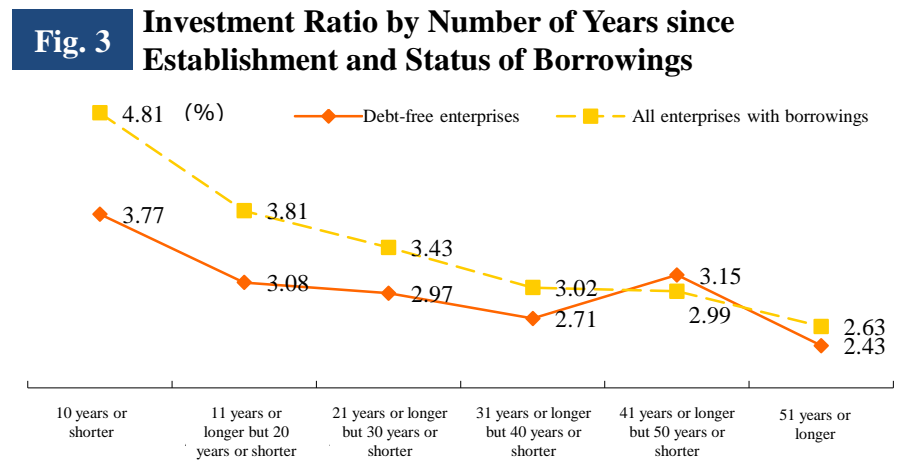
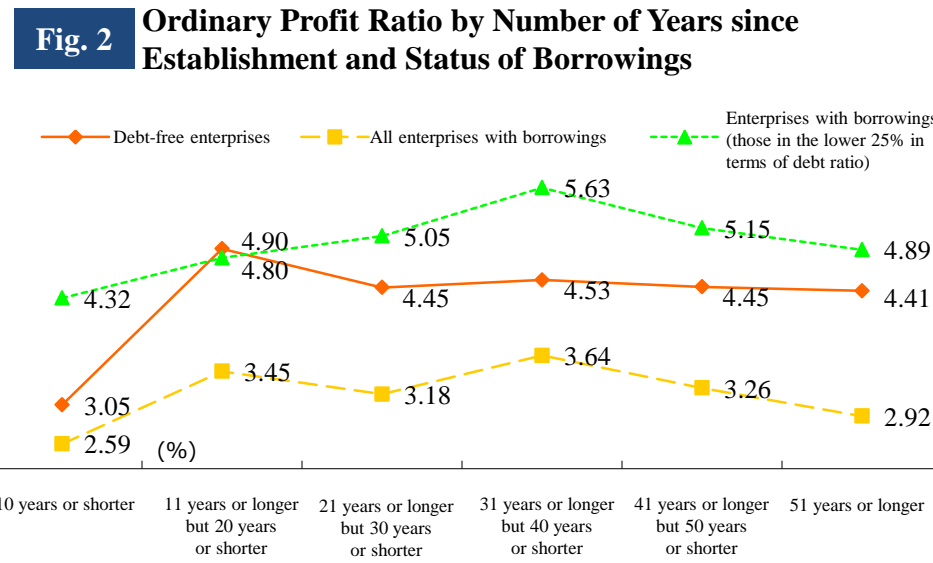
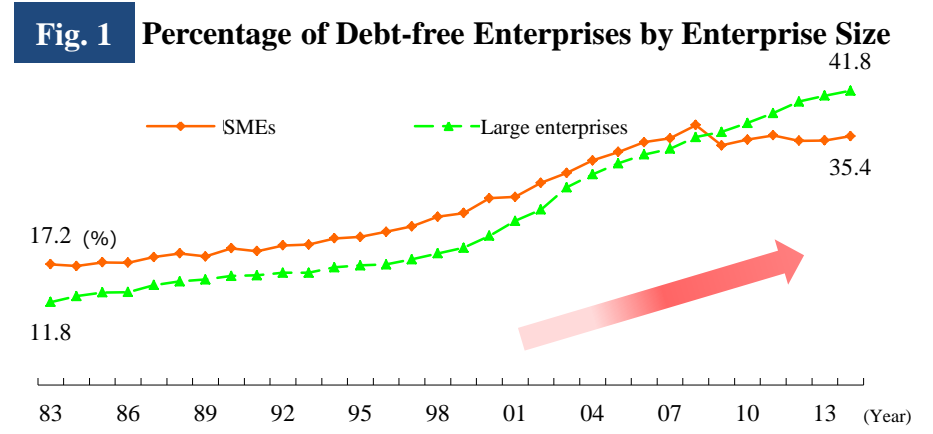
In recent years, large enterprises have promoted investment mainly in affiliated enterprises overseas by way of borrowings from financial institutions and capital increases, etc., in addition to utilizing reserves. In the meantime, borrowings from financial institutions has not increased among SMEs and their capital investment has increased only slightly.



[Remarks] "Financial Statements Statistics of Corporations by Industry (annual report)" (MOF) (rearranged and processed); [Note] SMEs are enterprises whose stated capital is less than 100 million yen, and large enterprises are those whose stated capital is 1 billion yen or more.

3. Finances Supporting Growth of SMEs (3) Current Status and Problems of Debt-free Enterprises

Enterprises free from borrowings from financial institutions are increasing, but such enterprises are apt to show lower profit ratios than those with a certain amount of debt. This is considered to be due to the fact that debt-free enterprises are generally less positive about investment and bear a tenuous relationship with financial institutions or other external entities. These enterprises should procure funds more wisely and consider making investment for achieving growth.



