

**JAPANESE SMALL ENTERPRISE DEVELOPMENT  
COOPERATION OVERSEAS:  
LINKAGES WITH JAPAN'S INDUSTRIAL ORGANIZATION AND  
TIES WITH JAPANESE SMEs**

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**FOREWORD:**

Small and Medium Enterprises are generally considered, both in developed and developing countries, as economic agents mainly responsible for employment creation and income generation, especially in comparison with large firms and transnational corporations, whose national and global contributions to employment is less significant. Therefore, any institution in charge of labour studies tends to devote some attention to the SME sector.

I would like to express my deep appreciation to the Japanese Institute of Labour Policy and Training (JILPT), Tokyo, for its generous invitation to visit Japan for two weeks as a foreign guest scholar (26 Sept.- 6 Oct. 2006). My gratitude also goes to both Mr Hayashi, Counsellor, Permanent Mission of Japan to the United Nations in Geneva, and to Professor Naoki Kuriyama, Faculty of Business Administration, Soka University, in Tokyo, who have introduced me so kindly to the JILPT in autumn 2005 and encouraged me to present a short visit research proposal.

Before my arrival on September 24th, 2006, I did not know in realistic terms how I would be able to conduct in only two weeks the proposed research, and to demonstrate in particular the linkages between Japanese domestic SME promotion policy and Japanese SME development cooperation overseas. I was fortunate to be introduced by Professor Kuriyama to two Senior Advisors of the Japanese International Cooperation Agency (JICA), namely Mr Yoshio Koyama and Mrs Yoko Suzuki, and to one Senior Advisor of JIBC, Mrs Kazuko Kano during the first 2-3 days of my research visit in Tokyo. These early meetings proved to be rather decisive for my following research orientations all along my stay. Therefore, I would like also to thank the three of them very warmly for their kind support, and even more specifically Mr Koyama, who showed so much interest in my research that we met about five times between Sept. 26th and Oct. 6th, 2006.

Finally, I would like to express my thanks to all Japanese colleagues and staff, who have facilitated this piece of field research work in Tokyo, and/or taken the

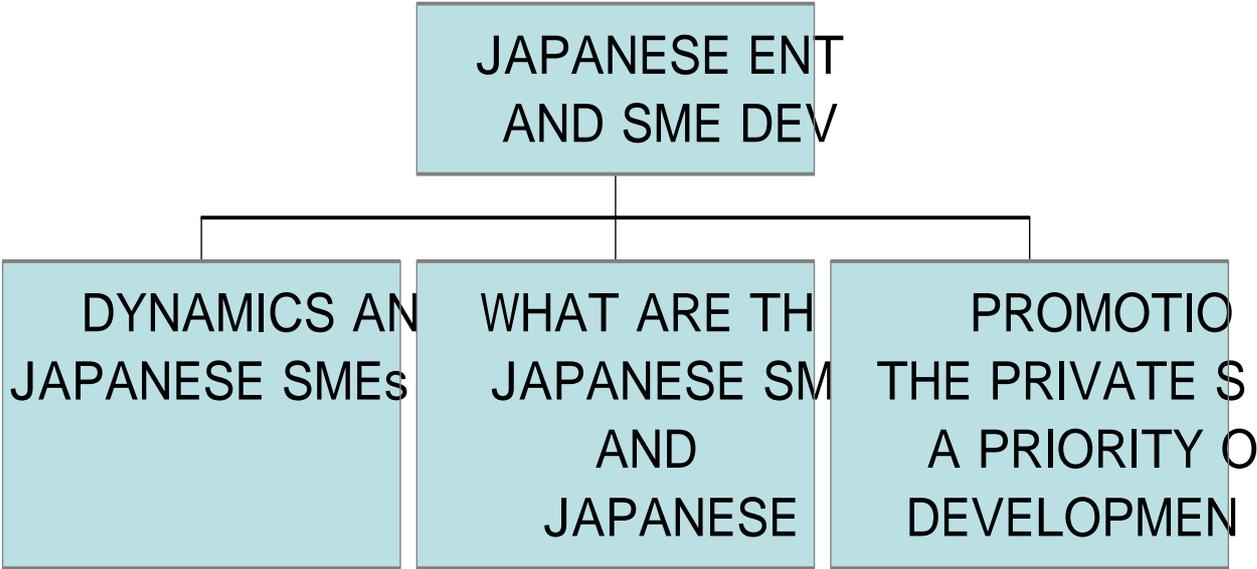
time to make themselves available to receive me for a research interview (see list of visited institutions in the annex). Some of them may consider to visit me in the future at our Geneva-based Graduate Institute of Development Studies, and they will be welcomed with much pleasure and full reciprocity.

**ARGUMENTARY:**

**The Research Hypothesis?**

The economic miracle of Japan since the Meiji restoration in the late 19th century, and especially since 1945, is based on two legs. Of course, the contribution of Japanese large firms and conglomerates (like pre-War zaibatsus) is universally well known. However, the dynamics of subcontracting, more autonomous, or highly specialized SMEs is less documented, except in the Japanese language, and therefore less well identified by the international community. Yet, The annual White Paper on Small and Medium Enterprises in Japan, also published in English, is very detailed and one of the best of its kind worldwide (*Japanese Small Business Research Institute, 2006, White Paper on Small and Medium Enterprises in Japan, Small and Medium Enterprises at a Turning Point : Strengthening Ties with Overseas Economies and Population Decline in Japan, Tokyo, Ministry of Economy, Trade and Industry, Small and Medium Enterprise Agency*).

The whole idea for this paper is based on the assumption that Japanese SME development cooperation overseas is linked to a rather great extent to the Japanese domestic experience of the Japanese SME sector. In other words, the proposed hypothesis tends to suggest that it is rather impossible to understand how Japanese SME development cooperation overseas is structured and operationally organized without some knowledge of Japanese contemporary economic history in general, and more specifically of Japan’s modes of industrialization including small enterprise promotion policies and development experiences.



## Two sources of scientific theoretical background

The research hypothesis is embedded in two sources of international scientific literature, which are also recognized and well known among Japanese academia and think tanks.

First, entrepreneurship studies and small enterprise development economics are well established subjects covered by social sciences, mainly in economics and management. On the one hand, the importance of the economic and social contribution of SMEs has been heavily studied in economic history and history of industrialization. These two subdivisions of history as a scientific subject have been inspired by the historical experiences of Europe and Japan, and have gradually been extended to developing and newly emerging countries. On the other hand, management studies have become a sub-segment of economics for several decades, especially in Northern America and Western Europe, with a strong focus on large firms and transnational corporations, and less on small and medium enterprises, which were for long considered as a transitory phenomenon and were supposed to grow to become large firms. However, the enterprise growth theory has been extensively contested since the 1960s and new theories such as those concentrating on industrial districts, clusters and flexible specialization of small enterprises have flourished (*Frank Pyke and Werner Sengenberger, 1992, Industrial Districts and Local Economic Regeneration, Geneva, ILO, International Institute of Labour Studies*). Furthermore, the 1980s and 1990s have contributed to the emergence of a new management subject, namely entrepreneurship studies, which suggest a pluridisciplinary approach to study entrepreneurs and enterprises, including contributions derived from behavioural psychology, economic history, sociology, economics, business law, management and engineering sciences (*Simon Bridge and other authors, 1998, Understanding Enterprise, Entrepreneurship and Small Business, London, MacMillan Business*).

Second, SME development cooperation policy of any country, including Japan, is considered as a sector, among others, of national development cooperation. The study of both national and international development cooperation is usually considered as part of so-called development studies, which is an academic pluridisciplinary theme researched and taught worldwide, including in Japan. The study of development cooperation generally focuses on the role of the OECD governments in shaping specific policies, definite instruments and field projects in order to provide overseas development aid (ODA) to developing countries worldwide. The SME promotion sector is present in most ODA policies conducted by the OECD countries during the last 30 to 40 years. Even though development studies tend to concentrate on public ODA policies, it also englobes the study of non-governmental actors such as the business private

sector, and non-governmental organizations. These two types of actors play a substantial role in the development and internationalization of SMEs.

Thirdly, ODA policy is usually considered as one segment or one pillar of foreign/external policy of the OECD countries, whether they were former colonial powers or not. Foreign/external policy is supposed, both theoretically and at the operational level, to reflect, directly or indirectly, the domestic core experiences and also the strategic interests of a country. Both ODA and external economic relations are important components of foreign policy, and small enterprise promotion can make some contribution on both fronts. This type of analysis explains why the research hypothesis presented in this article tends to suggest that SME ODA cooperation policy of Japan may be derived, at least partly, from Japan's SME development experience at home first.

### **National entrepreneurship capacity building: SME development is important both in developed and developing economies**

There is a rather substantial literature demonstrating that the SME sector is important, if not vital, for the sustainable economic and social development of both OECD and non OECD countries, with hardly any exception (*United Nations, 2004, Unleashing Entrepreneurship: Making Business Work for the Poor, New York, Commission on the Private Sector and Development, Report to the Secretary-General of the United Nations*). This observation is also valid for Japan, both in terms of historical retrospective and anticipating future developments.

The Japanese International Cooperation Agency (*JICA, 2002, Approaches for Systematic Planning of Development Projects: Promotion of Small and Medium Enterprises, Tokyo, Institute for International Cooperation*) has identified five key functions performed by SMEs internationally, which are classified as follows:

1. SMEs perform a substantial contribution to national economic activity,
2. SMEs are a major source of economic dynamism, thanks to their flexibility and capacity to specialize,
3. SMEs are a major source of provision of outsourcing products and services,
4. SMEs perform stabilizing economic and social functions at all levels of society, both in urban and rural areas,
5. SMEs are major contributors to regional, local and community economic development.

These five criteria identified by JICA can be linked to a world open debate regarding the dual economic versus social contributions of SMEs. This debate

tends to focalize on two major aspects of the discussion summarized by the above criterias as follows.

On the one hand, criterias 1, 2 and 3 as listed by JICA procede from the prioritization of the economic growth argument. This type of argument is the core one used by most governments and policy makers, in national and international fora. As a matter of fact, Japanese economic policy makers as well as Japanese SME ODA policy makers tend to valorize the economic role of SMEs, which can be measured by their quantitative and qualitative contributions to the growth of the national economy as well as to the growth of developing nations.

On the other hand, criterias 4 and 5 can be related to the fact that the role of SMEs is also frequently instrumentalized as one of the efficient tools to fight poverty in developing countries, and to contribute more generally to social development through the creation of employment and income generating activities. Under this argument, the SME sector should be understood as including not only properly registered and well idenfied SMEs, but also microenterprises and micro-level activities in petty manufacturing or services (often called the informal or underground sector). They provide employment and income to the poor and the most vulnerable segments of society.

This dual debate dealing with the economic and social virtues of the SME sector is less vibrant in Japan and the other OECD economies, than in the developing world. In LDCs, the conceptual distinction between the economic and social spheres is less clear than in developped countries having proper social policies. More importantly, the informal sector does exist in most OECD countries, but it tends to be residual or marginal except in a few economies such as Italy for instance. The situation is rather different in most developing and emerging countries, where the economic and social inclusion role of microentrepreneurship activities through microenterprises and very small firms, cooperatives, NGOs, self-help groups and other types of local communities is estimated to be very substantia (Amartya Sen, Nobel Price in Economics, 1999, Development as a Freedom, Alfred Knopf Publishing Inc.). Therefore, it can be said that the informal economy combined with the SME sector represent the bulk of the economy in the developing world, and it should be at the centre of any ODA policy.

