Evolution of SME Policy in Japan and Korea: Experience and Policy Implications

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Abstract This paper introduces Small and Medium Enterprises’ (SMEs) development and SME policies of Japan and Korea from a historical point of view in relation to the two countries’ economic development. Based on this, it sums up four characteristics of SME policies of the two countries: (1) Balanced development between SMEs and large firms is reached under governments’ efforts; (2) SMEs are encouraged to get more involved in the global network; (3) Innovation is ranking higher on policy agendas nowadays; (4) Administrative institutes are established for SMEs’ development and the better implementation of particular policies. After that, three SME policy suggestions are made for China: (1) to establish a uniform SME management organization; (2) to focus on finance policy and organize credit guarantee system; (3) to enhance innovation incentives.

Key words SME, Policy, Implications

1 Introduction

Nowadays Small and Medium Enterprises (SMEs) are gaining the recognition they deserve as the backbone of economy, acknowledged as a constant source of ideas, innovation and entrepreneurial skills, the principal providers of existing jobs and the main source of new employment. However, compared with large firms, SMEs have disadvantages such as a limited resource base, a different organizational culture linked to the proximity between ownership and management, and a lower ability to shape their external environment. All these characteristics put SMEs in inferior positions, calling for forceful policy from the government.

This paper introduces SMEs’ development and SME policy evolution of Japan and Korea in relation to the countries’ economic development. Based on this, it sums up characteristics of SME policies of the two countries in order to derive lessons from their experience. The remainder of the paper is organized as follows: Section 2 provides an overview of SME policy, categorizing major SME policies into four types. Detailed studies of Japan and Korea’s SME policies are carried out in Section 3 with their characteristics synthesized. Finally, Section 4 concludes and attempts are made to draw some SME policy implications for China.

2 SME Policy: An Overview

SME policy can be categorized into four types:

1) Finance Policy. Getting a company off the ground or expanding it requires money, and finding the right kind of finance is often a major difficulty for SMEs. Government can make it easier for SMEs to get loans from banks by providing guarantees through developing and funding financial instruments. It is also facilitating venture capital investment into SMEs.

2) Taxation Policy. Tax deduction proves to be an effective policy to stimulate investment. Taxation policies can be in favor of SMEs in designated priority sectors or with characteristics of innovation or globalization. Government can also impose special tax to foster SMEs’ development.

3) Industry Policy. In order to optimize industry structure, a considerable number of SME policies are industry-specific. It is equally important for the government to establish strict competition policy that protects SMEs against unfair practices by other economic operators.

4) Science and Technology Policy. Different from financial support and tax incentives for technology development of SMEs, S&T policy is usually portentous policy framing conducting innovative activities of SMEs.

3 SMEs Development And SME Policy of Japan and Korea
In this section, SMEs development and policy environment of two neighboring nations: Japan and Korea are presented. We introduce the SME policies from a historical review in relation to the countries’ economic development.

3.1 Japan

3.1.1 Japanese SMEs

Japanese SMEs account for 99.7% of the overall Japanese enterprises and 70.2% of the total employment. It is a well-established fact that Japan hosts the largest number of SMEs among industrialized countries (Hideki 2001). Appropriate and timely SMEs policies have always accompanied Japanese SMEs’ growing, ensuring the success of SMEs in keeping the economy afloat. Japanese SMEs development passed through three phases: Reconstruction Period, Growth Period, and Transition Period.

3.1.2 Japan’s SME Policy

As a natural consequence of World War II, Japanese SMEs began their operations. With the Small and Medium Enterprise Agency (SMEA) established in 1948, basic tools relating to financial resource, cooperatives, management consulting and guidance, and taxation to aid SMEs were carried out. Productions spurred during the next period, however, with the ‘advanced large-scale enterprises’ on one hand, and the ‘delayed SMEs’ on the other (SME Agency, METI 2002). In this context, the Law on Financial Assistance for Promoting Small and Medium Enterprises was enacted in 1956 with the aim of improving the productivity of SMEs through the usage of modern equipment. The government had also implemented measures for the diffusion of the subcontracting division of labor between large enterprises and SMEs.