[Remarks] Fig. 1: "Financial Statements Statistics of Corporations by Industry (annual report)" (MOF) (rearranged and processed); [Note] Debt-free enterprises here refer to those that have no borrowings from financial institutions as of the end of the current term.; Fig. 2 and Fig. 3: "2014 Basic Survey of Japanese Business Structure and Activities" (METI); [Notes] 1. Tabulated the average ordinary profit ratios of enterprises whose ratios are from -100% or more but less than 100%; 2. Those in the lower 25% in terms of debt ratio refer to enterprises with borrowings from financial institutions whose debt ratios (debt ratio: ratio of borrowings from financial institutions among total assets) are in the lower 25%. Investment ratio here refers to the ratio of the amount of capital investment (total of tangible and intangible assets) among total assets; Fig. 4: "Survey on SMEs' Fund Procurement" (December 2015; Mizuho Research Institute) under contract from the SMEA

3. Finances Supporting Growth of SMEs (4) Methods of Fund Procurement

Financial Institutions, which are the major fund suppliers for SMEs, intend to place more emphasis on business assessment upon granting loans, but in reality, they evaluate enterprises' financial conditions and asset surpluses of the relevant enterprises and managers. In order to realize lending based on business assessment, enterprises themselves need to better communicate their future business plans, etc.

Fig. 1 Suppliers of Funds Necessary for Resolving Problems to Achieve Growth

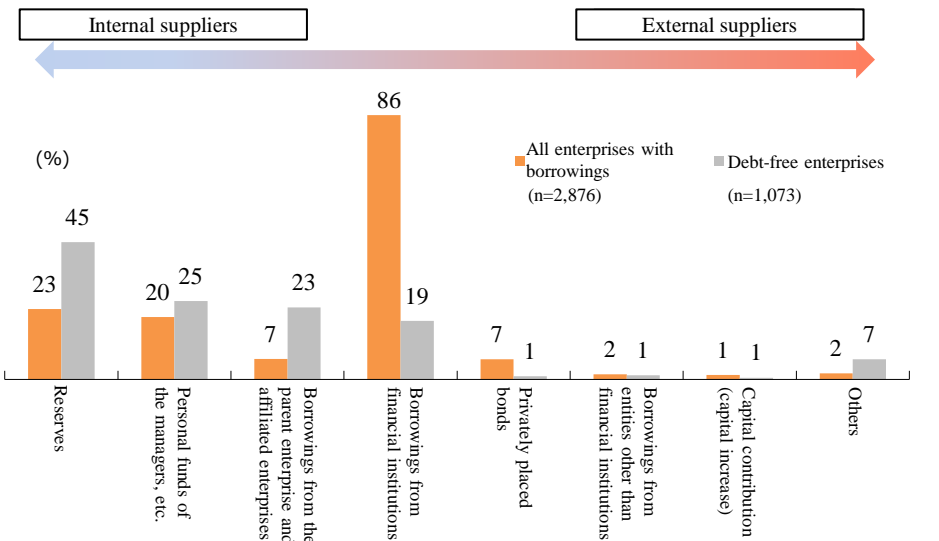


Fig. 3 Matters Evaluated by Financial Institutions Other than Collateral and Guarantees

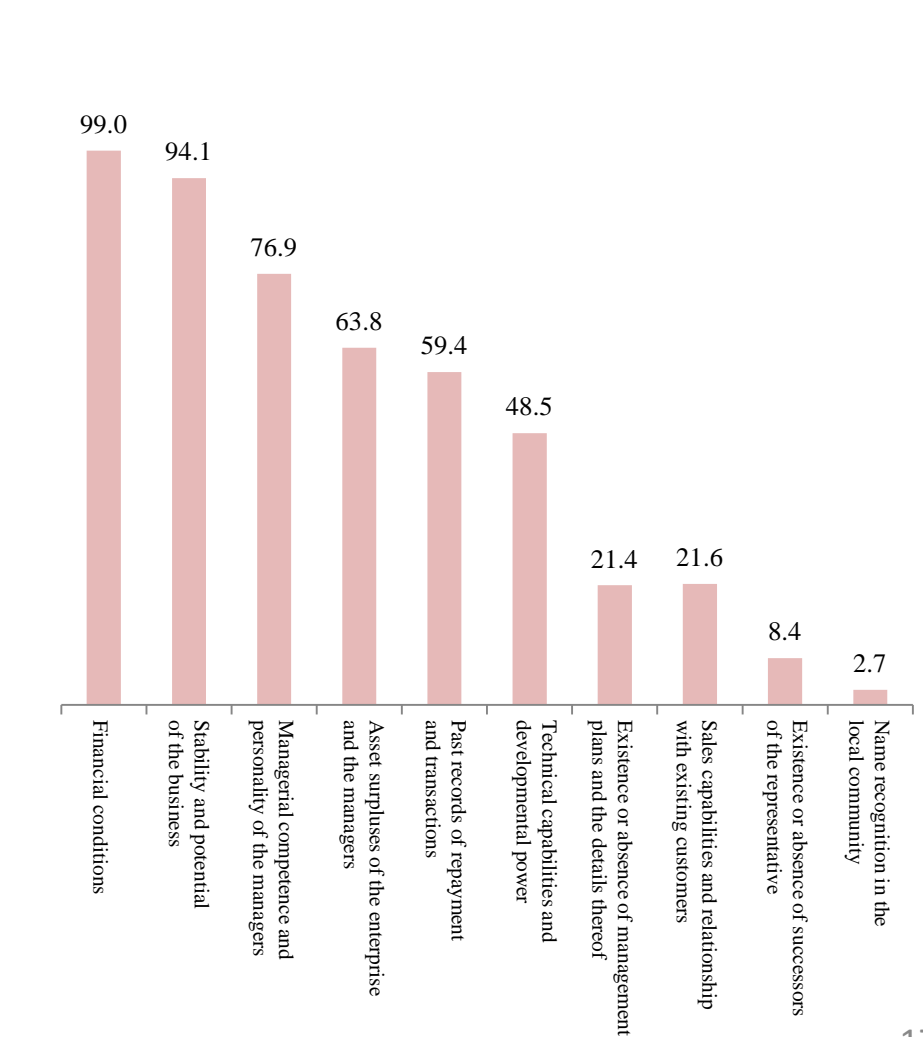
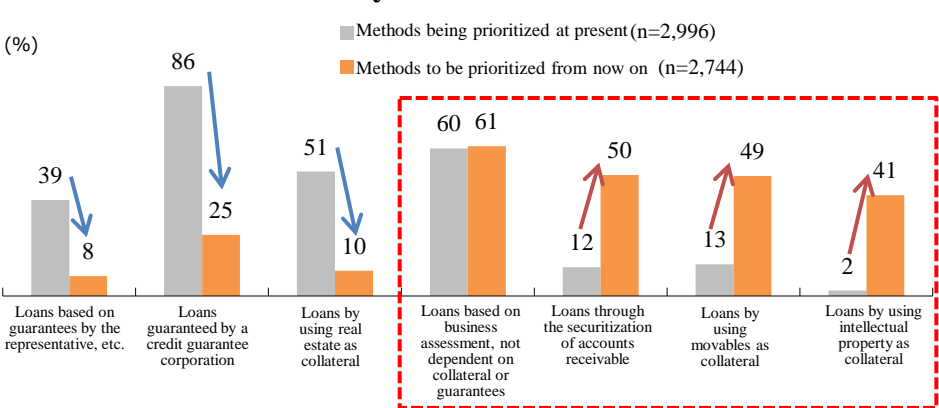