## **PART ONE:**

### **THE ROLE OF SMEs IN THE JAPANESE ECONOMY AND ITS RELEVANCE IN THE FORMULATION OF JAPAN'S SME INTERNATIONAL COOPERATION**

Part one deals with the structural role of SMEs in the Japanese economy, and paves the way to part two, which documents Japan's SME international

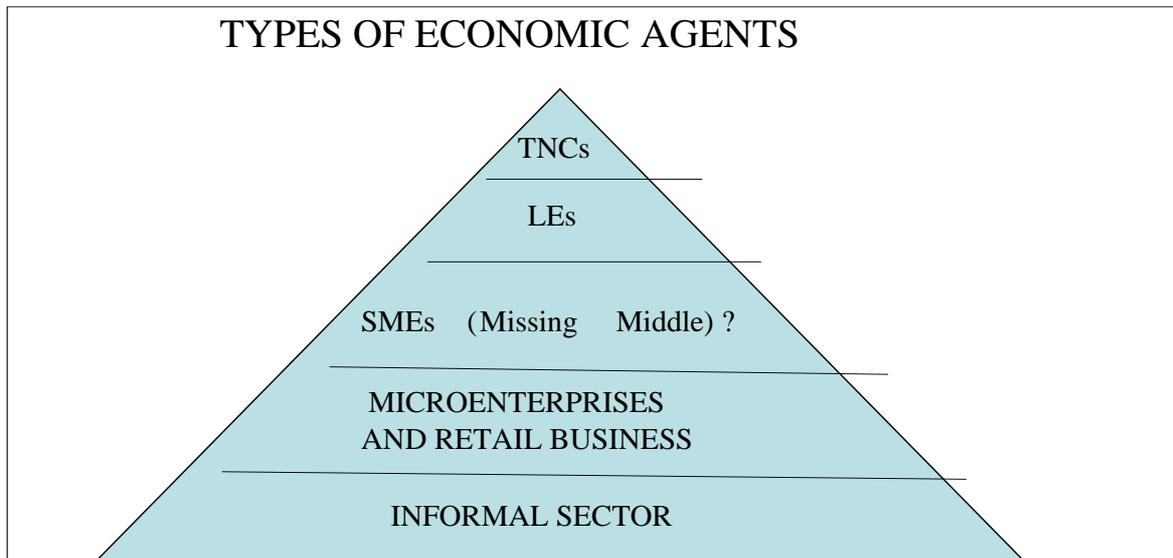
cooperation overseas. As underlined in the above discussion of the research hypothesis, it is assumed that both the domestic and overseas cooperation public policies of Japan are rather intimately interlinked. Actually, SME public policy has traditionally been rather sophisticated in Japan in comparison to most other OECD economies. It used to play a function of guidance along the industrialization process before and especially after World War II. This role has been gradually supplanted, both domestically and overseas, by the Japanese private sector and particularly by the Japanese transnational corporations. Due to the globalisation of vast segments of the Japanese industry, some Japanese SMEs have even become SME transnational corporations in their turn. (Masataka Fujita, 1998, *The Transnational Activities of SMEs*, Boston, Kluwer Academic Publishers).

### **1. Structure of national production both in developed and developing economies**

The structure of national production in manufacturing and services, both in developed and developing economies can be visualized as a pyramidal system ranking various types of economic agents. These agents can be classified as follows:

- i) Transnational corporations (TNCs), which are active on international and global markets,
- ii) Large enterprises (LEs), which are active both on domestic and external markets, but which have usually not become global firms,
- iii) Small and medium enterprise (SMEs), which are composed either of subcontracting SMEs linked to other SMEs, to LEs and sometimes even to TNCs directly, or of independent and highly specialized SMEs working for the domestic market, and more seldom overseas as well.
- iv) Microenterprises and retail business prevail especially in the service sector, and in manufacturing sub-sectors or locations where demand and/or supply remain constrained and limited for various structural reasons (*National Life Finance Corporation, 2006, Trends of Small Business in Japan, NLF-CRI Report no 14, August*).
- v) The informal sector, also called the unregistered or parallel/underground economy, englobes tiny or highly fragmented enterprises and networks, which are not legally registered, function outside any administrative and public control framework, and do not appear in national statistics.

# STRUCTURE OF NATIONAL PRODUCTION



Three major differences can be identified between developed economies such as Japan, and developing ones:

- i) At the top of the pyramid, TNCs and LEs are very few in developing countries. TNCs are not indigenous firms at all, but are foreign affiliates originating from Japan and other OECD economies, sometimes from emerging ones (like Brazil, China, India,...).
- ii) At the bottom of the pyramid, the informal sector is usually very substantial in developing countries and it also includes microenterprises and the majority of retail business (*Malcolm Harper, 1984, Small Business in the Third World, New York, John Wiley and Sons*). Most transactions in the informal sector contribute more to the economics of survival of poor or vulnerable segments of society than to market economics as understood in the OECD countries. In these countries on the contrary, most microenterprises and retail business have a proper legal and fiscal status and clearly appear in national statistics. Therefore, the informal sector is reduced to a very small fragment of the national economy, especially in Japan where public registration and control of business activities is considered as highly efficient. In the Japanese context, and in other OECD economies as well, the informal economy tends to correspond to the illegal economy, where economic agents tend to evade fiscal control or to conduct various types of criminal and other underground activities.
- iii) The middle of the pyramid is the most interesting for the discussion of this paper. SMEs have played and continue to play a substantial if not prevailing role in most OECD economies, especially in Japan and

Europe, and to a lesser extent in Northern America. Their contribution is important not only on the front of employment and income creation, but also on the front of making production flexible and specialized in many sub-sectors where large firms cannot enter or would be less efficient due to lack of economies of scale. On the contrary, most developing countries and all least developing ones have very few SMEs beyond their very large microenterprise and informal sector. Due to a such so-called « missing middle» (missing SMEs), their system of production is considered as poorly integrated, due to the lack of articulations and linkages between existing but also absent economic agents. (*United Nations Conference on Trade and Development (UNCTAD), 2001, Growing Micro and Small Enterprises in LDCs: The « Missing Middle » in LDCs, Why Micro and Small Enterprises are not Growing? Geneva, Enterprise Development Series, New York and Geneva*).

## **2. The Japanese SME success story in figures**

Japan is one of the few OECD Member States publishing the most detailed and sophisticated SME statistics. According to the SME Agency's White Paper annual series on SMEs, published under the authority of the powerful Ministry of Economy, Trade and Industry (METI), the contribution of Japanese SMEs is rather impressive.

### **High Numbers:**

Usually, Japan is known internationally only after his global corporate brands such as Sony, Toyota, Nikon, Mitsubishi, Suzuki, etc.... However, contrary to what one would expect, large firms beyond 300 employees represent only 0,3% of all existing firms in Japan with a small number of 13 430 in the year 2005. Small enterprises below 20 employees represent the bulk of the Japanese economy (87,2%, 4,102,169 establishments), whereas medium ones weight 12,5% (587 440 establishments).

### **High Contribution to Employment:**

Interestingly, the 12,5% of medium enterprises between 20 and 300 employees contribute to 44,9% of total employment. Together with the small enterprise sector (25,3%), they provide over two thirds of total employment in Japan (70,2 %) against only 29,8% for large corporations.

### **High Contribution to Value Added:**

The contribution of Japanese large corporations to value added in manufacturing is rather impressive with 43,2%. However, it must be noted that small and medium enterprises were still predominant in 2005 with 11,2% and 45,6% respectively. This last percentage highlights here again the strategic role of medium enterprises in the Japanese context.

### **High Contribution to Sales in Wholesaling:**

The contribution to total sales in wholesaling is even more striking when it comes to small enterprises (31,8%) and medium ones (32,7%). Large corporations contribute for 35,7% of the total.

**High Concentration in Retail Sales:**

With little surprise, small enterprises represent the majority in retail sales (54,2%) against 27,9% for large corporations, and only 17,9% for medium enterprises. The SME sector clearly prevails in retail sales with a total contribution of 72,1%.

**A Definite Role in Domestic Capital Investment Formation:**

It is not surprising that large enterprises tend to dominate in the field of domestic capital formation with 60,9% of the total, due to their high investment propensity. However, Japan publishes statistics only for large and medium enterprises in this particular category. The contribution of medium firms is quite impressive (39,4%), and this figure may be around or above half of the total if the small enterprise contribution was known and added!

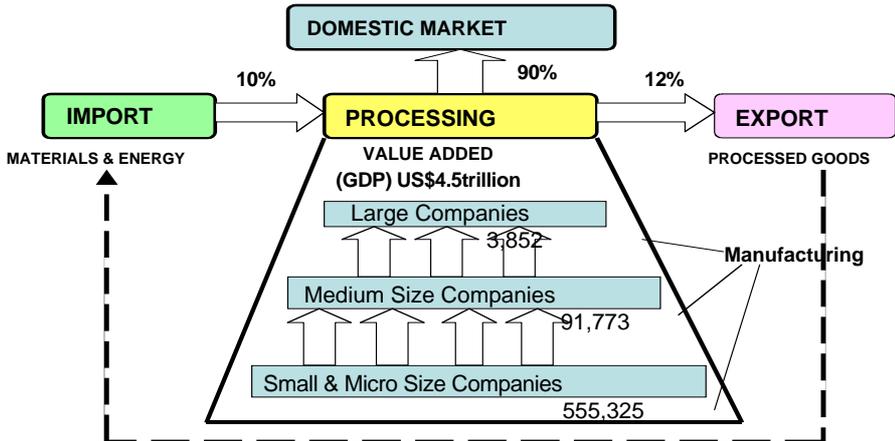
**3. The Japanese Industrial Structure and the role of SMEs**

The contribution of Japanese SMEs has been substantially studied, especially but not exclusively in Japanese (*Hiroshi Teraoka, 2004, Small and Medium-sized Enterprise Policy in Japan, Osaka, JICA Osaka International Center*).

**Japanese Industrial Structure**

(source 2006: Yoshio Koyama , SME Senior Advisor , Institute for International Cooperation , JICA, slides 7 and 10-17)

**JAPANESE INDUSTRIAL STRUCTURE**



This graph presenting the manufacturing production structure of Japan highlights the respective contribution of large, medium and small/micro enterprises.

It puts also the Japanese industrial structure in an international perspective, and underlines the primary function of the Japanese industry as a processing industry. The most striking feature of the Japanese industrial organization lies on the sharp dichotomy between the domestic and the international markets. Still today, about 90% of Japanese processing activities have a domestic market destination. This figure indicates that Japanese manufacturing highly depends on domestic demand, what is rather convergent with the situation of USA, and very divergent from the situation of the European Union and especially its small-sized Member States. The conclusion is that even if Japan is perceived as a highly export performing economy, with a high trade surplus traditionally, it remains primarily domestic market-oriented.