In 1963, SME Basic Law was enacted which aimed to eliminate perceived disadvantages faced by SMEs, support their self-help efforts, improve their productivity and trading conditions, as well as improve the social status of their employees. The SME Basic Law was important in that it stipulated general descriptions of SMEs and consolidated in a single document all preceding laws. Until the end of 1999, the Japanese government based its SME policies on the SME Basic Law. The premise is that SMEs are small in size but large in number, old-fashioned and undifferentiated, and particularly weak. Consequently, conventional SME policies has been basically aimed at closing the gap between SMEs and large enterprises through pursuing the scale merit of SMEs while developing a uniform modernization policy for each industry.

With entry to the new millennium, fundamental revision of the SME policy framework occurred, along with the revision of the SME Basic Law. The main point is to treat SMEs as the source of entrepreneurship, innovation and job creation. Differences of the old and new Japanese SME Basic Law are presented in Table 1.

| Table 1 Summary of Basic Differences Regarding Japanese SME Basic Law |
|-------------------------------------|-------------------------------------|
| **Previews SME Basic Law** | **New SME Basic Law** |
| Rectify the Gap Between LE & SME in terms of productivity | Developing a wide range of independent SMEs for greater economic vitality |
| | Creation of new businesses |
| | Promotion of market competition |
| | Increase of attractive job opportunities |
| Upgrading/Improving Productivity | Supporting self-help for ambitious enterprises: |
| | Strengthening of Management Base |
| | Facilitating apt responses by enterprise for abrupt environmental change (Providing Necessary Safety Net), facilitating change of business, provision of mutual relief system & legal system of bankruptcy |
| | Finance & Taxation (i.e. establishing various ways to supply fund including direct financing) |

Source: Small and Medium Enterprise Agency (www.sme.ne.jp/policies02_kaiseigaiyo/kaiseigaiyo.html)

3.2 Korea

3.2.1 Korean SMEs

The Korean model of industrialization is often described as “large-scale enterprise-oriented
development model”. As a result, the large scale firms grew faster than SMEs until the 1970s. The government has made serious efforts to promote SMEs through various support programs beginning in the early 1980s. Thanks to government’s intensive policy efforts SMEs began to recover their growth momentum and made a significant progress thereafter (Table 2).

### Table 2 Summary of Basic Differences Regarding SME Basic Law

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Establishments</th>
<th>Number of Workers (in thousands)</th>
<th>Value Added (percentage)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Large firms</td>
<td>SMEs</td>
<td>Large firms</td>
</tr>
<tr>
<td>1963</td>
<td>237 (1.3)</td>
<td>18,073 (98.7)</td>
<td>47.2</td>
</tr>
<tr>
<td>1973</td>
<td>1,037 (4.5)</td>
<td>22,256 (95.5)</td>
<td>72.8</td>
</tr>
<tr>
<td>1980</td>
<td>1,044 (3.4)</td>
<td>29,779 (96.9)</td>
<td>64.8</td>
</tr>
<tr>
<td>1990</td>
<td>1,193 (1.7)</td>
<td>67,679 (98.3)</td>
<td>55.7</td>
</tr>
<tr>
<td>2000</td>
<td>731 (0.7)</td>
<td>97,379 (99.3)</td>
<td>49.8</td>
</tr>
</tbody>
</table>

Source: Small and Medium Business Administration, Statistics on Small and Medium Enterprises, Various Issues. Note: Figures in parenthesis are percentages.

#### 3.2.2 Korea’s SME Policy

In the 60’s and 70’s, promotional measures for SMEs were largely of a legal and institutional nature laying the basis for the growth of SMEs. There were some monetary and fiscal incentives which were rather fragmentary and very selective. However, they were not very effective in stimulating the growth of SMEs because the overall industrial incentives scheme favored the large-scale firms.