Fig. 2 Methods of Granting Loans Being Prioritized and To Be Prioritized by Financial Institutions



[Remarks] Fig. 1 to Fig. 3: "Survey on SMEs' Fund Procurement" (December 2015; Mizuho Research Institute) under contract from the SMEA; [Note] Tabulated top five answers

3. Finances Supporting Growth of SMEs (5) Strengthening of Support Systems

Financial institutions positive about business assessment are also striving to collaborate with external organizations in order to respond to needs of enterprises and have successfully increased lending or achieved other outcomes. Financial institutions should strengthen collaboration with experts such as certified accountants and tax accountants, who often receive consultations from SMEs, and grant loans based on business assessment or offer other non-financial support to help growth of SMEs.

Fig. 1 Efforts for Enhancing Ability to Make Proper Lending Decisions and Results Thereof by Attitude toward Lending Based on Business Assessment

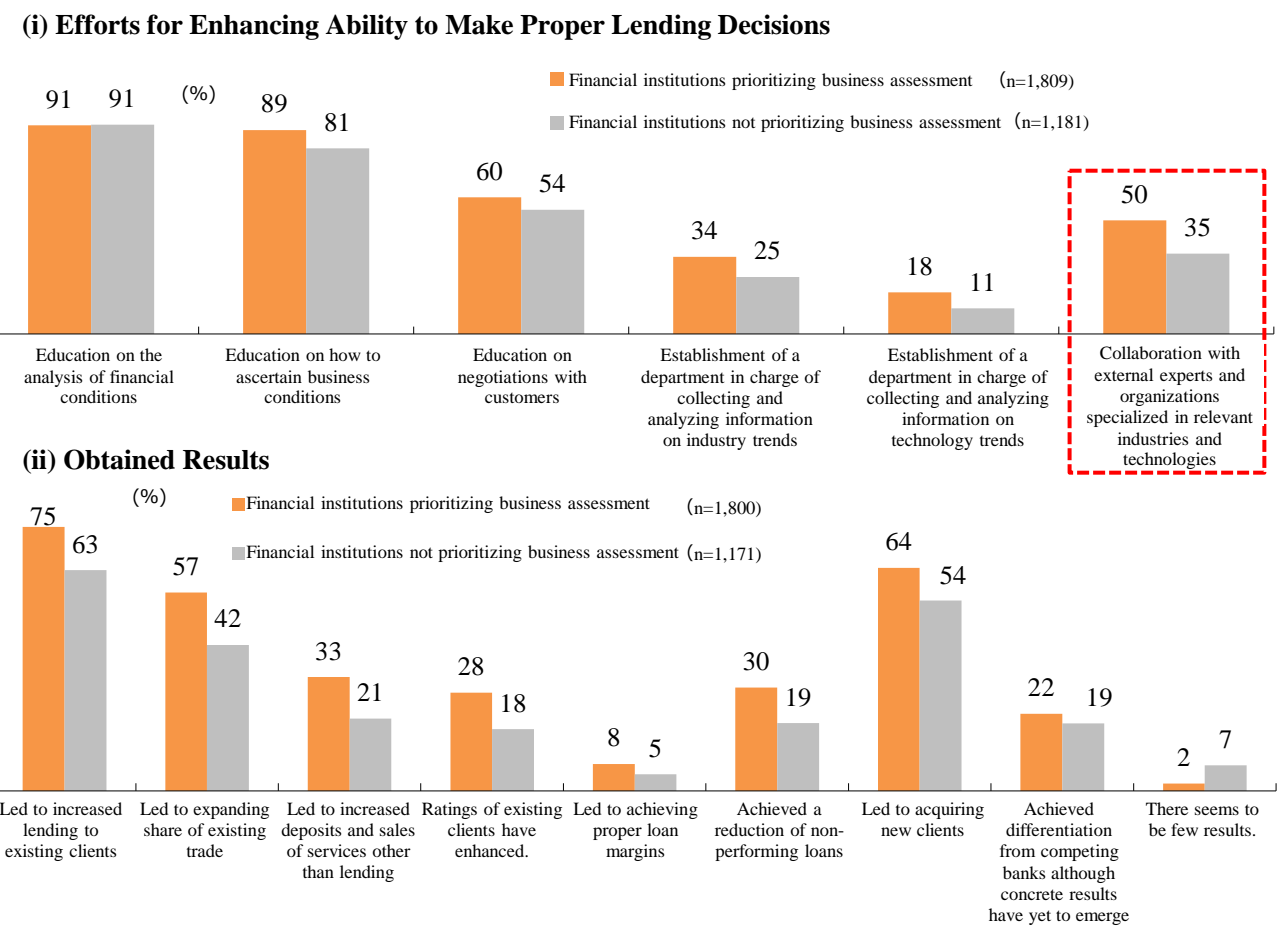
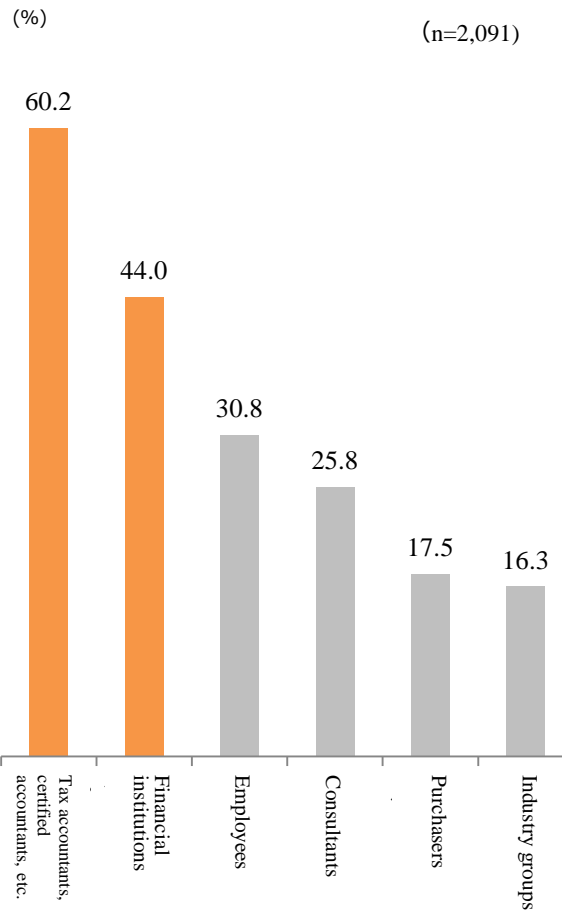