#### **4. Japanese policies in charge of a conducive SME business enabling environment**

Since the Meiji Restoration (1868), the State has played a driving and guiding role in the industrialization and modernization history of Japan. This was also true for the reconstruction after World War II, even though the private sector and large firms (inheriting from the so-called pre-War zaibatsu conglomerates) have gradually taken over the leadership from the 1960s onward.

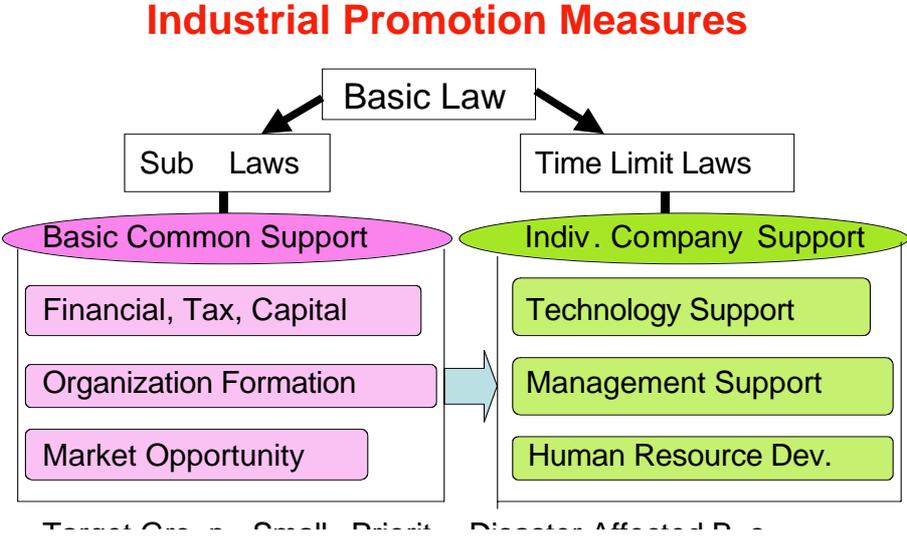
In this context, under the guidance of the MITI/METI, SME public policies have played and continue to play a substantial role domestically in shaping a conducive business enabling environment, where not only conglomerates but also a myriad of SMEs can be created and grow. These policies have also performed a suppletive public-private function to coach a sophisticated multi-layer subcontracting system between these two groups of firms, and the Japanese model has been quite unique among all OECD economies in this respect.

These observations are to be kept in mind if one wants to understand (a) the degree of sophistication of Japanese SME public and public-private policies conducted during the last 30 to 40 years, and (b) their pertinence and relevance, as considered by Japanese policy makers, to inspire the logics and the content of SME ODA cooperation overseas as documented in part two of this paper.

The following pages describe in generic terms those SME public and public-private policies developed by the Japanese central government until the present day. These policies include:

- The need for industrial promotion legislation and institutional framework targeting SMEs in priority sectors,
- The need for an institutionalized SME financial system,
- The need for SME policy implementation and sharing between the public and private sectors,
- The need for public-private partnerships at local government level,
- The need for SME public finance and specialized financial institutions,
- The need for local government (technical and financial support).

**4.1. The SME Legal Framework : Industrial Promotion Measures**



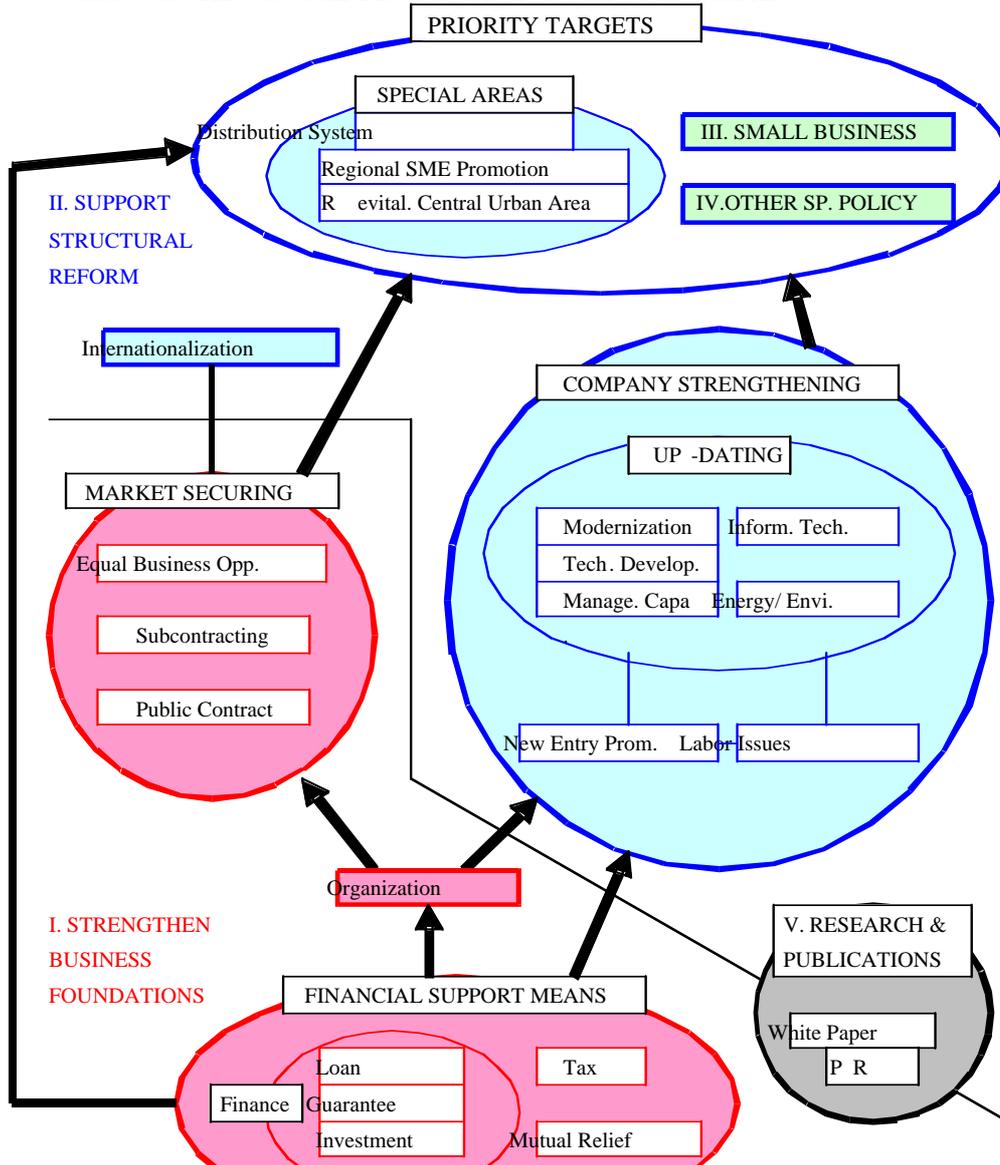
Legislation and respect of the legal order are important values in Modern Japan, including the legal business framework. The SME Basic Law adopted in 1963 has been revised in 1999. There are about 40 different specific laws (sub-laws) and various types of regulations (time limit laws) regulating the SME sector in Japan, probably one of the highest SME legal text production among all OECD economies.

It is quite interesting to note that not only domestic SME development regulators pay a special attention to the legal small enterprise framework in Japan. Based on such domestic experience, Japanese SME ODA policy makers tend to consider that all developing countries have to set up a proper SME business regulatory framework (namely legislation and appropriate institutions in charge of implementation). Otherwise, they can hardly achieve sustainable SME development as shown along the Japanese industrial development process.

**4.2. Structure of SME Promotion Policy in Japan**

The structure and substance of SME promotion policy in Japan is fairly complex as illustrated by the graph below.

## STRUCTURE OF SME PROMOTION POLICY IN JAPAN



A first set of policies aim at strengthening small business foundations through market access securization, especially in the fields of:

- **equal business opportunities**, that is to say protecting SMEs from large corporations' business malpractices and market distortions (unfair competition),
- **subcontracting**, that is to say the promotion of good practices in the various types of linkages between SMEs working as suppliers (up-stream linkages) and as agents or middlemen (downstream linkages) of large corporations,
- **and public contracting**, that it to say the opening of public tendering contracts to SMEs and their free access in terms of bidding options, in order not to favour systematically the large corporations alone.

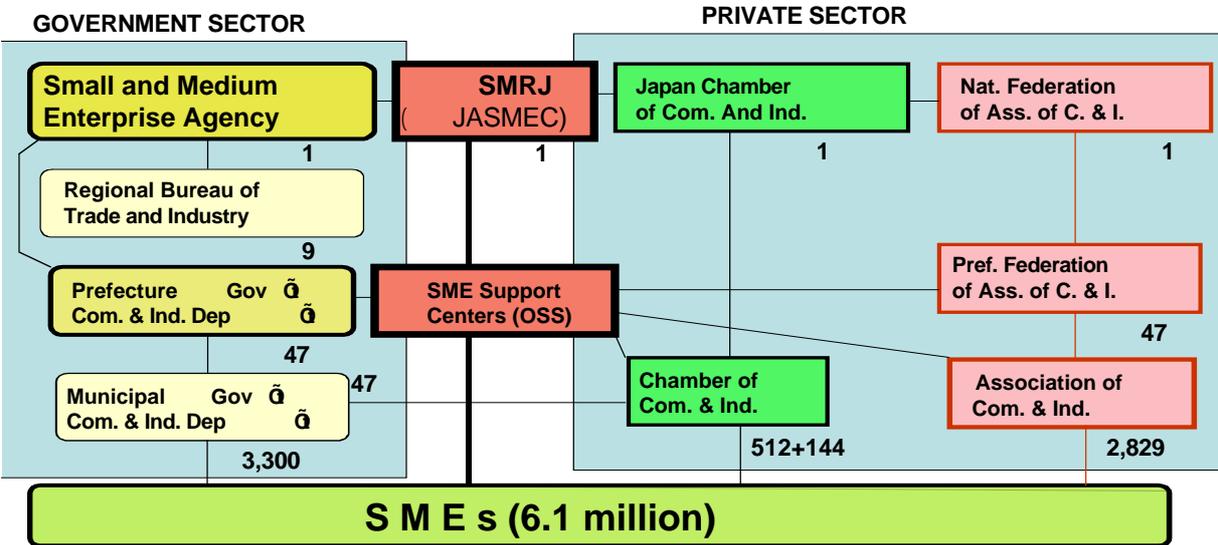
A second set of policies supports structural reform in priority areas, where SMEs face some difficulties like in marketing and distribution as they can hardly develop and handle their own facilities. Structural reform also covers the promotion of SMEs in specific regions, where local development is encouraged, or in some areas and urban centres which need to be economically and socially revitalized.

A third type of SME policies are supported by a diversity of financial means, which target SME strengthening at each individual enterprise level. Competiveness promotion of SMEs includes here technical and financial coaching in various areas such as business information access, market entry, technology development, use of energy and environment control, human resources up-grading and training, management capability, etc...

### 4.3. Organization of SME Policy Implementation

SME policy implementation in Japan provides an interesting model of public-private partnerships in several ways as shown in the following graph.

