

Economy

IMPROVING THE PERFORMANCE OF JAPAN'S SME SECTOR

- ▶ Between 1999 and 2014, the number of small and medium-sized enterprises (SMEs) in Japan dropped by 21% as a result of the retirement of ageing business owners and weak entrepreneurial intentions in the Japanese population.
- ▶ The productivity of small enterprises is only 45% of that of large companies, less than in most other OECD countries. To narrow the gap, it is important to promote R&D spending by small enterprises and strengthen entrepreneurship by raising both business entry and exit rates.
- ▶ The government has taken important steps to revitalise SMEs, including by expanding the use of the Guidelines for Personal Guarantees Provided by the Business Owners, reforming the Credit Guarantee System, upgrading managerial skills in SMEs, and nurturing entrepreneurial attitudes. It is also important to make the personal insolvency regime less stringent.

What's the issue?

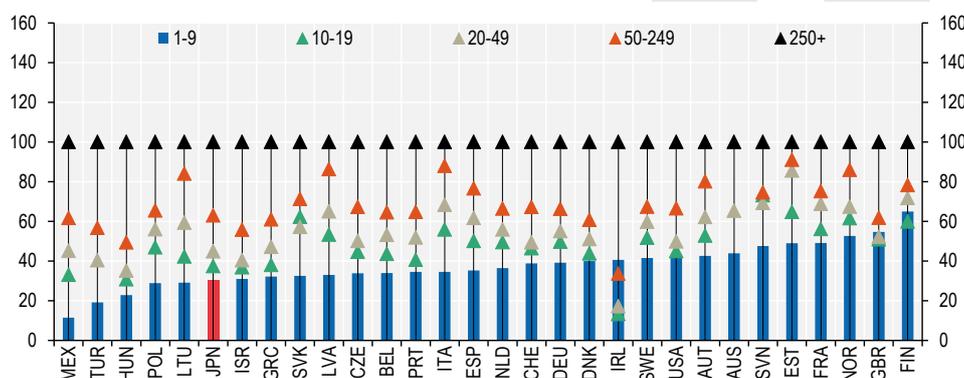
Business dynamism in Japan's SME sector is relatively weak. Between 1999 and 2014, the number of SMEs dropped by 21%, from 4.8 million to 3.8 million, a consequence of ageing business owners unable to find a successor and weak entrepreneurial attitudes in the society, particularly among women. As a result of the low business entry rate, Japan's SME sector is relatively old; firms over ten years old account for three-quarters of Japan's small enterprises (less than 50 workers), compared to less than half in most OECD countries. These mature companies also find it difficult to grow, with an average of only ten employees in manufacturing and six in services.

Small companies in Japan are much less productive than bigger ones (see Figure). Labour productivity in firms with 20-49 employees is 45% of that of firms with more than 250 employees, i.e. 10% less than the OECD average. Large labour productivity gaps by firm size are reflected in significant wage differentials between firms, as shown by the dispersion of average labour income, which is far above the OECD average.

There are two main ways to increase the productivity of the SME sector. First, it is important to promote R&D spending in small enterprises. Although Japan has one of the highest levels of R&D spending by the business

The productivity of smaller firms is pretty low in Japan

Value added per person employed, index 250+ = 100, 2013 or latest available year



Source: OECD (2016), *Entrepreneurship at a Glance*, OECD Publishing, Paris.

sector in the OECD area, at 2.8% of GDP, it is mostly concentrated in large enterprises. Second, business entry and exit rates need to be raised. Both are low by international standards, at around 4-5% and well below the 10% objective set by the Japan Revitalization Strategy. Higher business entry and exit rates are a proxy for entrepreneurial creative destruction, which raises productivity through competitive pressure on incumbents and the replacement of old, less efficient firms with new, more efficient ones.

The government has taken steps to boost the dynamism of the SME sector. In some respects, the regulatory environment in Japan is significantly more business friendly than the OECD average: Japan's corporate insolvency regime is highly efficient, in particular with regard to firm restructuring; administrative burdens on start-ups are below the OECD average, though they could be further reduced; trade restrictions in services are less severe than in most other OECD countries; and the quality of physical and ICT infrastructure is well above the OECD median.

Furthermore, the Guidelines for Personal Guarantees Provided by the Business Owners introduced in 2014 aim to reduce the reliance on personal guarantees and alleviate the effects of the personal insolvency regime, which unlike the corporate insolvency regime, is considered a major impediment to business exit. The Credit Guarantee System, one of the largest and most generous in the OECD, is being reformed to strengthen market force. This, together with improving economic conditions, is expected to contribute to a decline in outstanding credit guarantees and the share of guarantees covering 100% of the loans. Finally, educational programmes for university students (e.g. the Enhancing Development of Global Entrepreneur Program) have been set up to boost entrepreneurial attitudes among young people, the new Program on Open Innovation Platform with Enterprises, Research Institute and Academia (OPERA) encourages industry-university partnerships involving SMEs at the pre-competitive stage of development, and the SME Training Institute offers seminars for owners and managers of SMEs.

While all these efforts should help to strengthen SMEs as a source of growth, as outlined in the 1999 Basic Law on Small and Medium Enterprises, additional government responses are needed. For example, diversifying the sources of SME financing will be important to further reduce SMEs' debt exposure. Reforms to boost the productivity of existing SMEs and entrepreneurial dynamism need to be pursued as part of a broader package of structural reforms. For example, in Japan, less than half of displaced workers in 2014 were re-employed within one year, while a quarter had completely left the labour force, pointing for example to the importance of active labour market policies.

What should policy makers do?

- ▶ Facilitate the exit of non-viable firms by reducing the use of personal guarantees, making the personal insolvency regime less stringent, and expanding the use of the Guidelines for Personal Guarantees Provided by Business Owners to expedite out-of-court settlements for failed SMEs.
- ▶ Increase the productivity of existing SMEs by strengthening R&D links between firms and universities and upgrading managerial and workforce skills through training at the firm level.
- ▶ Support the access of SMEs to diverse non-traditional financing instruments and enhance SMEs' financial skills, in line with the G20/OECD High-level Principles on SME Financing.
- ▶ Strengthen entrepreneurial attitudes in the population through wider diffusion of entrepreneurship education at all levels of education, with a special focus on women.

Why is this important for Japan?

SMEs play an important role in the Japanese economy, accounting for 70% of national employment, compared to 60% for the OECD area. However, despite their weight in the economy, SMEs generate only slightly more than 50% of national value added, less than in most other OECD countries. Enhancing the productivity of the SME sector, alongside stronger entrepreneurial dynamics, will help Japan achieve stronger economic growth.



Further reading

OECD (2017), *Financing SMEs and Entrepreneurs 2017: An OECD Scoreboard*, OECD Publishing, Paris. <http://www.oecd.org/eco/surveys/economic-survey-japan.htm>

OECD (2016), *Entrepreneurship at a Glance 2016*, OECD Publishing, Paris. <http://www.oecd.org/std/business-stats/entrepreneurship-at-a-glance-22266941.htm>

OECD (2015), *G20/OECD High-Level Principles on SME Financing*. <https://www.oecd.org/finance/G20-OECD-High-Level-%20Principles-on-SME-Financing.pdf>