Fig. 2 Persons to Consult concerning Risk-taking Actions

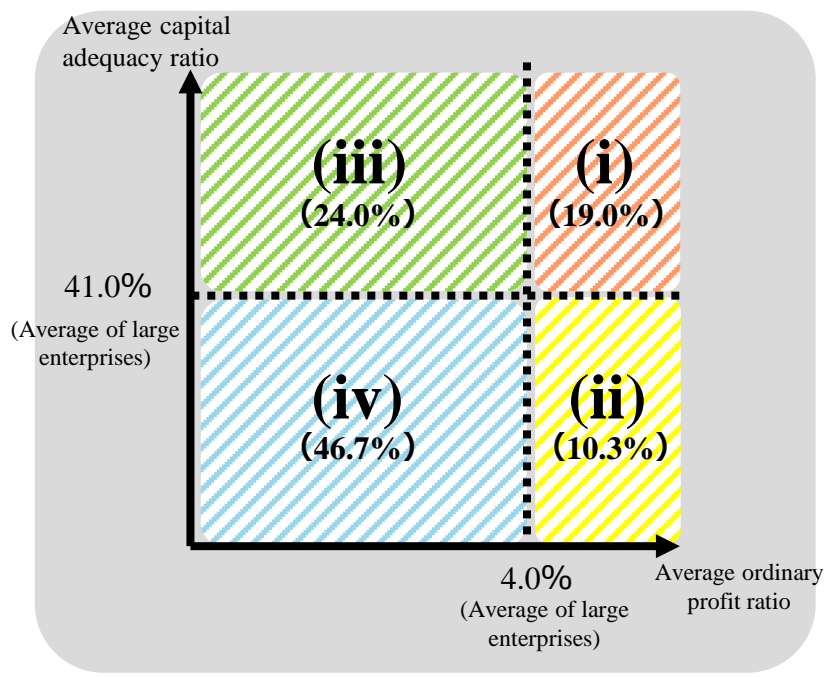


[Remarks] Fig. 1 and Fig. 2: “Survey on SMEs’ Fund Procurement” (Mizuho Research Institute) and “Questionnaire Survey on Growth and Investment Behavior of SMEs” (Teikoku Databank, Ltd.) under contract from the SMEA

4. Management Power of SMEs (1) Profitability

In order to ascertain characteristics of SMEs with high earning power, we classified and analyzed SMEs from the viewpoint of profit ratios and capital adequacy ratios. In terms of profit ratios, polarization is progressing among SMEs.