## ORGANIZATION OF SME POLICY IMPLEMENTATION



Government action in the SME sector is primarily conducted by the METI, especially its Small and Medium Enterprise Agency (located in Tokyo) and nine regional bureaus of trade and industry. At the local level, the rather effective role of the 47 prefectures (some of them particularly dynamic) is separate but often coordinated with the further non-centralised action of 3300 so-called

municipal governments, a small but more effective number in Japan than in most other OECD economies. The graph shows how the private sector is organized in Tokyo and outside to match the structure and territorial coverage of those central and decentralised public institutions.

Two specific categories of institutions, SMRJ and SME Support Centres, are in charge of bridging the public and private sectors (see two graphs below in sections 4.4. and 4.5.).

#### **4.4. Organization for SME Promotion and Regional Innovation**

The organization for SMEs and Regional Innovation (SMRJ) is a public funded decentralised network in charge of technical assistance to local SMEs throughout Japan. It is also supplemented by a software support program for SMEs (JASMEC) intended to contribute to up-grading their competitiveness through access to automation and information technologies.

### **SMRJ ( JASMEC)**

([http:// www.smrj.go.jp](http://www.smrj.go.jp) )

- 1) New Business Support
  - Incubators, Business Matching, Investment Fund
- 2) Management Support
  - SME University, Upgrading Loan, Consultations
- 3) Revitalization Support
  - Turn-around Fund, Mutual Relief System
- 4) Land Development
  - Industrial Parks, Regional Development
- 5) Information Service
  - Portal Sight    The J-Net 21    (<http://j-net21.smrj.go.jp>)

## 4.5. Prefecture SME Support Centres

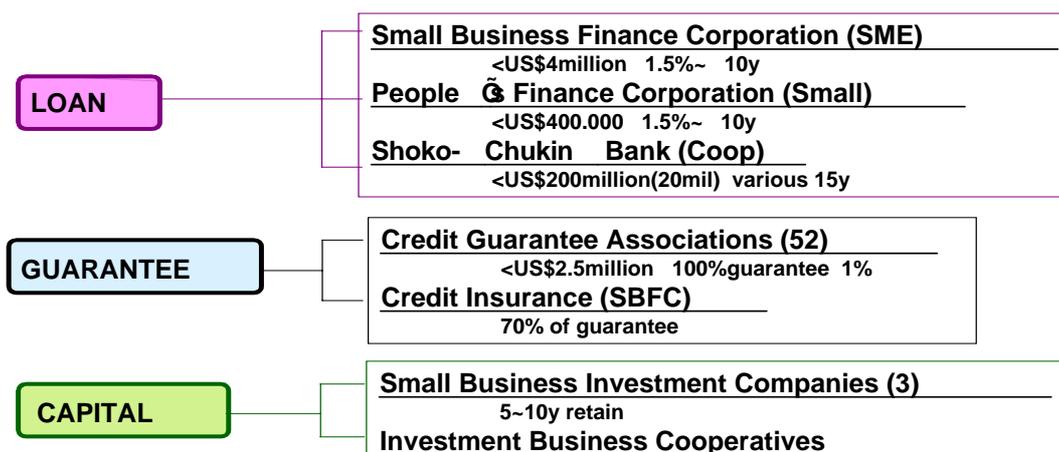
### Prefectural SME Support Centers

- One Stop Shop Service Center s (47) :
- (1) **Consultation** by Registered Consultants
  - (2) **Sending Experts** (SME Consultants, Tax Accountants, etc.) for **Company Diagnosis** on Finance, Technology, IT, Design, HRD (2/3 of cost support)
  - (3) Provision of **Seminars** based on SME Surveys
  - (4) **Evaluation and Appraisal of** **Business Feasibility** by Renowned Business Leaders

In each of the 47 prefectures of Japan, there is an SME support centre. This network all over Japan mobilizes around 15 000 consultants, most of them coming from the private sector, including some recently retired senior executives from large or smaller firms. This network proves to be quite performing. Consultants and trainers are also recruited out of this network by Japanese SME ODA institutions when required.

## 4.6. SME Financial System

### SME FINANCIAL SYSTEM



This graph provides an overview of those Japanese financial institutions targeting SME development in three different fields:

- SME access to credit mainly facilitated by three specialized banking institutions,
- Guarantee of SME loans, including an interesting insurance scheme for guarantors (so-called Credit Guarantee Associations),
- SME access to capital mainly facilitated by two types of investment institutions targeting SMEs.

#### 4.7. SME Promotion Budget Allocation

The following graph gives an estimation of public finance allocated to SME promotion in the year 2004.

Finance allocated under the national budget is rather limited and residual to avoid among other reasons various accusations of direct or indirect subsidies to the SME sector. The three types of listed measures take into account some aspects of the Japanese recession during the 1990s and beyond, namely the support to specific depressed areas and regions at sub-prefecture or municipal levels (reactivation and revitalization measures), and counter-cyclical support to cushion or counterbalance the overall economic recession and the restructuring of the production system (new SME creation encouragement).

However, specific budget allocations (indirect financing of SMEs) is far more generous and is divided among three major specialized institutions.

The total of these measures remains however very modest (about 1% of the total national budget?), especially if compared with the contribution of the SME sector to economic and social welfare as described in section 2 of this paper.

### BUDGET ALLOCATION (2004)

#### 1. SME Related National Budget

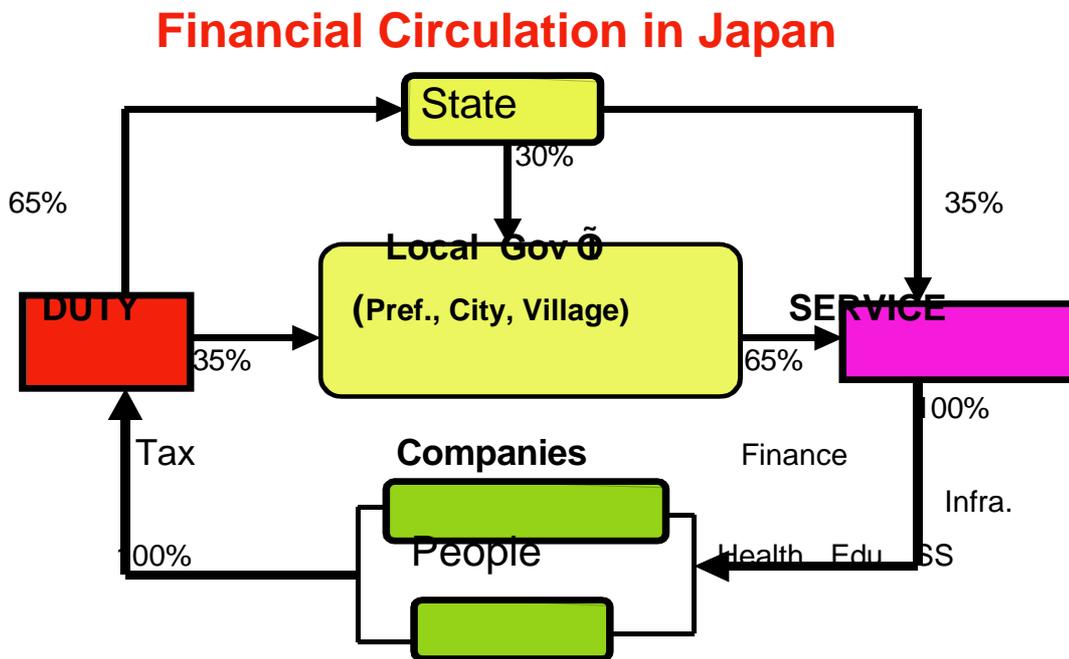
Total: US\$1.2billion

- Financial Safety-net & Revitalization of SMEs
- Support for Challenging SMEs (new entry encouragement)
- Reactivation of Small and Medium Commercial Businesses

#### 2. Special Budget for Financial Institutions

- |                                       |                        |
|---------------------------------------|------------------------|
| 1. Small Business Finance Corporation | <u>US\$17.2billion</u> |
| 2. Peoples Finance Corporation        | <u>US\$28.6billion</u> |
| 3. Shoko- Chukin Bank                 | <u>US\$16.8billion</u> |

#### 4.8. Financial Circulation of Budget in Japan



This graph is particularly interesting as it illustrates how SME fiscal policy is structured and used in Japan.

Two aspects are of particular relevance, and of possible effectivity / effectiveness (to be compared with other OECD fiscal and regional/local development policies and instruments, *see OECD Leed program*):

- i) 35% of total fiscal revenue from local economic agents and households are kept by local government institutions and reinvested in supportive services, including those for infrastructure and SME development,
- ii) 35% of total fiscal revenue of the central government are not channeled to local government institutions, but directly and in subsidiary terms to local supportive services, also and mainly subsidized by local government.

**PART TWO:  
JAPANESE OVERSEAS DEVELOPMENT COOPERATION  
POLICY: WHAT LDCs SHOULD LEARN FROM THE JAPANESE  
SME SYSTEM?**

Japanese official ODA is mainly under the responsibility of two public agencies, namely JICA (Japanese International Cooperation Agency) and JBIC (Japanese Bank for International Cooperation). JICA is in charge of grants and technical cooperation, whereas JBIC handles credit and preferential loans vis-a-vis developing countries. JICA and JBIC will be merged in 2008 into one single agency, which will become the number one bilateral donor agency among the OECD economies, and will rank second only after the World Bank in terms of financial resources.

The philosophy and policy orientations of Japanese ODA are rather different compared to most other OECD development cooperation agencies. They are a direct reflection of the modernization history of Japan, a rather recent phenomenon during the last 150 years, therefore still deeply rooted in the collective memory and conception of Japanese policy makers. One needs to understand this approach, when reading the mission statement of JICA as follows:

*« In the process of modernization, Japan has proactively studied the knowledge and systems of advanced countries and applied those of its own society and institutions, Based on this historical experience, JICA supports capacity development through technical assistance... » (JICA, 2004, Our Challenges for a Better Tomorrow, Tokyo).*

**1. Japanese SME Cooperation Policy: Convergence and Divergence vis-a-vis other OECD Member-States' ODA Policies**

Japanese SME cooperation policy is rather unique in several ways. First, it may be questioned whether such policy is nowadays still mainly driven by the public or most probably by the private sector, especially in developing Asia considering the high concentration of private sector activities and interests in the region. However, private SME cooperation activities of Japanese transnational corporations is out of the scope of this paper, which concentrates on Japanese official ODA, meaning public cooperation policy.

Four aspects may characterize the main specificities of Japanese ODA in the SME sector.

First, it is directly inspired from the tradition of strong State guidance in the field of domestic SME promotion policy as described in part one of this paper. It

implies that JICA puts emphasis on the role of good State economic governance for the construction and implementation of coherent SME promotion policies in developing countries. In this respect, JICA derives its inspiration from the industrialization role played by the Japanese central and prefecture governments since the late 19th century onward, and especially to foster dynamic industrial linkages between large conglomerates and smaller enterprises, the two pillars of the Japanese economic success.