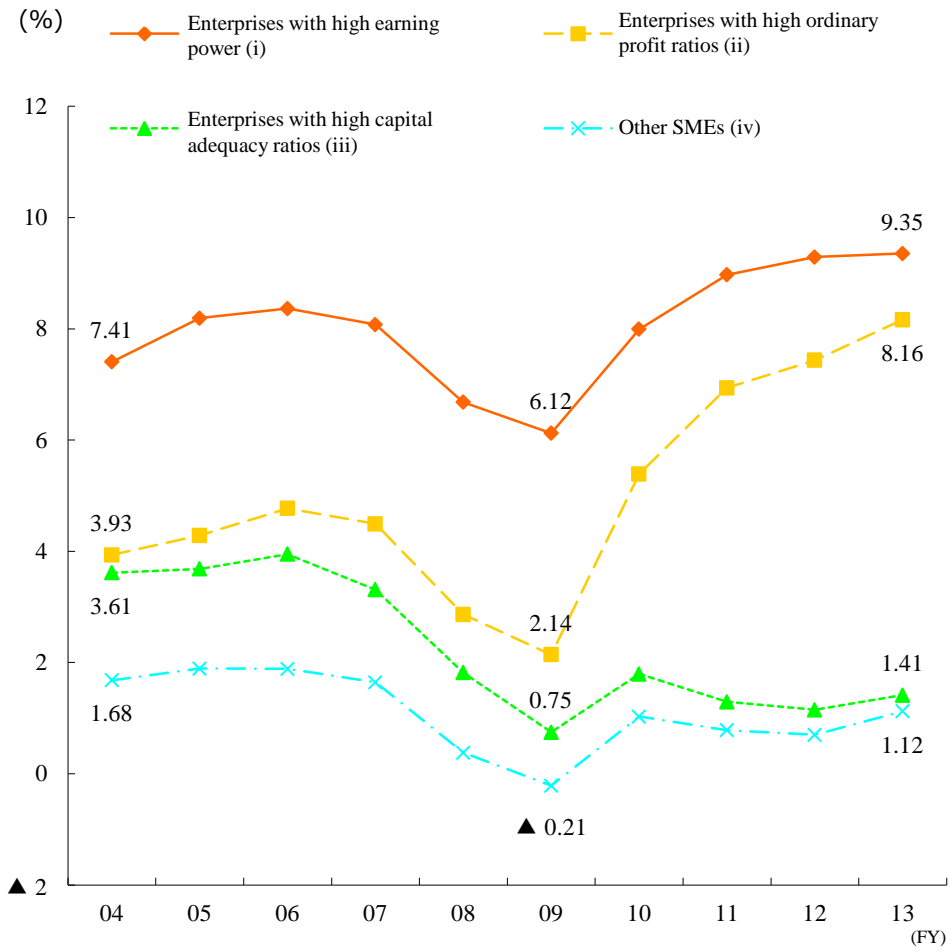
Fig. 1 Notion of Classification



- [Classification of enterprises]*
- (i) Enterprises with high earning power
 - (ii) Enterprises with high ordinary profit ratios
 - (iii) Enterprises with high capital adequacy ratios
 - (iv) Other SMEs

* Approximately 10,000 SMEs are classified based on their average ordinary profit ratio and capital adequacy ratio for three years from 2011 to 2013, while using the average ordinary profit ratio among large enterprises (4.0%) for the X-axis and the average capital adequacy ratio among large enterprises (41.0%) for the Y-axis.

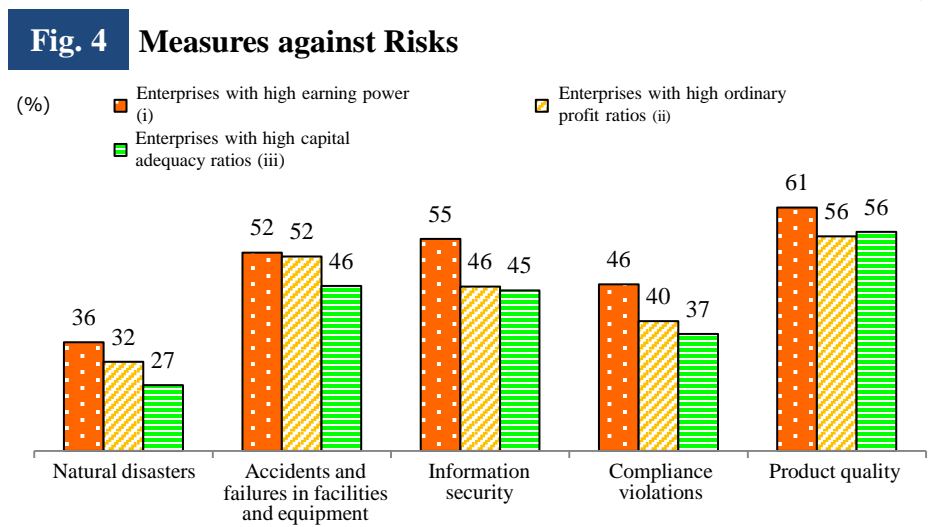
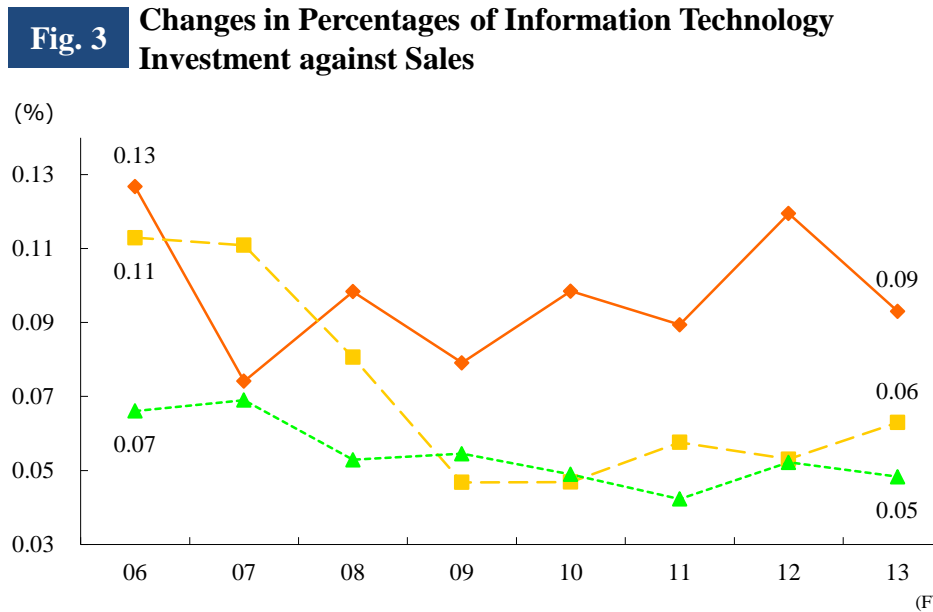
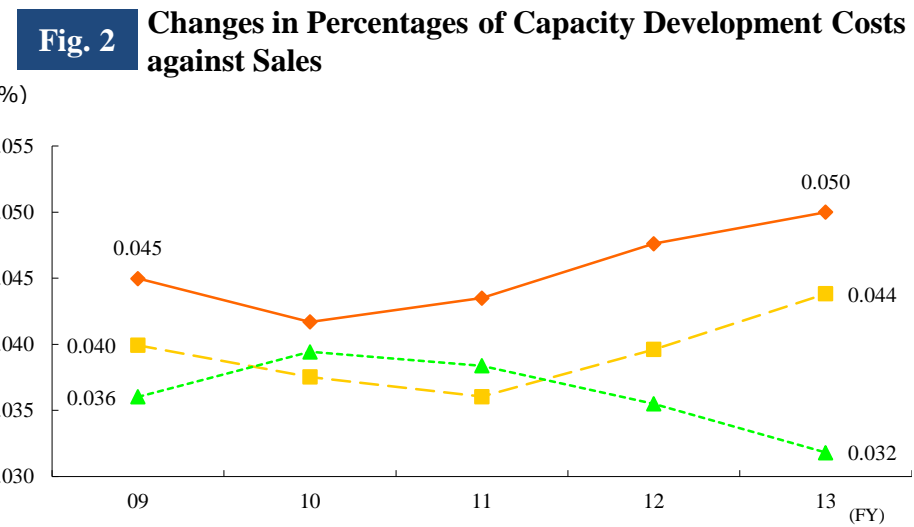
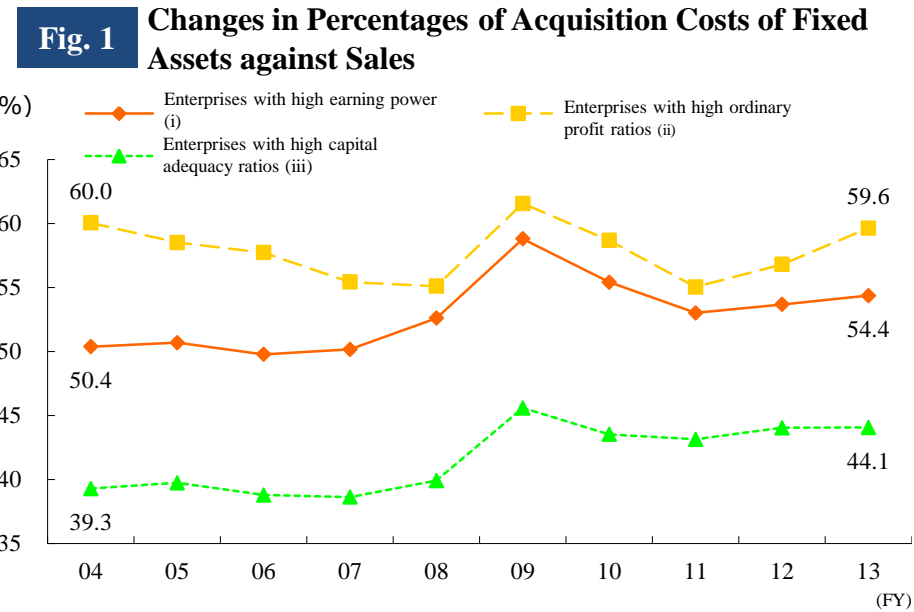
Fig. 2 Changes in Ordinary Profit Margins



[Remarks] Fig. 1 and Fig. 2 “Basic Survey of Japanese Business Structure and Activities” (rearranged and processed);
[Note] Excluding enterprises with less than 50 employees or those whose stated capital or contribution is less than 30 million yen

4. Management Power of SMEs (2) Investment

Looking at actual investment behavior, high-profit enterprises are actively making investment and promoting measures against information security risks and other risks, while low-profit enterprises are apt to be conservative about investment.



4. Management Power of SMEs (3) Managers' Characteristics (i)

High-profit enterprises are apt to have a corporate cultures that champion active, strategic engagement to meet new challenges. It has been noted that managers of SMEs who decide investment behavior are aging and that SMEs are generally more change adverse.

Fig. 1 Corporate Culture

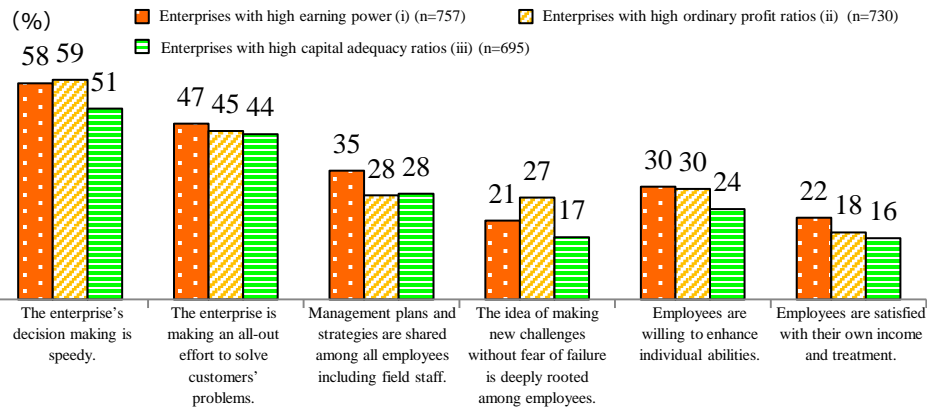


Fig. 2 Changes in Percentages of Aged Managers (by number of employees)