Second, the Japanese SME ODA policy can be perceived as a segment of a wider public policy, both domestically and overseas, which considers that market and private competition alone cannot support SME development. They cannot bring up just by themselves proper solutions to resolve the numerous constraints and problems that Japanese and foreign SMEs have to face, especially regarding their weak and often unfair position to access capital resources in comparison to large firms and transnational corporations. This is why public intervention and specific SME supportive policies are highly needed to promote a fair business playing field, both in Japan and overseas. This approach may differ, if not sometimes diverge, from pure market-driven SME development cooperation policies of the OECD and the World Bank/International Finance Corporation in particular.

Thirdly, Japanese SME ODA tends to target the capacity building of central and provincial governmental institutions in charge of small enterprise promotion in developing economies. Capacity building means more specifically:

- (i) to solve SME development problems at macroeconomic level through the design and implementation of appropriate industrialization policy and SME national development plan (two fields in which Japan has long and sophisticated experience),
- (ii) to solve SME development problems at the microeconomic level through the design and implementation of selective technical assistance policies vis-a-vis:
  - so-called growth SMEs (meaning promising SMEs),
  - and so-called supportive enterprises, through the promotion of local, national, international and global industrial linkages, in which the Japanese corporations may play various linking and networking functions (as they also play such functions vis-a-vis Japanese SMEs domestically).

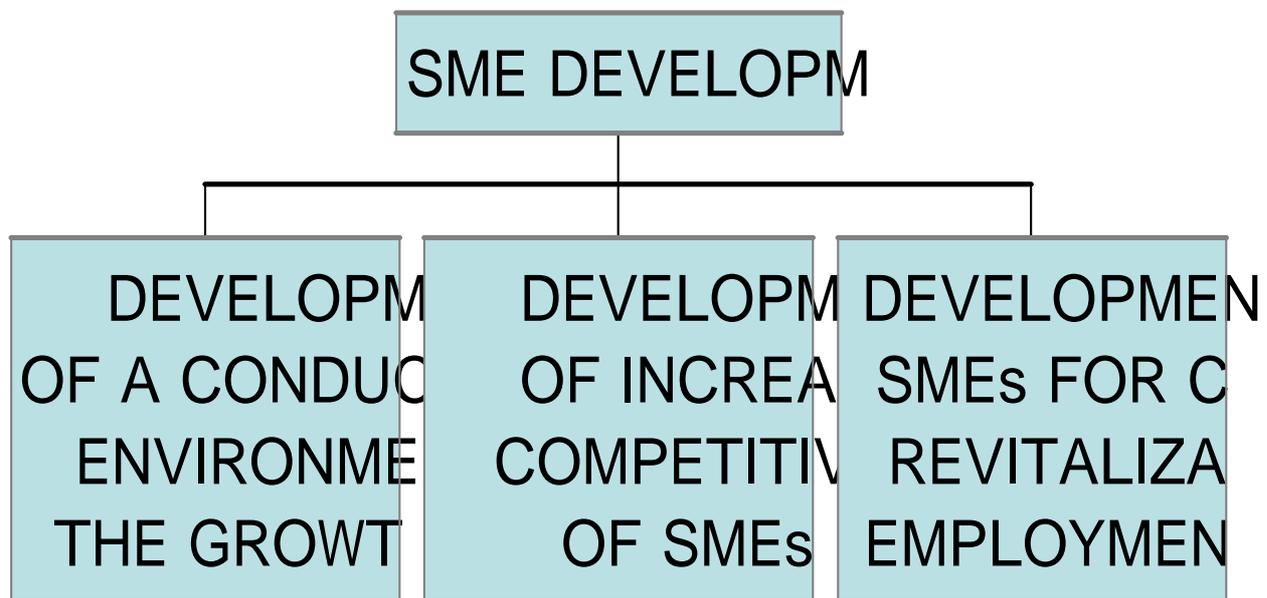
Fourth, Japanese SME ODA as described above has a long history of concentrating mainly (but not exclusively) on the most promising SMEs locally, which already belong to the formal and structured economy of Asian developing and emerging countries. Therefore, as stated in JICA's official documents, it has accumulated so far less exposure and experience in the field of promoting grassroot-level micro- and very small enterprises, mainly to serve a poverty

alleviation and social purpose, and less to serve the development of the national economy and its external linkages. The promotion of community development and of the so-called informal sector (meaning petty activities generating employment and income for the poor and for the most vulnerable segments of society in developing countries) is a preoccupation of some departments of JICA (such as the social and rural development departments of JICA), but with less emphasis and number of projects finalized so far. Some instruments, like microfinance for example, are still under study with a further need to document successful experiences internationally before moving into such instruments more systematically.

## **2. SME ODA Strategy of Japan and Formulation of SME Promotion Policies**

The SME ODA strategy of Japan seems to rely on the core concept of transferring overseas, and especially to East Asia, the Japanese State guided SME industrial development model described in part one of this paper. The focus on East Asia can be explained of course by the central localization of Japan in this particular region, but also by the high concentration there of Japanese economic interests, both in manufacturing and services. Furthermore, due to the magnitude of such interests in Northeast Asia (South Korea, Taiwan, Coastal China) and in Southeast Asia (most ASEAN economies: Indonesia, Malaysia, Singapore, Philippines, Thailand and Vietnam in particular), Japanese ODA in general, and SME ODA more specifically, are two instruments among a wide range of external cooperation instruments of Japan, which are envisaged by Tokyo as ways and means to contribute to the economic security and sustainable development of Japan itself, in a context of increased competition both regionally and globally. In other words, as the Japanese economy is not integrated in institutionalized regional arrangements such as in the cases of the European Union (EU) in Europe, or the Northern American Free Trade Area (NAFTA) in Northern America (its two major political allies but also economic competitors), Japanese policy makers view the whole external cooperation policy and its instruments (including SME ODA) as tools to serve the gradual and de facto economic interdependence and integration of Japan and the rest of East Asia. Tokyo perceives that such integration, under strong but discrete Japanese leadership, can serve not only economic, but also political and strategic convergence between major regional powers such as Japan, China, South Korea and ASEAN, in a region where the security situation still remains extremely volatile.

# ODA:Formulation of 3 SME Promotion Policies (institutional , economic , social approach of the Japanese experience )



Three major SME ODA policies can be clearly identified as indicated in the above graph. They are presented in the following three sections.

## **2.1. Policy One: Promotion of Conducive Environment for SME Growth**

This policy generally aims at the promotion of a conducive SME business environment in developing economies, from legal and institutional perspectives. This is an objective, which is also considered as a top priority by the SME Donor Committee coordinated by the World Bank Group.

First, Japanese SME ODA targets the promotion of an appropriate SME legal and legislation framework in developing countries. This reflect, as described in part one of this paper, the importance which Japanese SME policy makers have always recognized not only to the adoption and constant revision on paper of laws and regulations adapted to SMEs, but also to the functional supportive role of central and local government institutions. These institutions are supposed to be empowered with the capacity to implement policies and make them directly accessible and operational for SMEs as locally incorporated beneficiaries and end-users.

Second, JICA has developed the interesting concept of promoting appropriate « intellectual infrastructure » in developing economies for the smooth development of SME industrial activities locally. Intellectual infrastructure includes, under this Japanese concept, all economic, trade and finance regulations affecting directly or indirectly SMEs. A specific attention goes to standards and norms of production and marketing for SMEs, to the protection of intellectual property rights of SMEs, to trade and customs certification processes accessible or adapted for SMEs. It also includes the build up of national SME statistic data systems, as it is otherwise rather difficult to design and implement SME policies close enough to the needs of SMEs, and to measure their impacts. In geographic terms, this policy primarily targets East Asian developing and emerging economies.

## **2.2. Policy Two: Development of SME Competitiveness**

This policy is the most developed one within all Japanese SME ODA cooperation activities. It naturally reflects a field in which Japan has accumulated enormous experience. This policy is also one instrument among others to project Japanese economic and corporate interests overseas in addition to addressing local development needs. It is rather surprising and revealing to note that SME competitiveness promotion is a central task of JICA and JBIC, more specifically of the Economic Department in the case of JICA, this department being directly related to the Ministry of Economy, Trade and Industry (METI). This is a clear difference with most other OECD economies, where there is generally a clear distinction between SME development aid – carried by national donor agencies on the one hand, and promotion of private sector and external economic relations – carried by specific agencies under national Ministries of Economic Affairs and Industry on the other hand.

JICA's Economic Department, in cooperation with JBIC and JETRO, puts a strong focus on so-called growth SMEs. The objective is to select and boost together with national/provincial authorities, and sometimes in cooperation with the Japanese private sector, the most promising or already competitive SMEs domestically, and encourage those with best potentials to link-up with Japanese foreign affiliates (large or SME firms), either already established within the national market concerned, or in neighbour countries and the region, or in Japan itself. Technical support to the selected SMEs can take various forms (technology up-grading, management support, access to credit, marketing capacity, etc...). The different types of selected SMEs generally include SMEs active in specific manufacturing sectors or sub-sectors with good potentials for value added and exports, supporting industries (SME suppliers and subcontractors to larger national or foreign firms), SMEs in wholesaling and

retail business, and more recently innovative SMEs and SME start-ups in niche or high tech areas.

The geographic concentration of this policy includes mainly China and Southeast Asia, but also non-Asian emerging economies such as Brazil, Mexico, South Africa. It also englobes a few developing countries rich in energy or other commodities such as Nigeria, Venezuela and some Central Asian newly independent republics. Surprisingly, it is not yet much active in rising India.

The competitiveness of individual SMEs (pure local ones or SME joint ventures with Japanese partners) and of supportive SME industry networks can be upgraded through technical assistance (provided by JICA), marketing and trading assistance (JETRO), and financial support (credit and loans by JBIC). Most business operators in developing countries face the central problem that only short term capital is available, yet not always accessible, and further more inappropriate to address medium- and long-term investment needs of SMEs. When it comes to preferential long-term loans to local SMEs, JBIC (Japan Bank for International Cooperation) has set up a so-called two-step loan policy as follows:

- (i) JBIC can extend a loan directly to a national financial institution jointly selected with the local government in the developing country concerned, and doing so JBIC will absorb the country risk which may be a deterrent for most private bankers,
- (ii) The local branch of the national financial institution can then provide a special loan to the final SME beneficiary.

This credit policy has two merits. First, it enables JBIC to transfer responsibility to the local financial institution as counterpart and full partner. Second, it relies on the domestic network and banking retail organization of the selected national financial institution, and prevents JBIC to install and support its own banking infrastructure and logistics to reach the SME end-users locally.

However, practice has shown that the two-step loan approach may too much depend on the still very limited skills and performance of fragile national banking institutions, yet selected as the designated local counterparts by JBIC together with the national government and its central bankers (*See: JIBC, Annual Reports and Bulletins*).

### **2.3. Policy Three: Regional Development and Local Economic Revitalization**

Japan has much experience at prefecture level in the field of regional development and local revitalization, especially in rural/urban areas affected by economic and social difficulties, restructuring and transition constraints. However, such domestic experience has not been yet frequently valorized and translated into decentralized SME development cooperation programs overseas.

This situation could be inverted in the near future, as developing countries express more and more demands concerning infranational and local development. .