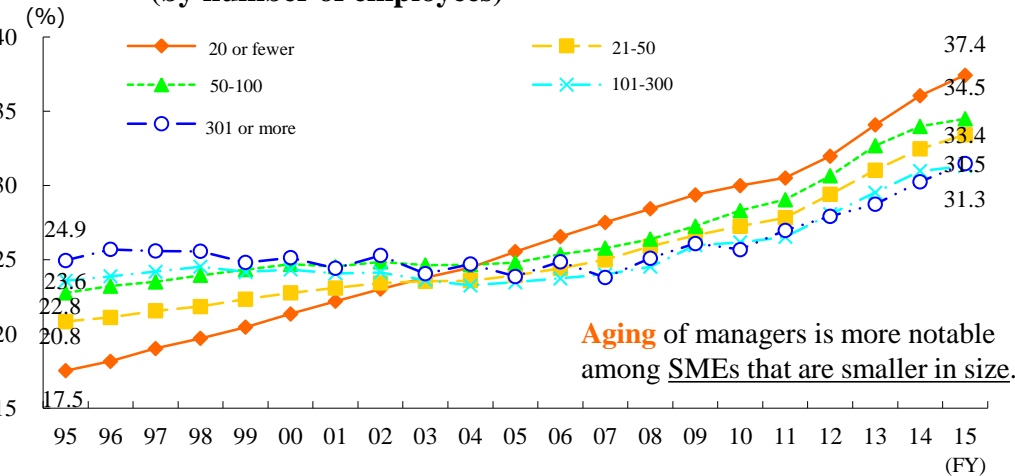
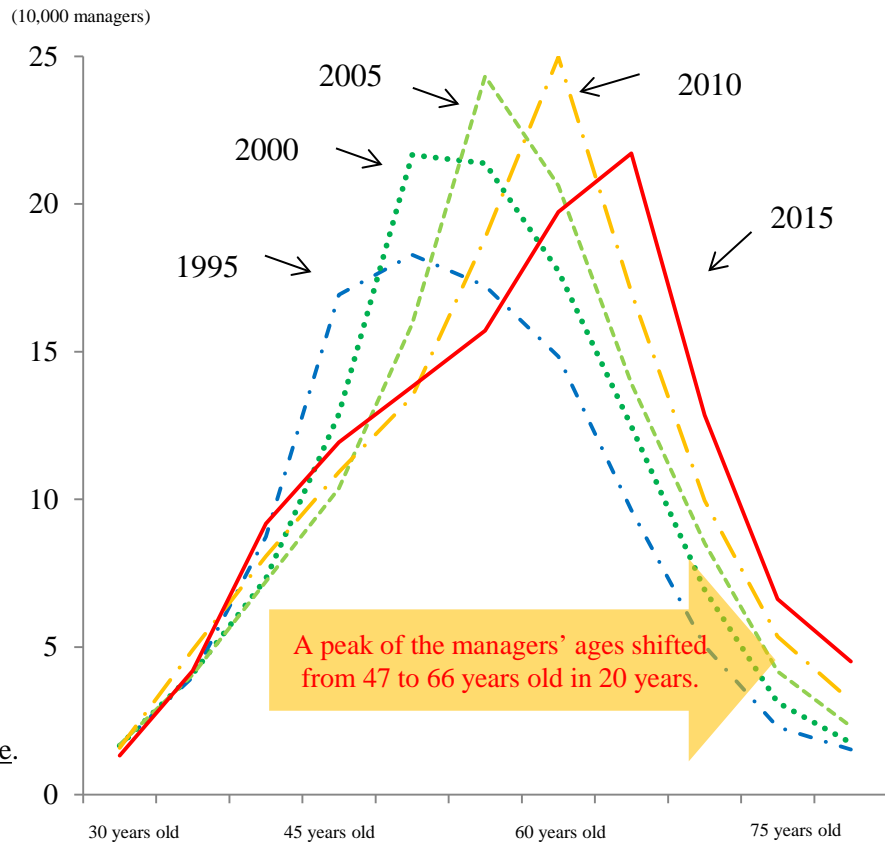


Fig. 3 Distribution of Ages of Managers of SMEs (by five-year interval)



[Remarks] Fig. 1 to Fig. 3: "Questionnaire Survey on Growth and Investment Behavior of SMEs" (December 2015; Teikoku Databank, Ltd.) under contract from the SMEA and "COSMOS1 (unconsolidated corporate financial file)" and "COSMOS2 (corporate information file)" (Teikoku Databank, Ltd.) (rearranged and processed); [Note] Fig. 2 and Fig. 3 are prepared based on data for approximately 1.2 million SMEs held by Teikoku Databank, Ltd.

4. Management Power of SMEs (4) Managers' Characteristics (ii)

The older the manager is, the less positive the enterprise is toward investment, preferring to avoid risks. Enterprises that have started afresh under a new manager show slight increases in profit ratios, and this fact suggests the importance of deliberately planned business succession.

Fig. 1 Awareness concerning Growth by Age Bracket of Managers (%)

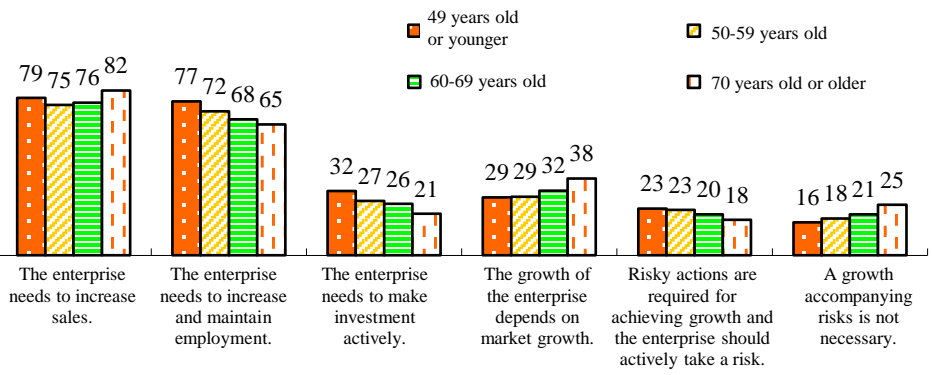


Fig. 2 Appetite for Investment for the Coming Three Years (%)