Most projects under policy three have addressed so far LDCs' requests, which concentrate on various needs to up-grade local urban or rural industries/SMEs in specific manufacturing sectors or sub-sectors.

A small number of other projects focus on community development and poverty reduction at local level. Interestingly enough, Japanese ODA has tried to transfer and adapt two of its specific domestic regional development policies, which have shown tangible results in some rural prefectures.

**(i) One village, one product movement**

This regional development policy, which has been experienced so far in a few developing countries such as Thailand and Malawi, is based on a rather simple concept. Its origins dates back to the year 1979, when Ex-Governor Hiramatsu of Oita Prefecture launched a new development policy for his own prefecture. The « One Village, One Product Movement » aimed at regional revitalization and development based on the independence, motivation and creativity of local residents. The motto of this movement was that « Each city, town and village should have something of which they can be proud ! ». It can be anything from farm products to sightseeing spots or even cultural patrimony. The whole idea was to divide the prefecture in several areas or districts, and to try to specialize each one in the production of one major product or specific service. Appropriate and highly localised technical and financial assistance were provided during the initial taking off period of each local initiative, being envisaged to become at least self-supportive if not profitable in the long run.

During the last two decades, this one village, one product movement policy has been adopted throughout Japan, mainly in rural prefectures facing problems of economic and social diversification. In several cases, local but highly specialized products, notably in the agro-food sector (candies, mushrooms, fruits, cookies, flowers,...) have become rather unique, have gradually supplied the entire region, and have even reached sometimes the national market. This success has been attributed to:

- Capacity of building awareness among local residents,
- Good identification of local resources and local treasures,
- Perseverance as the key to create capacity and power,
- Making of high value-added products,
- Securing marketing channels,
- Investment in local human resource development.

This concept has been studied and partially adopted by the United Nations and World Bank in order to improve the design and content of regional development instruments and tools to be tested and implemented in

developing countries. The case of the United Nations Centre for Regional Development (UNCRD) in Nagoya, Japan, is a good illustration ([www.uncrd.or.jp](http://www.uncrd.or.jp), see also: Teruhiko Yoshimura, 2004, *Sustainable Local Development and Revitalization: Case of One Village One Product Movement, its Principles and Implications*, Nagoya, UNCRD, 14 June).

## **ii) Promotion of road stations**

This concept was launched in 1993 by some prefecture governments and the Japanese Ministry of Roads and Construction in order to respond to the economic recession affecting Japan, and certain regions and sectors in particular.

In 2006, Japan can claim a network of 845 road stations in 44 out of a total of 47 prefectures. Each road station is located aside a main local road or a major road interconnection. It offers various facilities such as basic stop over, resting and telecommunication infrastructure, recreational and tourist facilities, cultural and educational activities, display of local products including farmers' market and handicrafts. Most of the construction and hardware have been financed by regional development subsidies from the Ministry of Roads and Construction together with prefecture and municipal/village authorities. A significant portion of the soft-ware is self-financed by local producers' post-farming cooperatives, associations of women, other types of local NGOs handling various tasks of valorization and sales of traditional and new products 100% made by themselves.

To summarize, road stations have demonstrated the following characteristics:

- attraction of many people and visitors,
- employment creation and income generation (cottage SMEs),
- utilization of local resources and production of value added,
- function as a core nucleus for community development and local economic revitalization,
- small entrepreneurship opportunities for empowerment of rural women in particular.

A program of road stations, combining community and product development, has been facilitated thanks to the Japanese cooperation (JBIC) in a few countries such as China, India, the Philippines and Thailand. This program like in the Indian case has been able to support direct cooperation between the Nara prefecture (old capital city of Japan with exceptional Buddhist architectural heritage) and the Kushinagar district (Uttar Pradesh, a district composed of 8 most important Buddhist sites of India). The project in Thailand is mainly conducted by the Chiba Prefecture, and supports local community development in Kiritwong sub-district specialized in natural dyeing tapestry and carpets.

During our research survey, the question has been raised whether and how far Japanese ODA makes use of microfinance tools to promote such regional and community development policies targeting local products and services. The overall response at JICA and JBIC has been that Japanese cooperation has not yet developed much expertise of its own in microfinance. In addition, Japanese microfinance institutions have not performed particularly well within Japan: the system is particularly shaky when looking at informal financial markets and so-called city lenders, which have developed rapidly during the 1990s because of the national economic recession and the sharp increase of defaulting debtors vis-a-vis formal sector financial institutions.

### **3. Types of SME Development Cooperation Instruments**

There are five types of instruments which are individually or jointly utilized in any SME development project conducted under one of the three policies presented above:

- SME Policy Advising,
- Drafting of National SME Master Plan,
- Promotion of Growth SMEs or Supportive Industries,
- Individual or Thematic Support,
- Technical Assistance and Training.

**SME Policy Advising** is the most common form of Japanese SME ODA reply to any government's request for SME development counselling. Many developing countries have no proper SME policy, or only on paper, and may ask first for external expertise before taking any action. Counselling may take several years depending on several socio-economic but also political conditions in the recipient country. This is for instance the case of JICA in Sri Lanka since 2005.

**National SME Master Plan** is a comprehensive strategic document, which is considered by Japanese cooperation as an important instrument, based on the institutional experience of Japan (see part one of this paper). It is supposed to show how central and local government institutions can be mobilized to serve a national SME promotion policy, also in terms of systematic mobilization of technical and financial support delivered either from the national budget and/or from external donors. Normally, some Japanese eminent experts from the public administration or from academia are commissioned by METI or an other Ministry to supervise the drafting of a national SME Master Plan, as it was the case a few years ago in Indonesia and Thailand. The senior expert, together with a team of other Japanese SME development experts, is usually assigned at ministerial cabinet level in the recipient country.

**Promotion of Growth SMEs and Supportive Industries**, as already, underlined is one of the core objectives of Japanese SME cooperation overseas. It can take various avenues and forms, including public-private partnerships together with the private sector, both in the recipient country and in Japan. In addition to technical assistance, financial cooperation is rather instrumental to provide long term investment credit, access to automation and IT technologies, preferential import-export loans, etc...

**Individual and Thematic Support** usually designates SME cooperation tools, which can focus either on specific SMEs or supportive SME industries at sub-sector level, or on specific issues to promote a set of SMEs in a specific territory and/or in as specific sector of a recipient country. Individual support may address not only the improvements of SME internal conditions (technology, management, human resources, finance,...) but also their upstream and downstream linkages (supply networks, marketing channels).

**Dispatch of Technical Experts and Delivery of Training** refer to a whole set of training assistance particularly well organized in the case of Japanese SME development cooperation. JICA is able to call upon a wide national network of 15 000 senior technicians and management experts organized to answer the needs of Japanese SMEs (see part one of this paper). Depending on their field of expertise and availability to travel overseas, they are assigned to help and possibly solve a specific SME problem overseas. Furthermore, private sector experts may be also called in as additional human resources, and depending on the nature and technicality of the problem. This expertise system functions well as most senior experts are themselves retired senior executives from the private industry, and are organized at prefecture level in effective senior experts' associations ready to help local economic development.

Japanese ODA being among the leading ones in the world is a large contributor in the field of training for developing countries. Part three deals with this particular subject.

#### **4. SME Development Cooperation Financing**

The research survey has permitted to identify three major public institutions having substantial and complementary financial means to support Japanese SME development cooperation overseas, both in terms of pure development assistance or of more private market-oriented economic and industrial promotion, as described in the graph below.

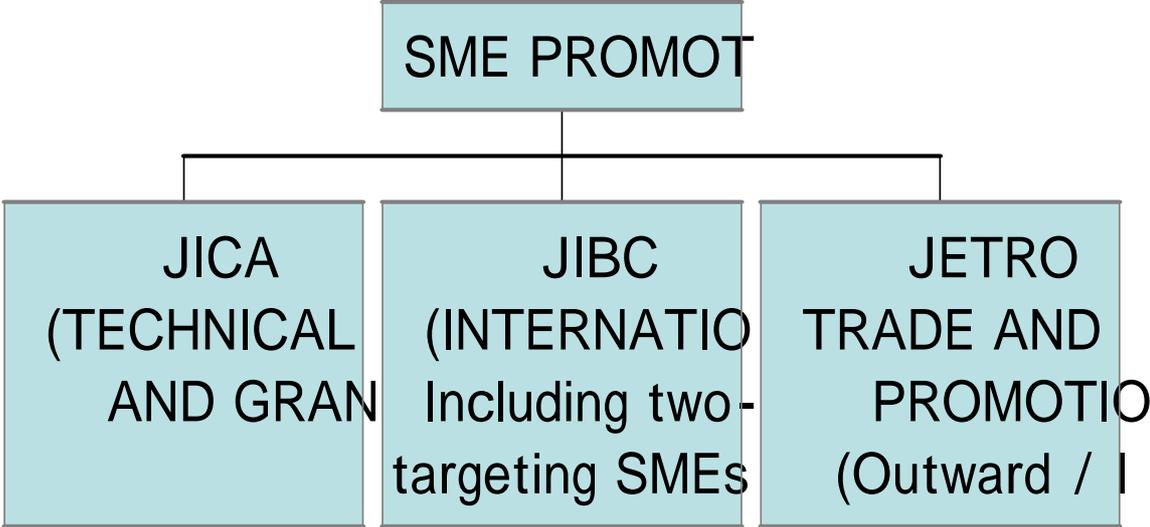
As explained already, JICA is mainly in charge of technical assistance and grants vis-a-vis developing countries. This includes of course pure development aid projects. But it has been shown that it may cover economic and industrial

promotion as well targeting so-called growth SMEs and SME supportive industries.

JBIC as the former Import-Export Bank of Japan is responsible for the allocation of specific international loans to the SME sector of developing economies, among other sectors. A number of loans are granted on a commercial basis, but some others are preferential loans, with conditions close to grants and aid assistance for some of them. Some loans are not targeting SMEs in particular, but project financing may still benefit local economic and community development, and therefore grass-root level SMEs at least indirectly.

JETRO is a special agency under METI in charge of facilitating exports of Japan but also imports to Japan, including from developing economies. In recent years, an additional strategic function has been assigned to JETRO, which is to promote Japanese outward investment (including to developing economies), but also foreign investment to Japan. This additional function can be explained due to the huge financial savings and surpluses of Japan, the insufficient internationalization of its economy to meet new global competition challenges, and the need of Japanese direct investment to contribute to local industrialization and economic development both in priority emerging economies of East Asia close to Japan, but also in the rest of Asia and elsewhere.

## SME Promotion Project Financing



### PART THREE: ODA SME TRAINING COOPERATION OF JAPAN

Entrepreneurship and SME training is conceived by Japanese ODA policy as one segment fully integrated to SME technical cooperation projects. In other words, SME training is seldom offered as a single and isolated item.

## **1. SME Training Cooperation Policy**

SME development takes place mainly in the developing countries themselves or in sub-regional training centres, such as Singapore in Southeast Asia for instance. In addition, regular SME module training courses of 6-8 weeks on average are organized in Japan. Such courses target governmental and NGO officers from developing countries in charge of SME promotion policies, with the expectation that they can diffuse after their return what they have learnt in Japan (multiplier effect). Small entrepreneurs themselves are rarely trained in Japan, but are direct beneficiaries of technical assistance and training programs within their local context and sector of activity.

JICA is the main development agency responsible for public SME training cooperation. In this particular field of activities, JICA usually works in close cooperation with:

- (i) **The Association of Overseas Technical Scholarship (AOTS)**, which is specialized in training guest visitors from LDCs in Japan. AOTS is sponsored by METI (Ministry of Economy, Trade and Industry) and has developed a strong network of training cooperation with the Japanese private sector, which enables JICA together with AOTS to deliver rather highly specialized training whenever needed.
- (ii) **The Japanese Overseas Development Cooperation (JODC)**, which is also sponsored by METI, is responsible together with JICA for sending various Japanese experts overseas. It has developed strong links with JETRO, SME Associations and SMRJ (Organization for SME and Regional Innovation, [www.smrj.go.jp](http://www.smrj.go.jp)) at prefecture level, as described in part one of this paper. Therefore, it has a direct access to a national network of about 15 000 consultants and experts in a wide range of technical fields.

## **2. JICA SME Training in Japan**

For most public sponsored training programs organized in Japan, JICA can put at disposal an impressive infrastructure of 18 JICA international training centres in various urban centres of Japan.

As the region of Osaka is considered to have one of the most dense and sophisticated network of SMEs, its JICA international training centre is

particularly but not exclusively specialized in SME training. Three types of SME training courses are offered annually, namely:

- (i) A rather generic seminar on the development and promotion of SMEs, which has been opened in recent years to participants from 8 Asian countries and 5 non Asian ones,
- (ii) A first technical course called « Technical Support for SME Promotion I », which is usually specialized in biotechnologies and plastics. This course has been opened in recent years to 4 Asian countries and 7 non Asian ones.
- (iii) A second technical course called « Technical Support for SME Promotion II », which is usually specialized in organic and inorganic materials and metals. It has been opened in recent years to 5 Asian countries and 5 non Asian ones.

These courses are normally offered during three to five years, and are regularly evaluated. In addition, by the end of each training session, each participant is supposed to present an SME development-oriented report related to its own national or local field and professional experience. A first objective is to build up the capacity of each participant in addressing its own SME environment and problems, and to find out possible solutions derived from its exposure to Japanese experiences during the training course. A second objective is to enable and empower each participant with the capacity to submit a specific SME development project proposal to the nearest JICA cooperation office, as an optional but direct follow-up of the training course after each participant has returned home.

Since 2006, JICA training activities have also innovated in the field of gender and women's entrepreneurship in developing countries. The JICA Tokyo International Centre has launched a first training program addressing this particular issue. The targeted public is over three year experienced professionals of governmental or non governmental organizations in charge of women's economic empowerment. This program is the first of its own to complement various cooperation activities carried out under JICA gender policy. The content of this new training is to help with the design of support programs to promote local women's income generating activities in developing countries.

Apart from gender issues, JICA has also taken some initiatives in some other new fields such as social responsibility of SMEs. For example, it has commissioned the Japan International Labour Foundation (JILAF), a collective of Japanese trade unions, to design and deliver specific training modules addressing the improvement of working conditions in the Jiangsu and Zhejiang provinces of China. Under its so-called Positive Program, the JILAF has accumulated some experiences in nine Asian countries since 1994. Its action is

structured under three major themes: Work Improvement in Small Enterprise (WISE), Work Improvement Neighbourhood (WIND), Work Improvement for Safe Home (WISH) (*JILAF, 2005, Past JILAF Activities, March*). In addition to Japanese trade unions, JILF activities overseas are sponsored by the Japanese Ministry of Social Welfare, the Ministry of Foreign Affairs, and JICA (China project). JILF cooperation does not necessarily rely on the labour and welfare system of Japanese SMEs, whose standards are not particularly performing (according to JILF itself). In addition, most Japanese SME staff are not unionized. The purpose of JILF is to promote international labour best practices such as those diffused by the International Labour Organization. This approach may also apply to Japanese firms, including SMEs, which are investing or outsourcing in developing countries.

## **TENTATIVE CONCLUSIONS**

The following conclusions can be only tentative ones, as they are derived from a short research survey of only two weeks in Tokyo in late September and early October 2006.

The overall results of the survey tend to demonstrate the existence of several clear linkages and ties between Japanese public SME development policy and Japanese SME cooperation overseas, as suggested in the title itself of this paper. These results were not challenged during the final research debriefing presentation at the JILPT on October 6th, 2006.

### **First Tentative Conclusion**

A first and probably one of the more important tentative conclusion has been inspired by Prof. Naoki Kuriyama, professor at the Faculty of Business Administration, Soka University, Tokyo, and who attended the final debriefing. It can be said that the industrial model of Japan, including SME development policy, has been guided by the State, which has remained quite strong until today. However, the economic and financial intervention of the State has been gradually overtaken by the spectacular expansion and internationalization of the Japanese private sector, especially since the 1960s onward. The repositioning of government has therefore shifted from a leadership role to a much more subsidiary role in the economic sphere during the last few decades. This trend will not be inverted due to additional global competition pressures on the Japanese economy and other OECD countries as well.

This observation has at least two clear implications. On the one hand, Japanese SME public policy still seems rather substantial at the domestic level, but how far does it reflect reality? In fact, it has become a kind of subsidiary policy, suppletive or complementary to prevailing and more and more substantial

business to business/B2B linkages between private conglomerates and other large firms on the one hand, and on the other hand a myriad of SMEs at various layers of supplying and sub-contracting activities, both domestically and internationally. Japanese SME cooperation overseas does reflect to a large extent the SME sector endeavour to support directly or indirectly business internationalization and globalization strategies of large corporations, particularly active in emerging East Asia. The strong role and influence of the METI Ministry (ex-MITI) can be perceived as suppletive to the Japanese corporate sector on both the SME domestic and overseas cooperation fronts. Therefore, it is suggested here that Japanese SME overseas cooperation, especially through JIBC and the economic promotion department of JICA is at minimum level subsidiary to private sector B2B strategies involving large and small firms together with selected local business partners in developing countries, and at maximum level a kind of indirect support (or subsidy) to the Japanese private sector. This tends to be convergent with the international literature generally describing Japanese ODA as rather tied to Japanese economic interests. This trend is not per se surprising, especially in a sector of cooperation like small enterprise development, in which PPP (public-private partnerships) will contribute more and more.

### **Second Tentative Conclusion**

The recognition that Japanese SME ODA concentrates on growth and supportive SMEs through the cumulative actions of JIBC, JETRO and JICA (economic department) does not however contradict other JICA small enterprise development policies more geared towards local community development and poverty alleviation through microentrepreneurship promotion. These policies are led by JICA departments of rural development, social development, human resources and the environment, and concentrate on very small-scale activities creating local employment and income. However, as reflected in JICA's own publications and annual reports, these activities still remain modest in comparison with those concentrated on growth and supportive SMEs. Of course, further research would be needed to evaluate in more details the respective projects conducted in the SME sector by each department of JICA, both in terms of content and allocated budget.

### **Third Tentative Conclusion**

A third tentative conclusion refers to a certain fragmentation and segmentation of Japanese SME ODA policies, even within JICA itself, with no clear and consistent strategy. This is a rather common criticism addressed by the World Bank (SME Donor Committee) and some other OECD donors. However, this survey has come across a certain Japanese misunderstanding and even some disagreement vis-a-vis the World Bank/IFC SME development discourse. For instance, JICA does not fully share the free market ideology as reflected in the

SME development guidelines published by the SME Donor Committee coordinated by the World Bank Group (*Committee of Donor Agencies for Small Enterprise Development, 2001, Business Development Services for Small Enterprises : Guiding Principles for Donor Intervention, Washington D :C, World Bank, SME Department*). This type of approach does not correspond much to the mode of the Japanese industrialization and SME development, which were much impulsed by the State at least until the 1970s. This may explain why Japanese SME ODA still targets national governments and public development institutions as its direct counterparts, and less the private NGO sector contrary to some other OECD donors. In its latent opposition to such guidelines, the Japanese cooperation points out that coherence and consistency of SME cooperation overseas are far less important than content and effectiveness, in the absence of well established World Bank/OECD criterias for SME development project monitoring and evaluation. A third Japanese response underlines that the prioritization of targeted growth SMEs, especially in East Asian developing and emerging economies, may be derived from Japanese public and private sectors' pragmatism, but involves both public and private operators, which have the means to deliver concrete and substantial assistance locally, what is not always the case in the overall documented experience reported by the SME Donor Committee. Finally, JICA recognizes that Japan has less experience than other donors, especially outside Asia, in the field of microenterprise and informal sector promotion serving the so-called poverty reduction objective of the Millenium. However, it is noted that those OECD donors, targeting this precise sector in developing countries, cannot much rely on domestic experiences of their own considering the absence or tiny size of this sector in their respective economies. Furthermore, JICA is not yet fully convinced whether targeting this type of microenterprises is more effective than focusing on formal sector and growth SMEs. Actually, it can be less effective first because the informal sector is huge and cannot be easily reached even by local governments and NGOs (not to mention foreign donors coming from the outside), second because JICA has not yet come across tangible evidence from other donors that they are particularly advanced and highly successful in this type of endeavour.

#### **Fourth Tentative Conclusion**

One can wonder whether there is any well identified and coherent Japanese SME development policy both at home and overseas, and who is exactly in charge on the public side. This question is not a pure theoretical one considering that not only METI but many other ministries and agencies are in charge, explicitly or not, of SME promotion at decentralized, regional and local levels. For example at the central government level, the Ministry of Finance can decide a special SME budget allocation in direct consultation with the Cabinet, when there is a sudden highly politized bilateral or multilateral aid request addressed

to Japan, or when an unexpected international crisis happens like the tsunami in December 2005. At SME sectoral level, several ministries and agencies are active both domestically and overseas such as the Ministry of Agriculture and Fisheries, the Ministry of Construction and Public Works, the Ministry of Labour and Social Affairs, etc... In addition, as described in this paper, prefectures and large urban municipalities are also active on the SME domestic and international cooperation fronts.

### **Fifth Tentative Conclusion**

Japanese SME ODA policy is still probably missing a specific concept for economic and small enterprise cooperation for least developing countries, and more specifically in Africa where the informal sector is predominant. Current JICA President Mrs S. Ogata has contributed to forge the new concept of a « missing middle » inbetween pure humanitarian assistance to LDCs, and economic cooperation (but not aid) for developing and emerging countries. The debate continues in three directions as follows:

- (i) Should the Japanese and international private sector be in the driving seat? This is suggested for example by the role of Japan played in the NEPAD/TICAD development strategy through private sector stimulation in Africa. But the immediate concern is whether and how far the Japanese sector is interested to trade and invest substantially in this region. Obviously, the so-called Japanese investment « flying geese » concept, which worked so well in terms of analyzing the Japanese economic contribution to East Asia's rapid industrialization, is totally unapplicable to Africa.
- (ii) On the contrary, if one considers that there is little role yet for the Japanese private sector, then should the public sector take the lead? As shown in this paper, one central question is whether Japanese SME cooperation should target growth SMEs – which are present in a very limited number of African economies, or whether it should shift to the large informal sector (microenterprises) prevailing in most African countries.
- (iii) A third possible and more pragmatic approach could suggest that neither pure private market promotion nor pure public intervention are adapted to the African context. Then, should PPPs (public-private partnerships) be encouraged in order to serve the specific development needs of African LDCs? What role could Japanese PPPs play in that respect? PPPs seem to operate rather informally in Japan, but they are not yet much documented outside Japan, and in developing countries in particular. So far, very few Japanese corporations like Toyota for example have played a leading role in the Global Compact of the United Nations initiated since 1999. However, Japan is recognized for a long tradition of corporate citizenship and social responsibility at

home, which has not been carefully studied by foreign observers and not much exported as yet. Some Japanese global firms could take more initiatives on the world development scene, and publicize more what they have already done so far.