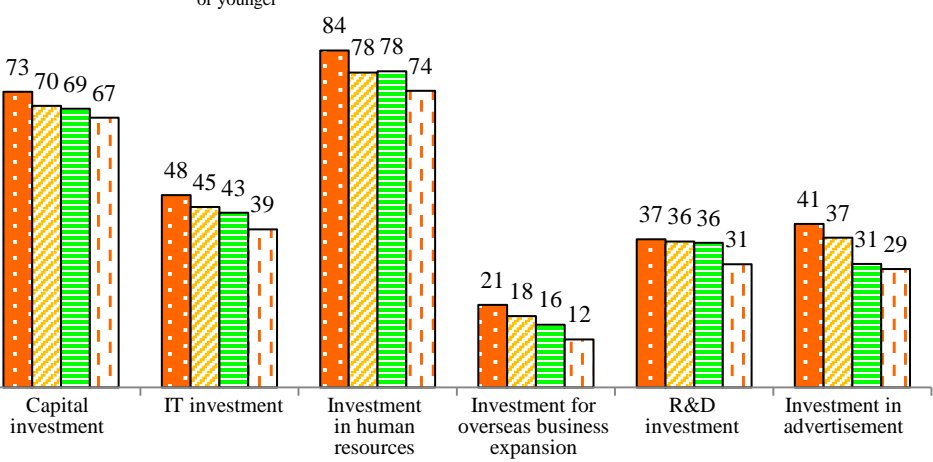
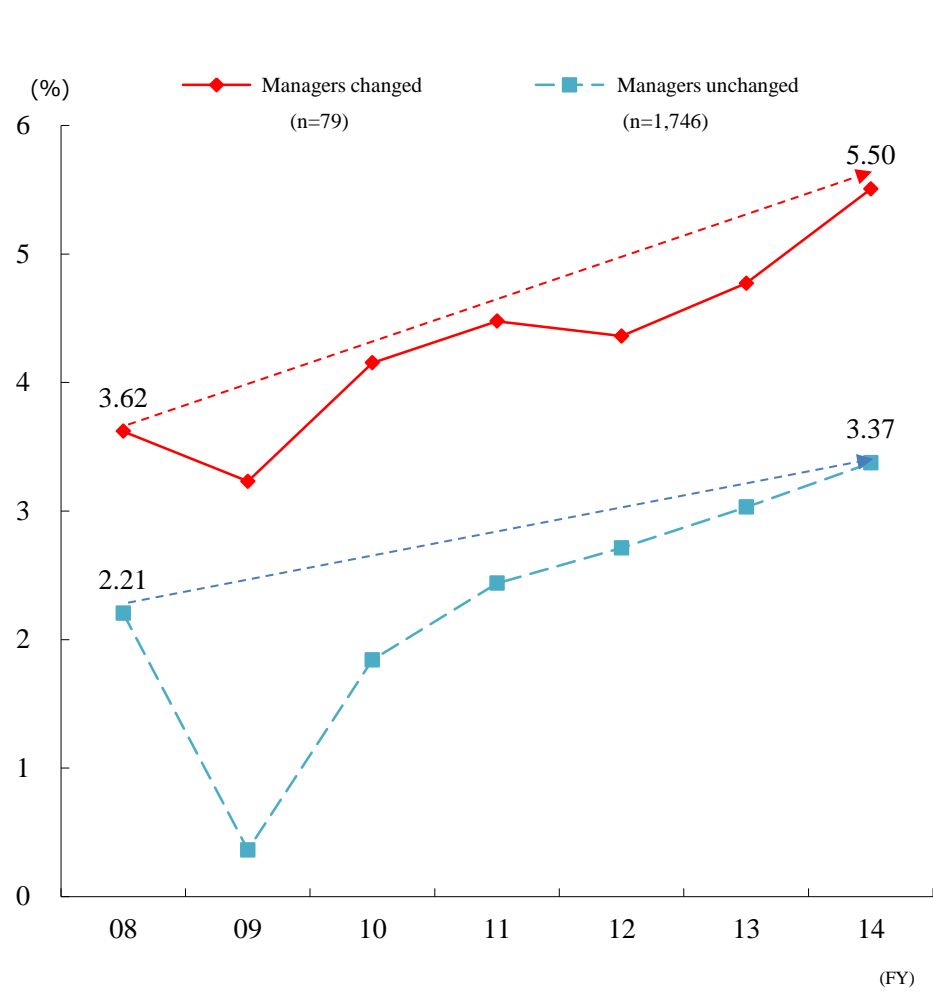


Fig. 3 Differences in Ordinary Profit Ratios through Change of Managers



[Remarks] Fig. 1 and Fig. 2: "Questionnaire Survey on Growth and Investment Behavior of SMEs" (December 2015; Teikoku Databank, Ltd.) under contract from the SMEA; Fig. 3: "COSMOS1 (unconsolidated corporate financial file)" and "COSMOS2 (corporate information file)" (Teikoku Databank, Ltd.) (rearranged and processed); [Note] With regard to managers aged between 55 and 64 as of FY2007, ordinary profit ratios were compared based on whether managers changed from FY2007 to FY2008 or not.

Earning Power of SMEs: Summary

1 Efforts by SMEs with High Earning Power

- The 2016 White Paper on Small and Medium Enterprises focuses on the earning power of SMEs, and the various measure being taken in order to increase profits. The analysis is centered on IT investment, overseas business expansion, and risk management.
- Enterprises that are making profits through these efforts show commonalities in that they (i) clarify visions, (ii) listen to opinions of employees, (iii) foster personnel and (iv) enhance business processes, thereby further enhancing productivity. One of the common shared challenges is labor shortages.

2 Finances Supporting Growth of SMEs


- The percentage of debt-free enterprises is increasing, but enterprises with a certain amount of borrowings generally have better earning capacity.
- It is primarily financial institutions that supply necessary funds to SMEs for making growth investment.
- Financial institutions evaluate enterprises' current financial conditions and asset surpluses upon making lending decisions.



In order to realize lending based on business assessment, **financial institutions should change their stance to offer support to enterprises in collaboration with other organizations**, while **enterprises should strive to positively communicate their business plans, etc. to financial institutions.**

3 Management Power of SMEs with High Earning Power

- Low-profit enterprises are conservative about investment, but high-profit enterprises are making investment positively in a planned manner while preparing for risks.
- Enterprises that have started afresh under a new manager show better earning capacity than those whose managers remain unchanged.



It is important for an enterprise manager to clarify the corporate philosophy, operate the enterprise in a well-organized manner based on opinions of field staff and in collaboration with financial institutions and other external experts, promote growth investment and stimulate the corporate metabolism, thereby striving to enhance earning power of the enterprise.