### **Sixth Tentative Conclusion**

Two weeks of daily exposure to the Japanese high intellect of senior cooperation officers can suggest a necessary revisiting of some core Western/OECD cooperation terminology and concepts too often taken for granted. In other words, Japanese cooperation experience and language has not yet much contributed to the SME discourse of the international community, which has been primarily influenced by the World Bank.

The study of the Japanese SME cooperation overseas does not allow to draw a very clear line between the usual OECD distinction between development aid on the one hand, and external economic cooperation on the other. Development aid is usually but not everywhere under the formal authority of the Foreign Ministry, even though career diplomats have little or no experience in development aid proper. This is why specific development agencies have been created such as JICA. However, in the case of Japan, METI, which is the major and powerful ministry conducting Japan's official external economic relations, is also highly influential in the field of development cooperation overseas, and in the SME sector among others through the arms of JICA, JBIC and JETRO.

An other Western concept normally suggests a definite distinction between foreign economic policy and external economic relations of most OECD countries, but not entirely to the case of Japan. Foreign economic policy usually refers to the authority of a government and the public sector at large. External economic relations normally include both public and private institutions conducting some external economic activities worldwide, including in developing and emerging countries. Under the first concept, SMEs are envisaged as beneficiaries, whereas they are considered as existing or possible actors under the second one. This distinction is not so clearly cut in Japanese policy and practice, the two situations being often combined or intertwined. Overtime, the post-modern experience of Japan may suggest that SMEs are less and less envisaged as pure policy beneficiaries, and more and more as economic agents of their own interacting with other economic agents and the public sector. This evolution has various implications on the ways and means the Japanese SME cooperation is projected vis-a-vis developing economies and their respective SME sector.

## **FURTHER RESEARCH PERSPECTIVES**

This two week research survey and the above tentative conclusions could pave the way towards further interesting research at least in three directions.

### **First Perspective**

As Japanese SME cooperation is primarily concentrated in East Asia, it should be explored how far it can address in the future the rising gap between matching continued demands from emerging economies (China, ASEAN countries, possibly India) versus pressing ones from least developing countries, especially in Africa but also elsewhere. In other words, Japanese SME development cooperation seems to have concentrated so far, but not exclusively, on the growth development of local SMEs and so-called supportive SMEs, a field where the Japanese economy has obvious interests domestically and abroad. On the one hand, it could be argued that the promotion of the most promising SMEs can contribute directly and indirectly to the reduction of poverty through the creation of employment, income and wealth. On the other hand, as their proper SME sector is still fragile and scarce, LDCs might be more interested in the promotion of microenterprises and microfinance, a field where Japanese cooperation has accumulated so far less experience.

### **Second Perspective**

Beyond the role of the public sector in SME cooperation, there is an obvious imperative to document and analyze the main contribution of the Japanese private sector in the promotion of local SMEs in developing countries, and in the internationalization of both Japanese and local SMEs, a task which was beyond the scope of this paper. The size of the Japanese private sector and the magnitude of its regional, international and global outreach tend to indicate that intra-industrial and inter-industry linkages, especially in East Asia, have become strong leverages of SME promotion between Japan and developing economies, especially through trade, technology and even finance. However, such a study would require very substantial research means, even if it would be limited as a start to a couple of major Japanese multinational corporations.

### **Third Perspective**

Thirdly, as suggested in part one of this paper, the role of public-private partnerships in SME development seems to have played and to continue to play a central role in Japan, particularly at prefecture and municipality levels. Various questions arise from this observation such as: How and how far these public-private partnerships and experiences could be transferred to developing countries, if transferable? How far some of these public-partnerships in specific areas or sectors have already induced some spillover cooperation overseas, at least in neighbour Asian developing and emerging countries? How and how far development cooperation and economic promotion agencies such as JICA, JBIC and JETRO rely gradually more and more on such public-private partnerships,

and what kind of instruments and tools are mobilized for what types of direct or indirect impacts on the SME sector in developing economies? How far the emergence of SME incubators and start-ups in Japan could also lead to new possible ways of SME internationalization, as shown by some high tech and research & development sectors for example in the case of the United States of America?

**Fourth Perspective**

It would be also interesting to document and analyze some specific areas where Japanese public and public-private cooperation is also active, but has not been covered during only two weeks of research survey in Tokyo. One can think of very diverse areas such as: community development and small enterprise promotion, microentrepreneurship and microfinance, post-crisis reconstruction and economic rehabilitation, women’s empowerment and promotion of income generating activities, etc.

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## **ANNEXES:**

### **Annex 1:**

#### **INSTITUTIONS VISITED DURING JILPT RESEARCH PROJECT CONDUCTED IN TOKYO**

From 26 September to 6 October 2006

#### **Several in-depth meetings (2-3 hours on average, without interpreter) :**

1. JICA (9 meetings, 5 different departments : JICA Institute, SME Team, Human Resources, Economic Relief, Africa Dept)
2. JIBC (2 meetings, One Village One Product Policy and Road Station Policy, Two Step Loan Policy and SME Promotion)
3. SOKA UNIVERSITY (Faculty of Business Administration)
4. SWISS EMBASSY (Trade Section and SME Business Hub, Scientific Cooperation Section)

#### **One in-depth meeting (2-3 hours on average, with or without interpreter) :**

1. Ministry of Economy, Trade and Industry (METI): SME AGENCY
2. JICA INTERNATIONAL TRAINING CENTRE, TOKYO
3. JAPAN ENTREPRENEURS ASSOCIATION
4. JAPAN INTERNATIONAL LABOUR FEDERATION
5. SIV ENTREPRENEUR LABORATORY, KEIO UNIVERSITY
6. EMPLOYMENT AND HUMAN RESOURCE CENTRE (MINISTRY OF LABOUR)
7. NOKADAI, EMPLOYMENT AND HUMAN RESOURCES DEVELOPMENT ORGANIZATION OF JAPAN

## **Annex 2:**

### **LIST OF RESEARCH DOCUMENTS COLLECTED IN TOKYO (25 September - 6 October 2006)**

#### **SOURCES ON JAPANESE SMEs (in JAPAN)**

##### **1. EHS Law Bulletin Series (1998)**

Medium and Small Enterprise Basic Law no 6810

Medium and Small Enterprise Modernization Promotion Law no 6815

Medium and Small Enterprise Guidance Law no 6820

Revised Version of the Basic Law on Small and Medium Enterprises

The Law on the Promotion of Subcontracting Small and Medium Enterprises

The Law on the Prevention of Delay in the Payment of Subcontracting  
Charges and Related Matters

##### **2. METI, SME Agency, Japan Small Business Research Institute (JSBRI)**

2005 White Paper on Small and Medium Enterprises in Japan : Structural  
Change in Japanese Society and the Dynamism of Small and Medium  
Enterprises

##### **3. National Life Finance Corporation (NLFC)**

Trends of Small Businesses in Japan, *NLFCRI Report*, no 14, August 2006

##### **4. Shoko Research Institute (SRI)**

Japanese SMEs 2006

##### **5. Japan Economic Foundation**

« Japan's SMEs », *Japan Spotlight (Bimonthly)*, May/June 2006

##### **6. Japan Entrepreneurs Association**

JEA Business Operations (2006)

Kanagawa Science Park Inc. (2006)

« Education and Entrepreneurship in the Asia-Pacific Region : Diverse Perspectives and Methods », JEA and University of Stanford, 2005

## **7. Keio University, SIV Entrepreneur Laboratory**

« Entrepreneurship in Japan », by Kanetaka Maki, Tokyo, Keio University/SIVEL, Graduate School of Media and Governance, Taipei, APEC-TIC 100 Conference, August 2006

## **8. Nokadai, Tokyo**

Activities of the Employment and Human Resources Organization of Japan, 2006

## **9. Gender and Development in Japan**

Kazuko Kano, « Entrepreneurship and Rural Women's Empowerment : Some Japanese and Thai Cases » in Mayumi Murayama (ed), *Gender and Development : The Japanese Experience in Comparative Perspective* », London, Palgrave MacMillan, 2006, pp 85-116

# **SOURCES ON JAPANESE SMALL AND MEDIUM ENTERPRISE ODA COOPERATION OVERSEAS**

## **1. JAPAN INTERNATIONAL COOPERATION AGENCY**

Annual Reports (2004, 2005)

Our Challenges for a Better Tomorrow, JICA's Contribution for Achieving the Millennium Development Goals (MDGs)

Approaches for Systematic Planning of Development Projects : Promotion of Small and Medium Enterprises, JICA Institute for International Cooperation, May 2002

« Industrial Structure Transformation and SME Promotion System in Japan », by Yoshio Koyama, JICA SME Senior Advisor, Institute for International Cooperation, September 2006

JICA, Osaka International Training Centre, Group Training Course, List and Training Programs dealing with SME Development (2005-06)

JICA in Indonesia,  
JICA in Aceh  
JICA Community Empowerment Program (CEP) for Rehabilitation  
/Reconstruction of Aceh and North Sumatra

## **2. JAPAN BANK FOR INTERNATIONAL COOPERATION (JBIC)**

The Role and Function of JBIC

An Introduction to JBIC International Financial Operations : Operations of  
the Advisory Consulting Office for SMEs

Annual Report (2005)

Evaluation Highlights on ODA Loan Projects (2005)

JBIC Today (Journal) July 2003, March 2004, November 2005, March 2006,  
July 2006

« Road Stations for Rural Development : OVOP, Tourism and Local  
Industry », by Kazuko Kano, JBIC Senior Advisor, Hanoi, APEC « One  
Village One Product » Seminar, 22-23 September 2006

« One Village One Product Strategy », by M. Yamakage (in cooperation with  
Mrs K. Kano, JBIC), Oita Prefecture, Oita International Center, 2004

## **3. Japan International Labour Foundation (JILAF)**

What is JILAF? (no date)

What is the Positive Program? (no date)

Past JILAF Activities, March 2005

## **4. Association for Overseas Technical Scholarship (AOTS)**

Activities in 2005

Activities in 2006

## **5. United Nations Centre for Regional Development, Nagoya**

« Sustainable Development and Revitalization : Case of One Village One  
Product Movement, Its Principles and Implications », by Teruhiko  
Yoshimura, UNCRD, 14 June 2004 ([www.uncrd.or.jp](http://www.uncrd.or.jp))