Entering the 1980s, the government began to reshape industrial incentive system from industry-specific support to functional support while making intensive and integrated policy efforts to promote SMEs. In April 1982, ten-year Long-term Plan was formulated for the promotion of small and medium industries covering up to 1991. SME-related laws such as the SME Basic Act and SME Promotion Act were amended to help achieve the long-term development goals. A number of new promotional measures were taken. It is note-worthy that industrial policy with great emphasis on technology and manpower development was very conducive to the development of SMEs because the new policy direction greatly encouraged innovative activities of SMEs. Trade liberalization policy also greatly helped SMEs by facilitating the inflow of foreign capital as well as technology licensing.

The industrial policy in the 1990s was directed towards enhancing industrial competitiveness as the Korean economy was rapidly liberalized and integrated into the world economy. The SMEs development policy geared to promoting technology development has been further intensified after financial crisis in 1997 because the Korean economy could no longer rely on big corporations. Venture Business Promotion Act enacted in 1997 encouraged venture business in high-tech industries. SMEs are also encouraged to utilize IT by carrying out IT education, promoting information-based management system and assisting digitalization of production lines, etc.

#### 3.3 Characteristics of Japan and Korea’s SME Policy

From the evolution of SMEs’ and SME policies of Japan and Korea above, it is evident that the growth of SMEs and their structural change in both countries are greatly affected by the government policies during the last several decades. Under the framework of SME policy categorization introduced in Section 2, we observe comprehensiveness of Japan and Korea’s SME policies, covering all respects. Fundamental policies such as providing financial resources, deducting taxes, procuring SMEs’ products, giving managerial guidance and training services, facilitating incubation, accelerating technology transferring, etc have been established, improved and carried out forcefully. Meanwhile, there are emphases on some aspects which need our attention:

**First, balanced development between SMEs and large firms is reached under governments’ efforts.** Aside from the traditional SME promotion means, governments of both countries have reduced
the conflicts and unfair practices of large firms while promoting cooperation between the large-scale firms and SMEs. Sub-Contracting Promotion Act stipulates product for sub-contracting production. Related Subcontractors’ Payment Law prevents abuses of large enterprises such as delaying or reducing payment. Moreover, some business areas identified suitable for SMEs are reserved, prohibiting large firms from participating in. In doing so, mutually beneficial linkages between SMEs and large firms are established with SMEs’ association strengthened.

Second, SMEs are encouraged to get more involved in the global network. Due to rapid globalization, economies of both countries are experiencing structural changes. SMEs have relatively more difficulties in their adjustment since they typically operate on a small scale and concentrate more on domestic markets. To alter this situation, internationalization has been a major policy objective of both countries. Requirements for entering export and import business has been greatly relaxed and reduced. These measures have greatly inspired SMEs’ enthusiasm and accelerated their globalization pace. In Korea, for instance, share of SMEs in export grew from 38% in 1988 to 43% in 2001.

Third, innovation is ranking higher on policy agendas nowadays. This change is nurtured by the understanding that innovation is the key to economic development for developed, high-wages countries. It is becoming visible through a gradual shift in policy from support to R&D and technology diffusion, towards the promotion of innovation since the 1990s’. This change in focus reflects the efforts paid to meet the view that innovation is an interactive, rather than linear, process.

Moreover, both countries have established independent organizations for SMEs’ development. In Japan, there are Small and Medium Enterprise Agency and National Life Finance Corporation. In Korea, there is Korea Federation of Small Business. These administrative institutes for SMEs’ development later became major policy sourcing places. Additionally, several independent institutes are also established for the better implementation of particular policies.

4 Conclusion and Policy Implications
SMEs are the backbones of the economies of Japan and Korea. SMEs policies of both countries are all-rounded with special emphasis on innovation, globalization and balanced development with large firms. Both countries have also established SME institutes in early development stages which later become important policy sourcing places.

Even though there is truly no unique pattern of SME policies and what may work for one country, may not work for another, there are a lot of experiences we can draw from Japan and Korea’s SME policy.

First, there is an urgent need to establish a uniform SME management organization. In China, SMEs are administrated by different sectors, badly hampering SMEs’ development. A country-level SME institute can coordinate interests of different parts of the economy and protects healthy growth of SMEs.

Second, policies with regard to finance should be current focus of SME policy. In China, the biggest challenge SMEs face is the under-developed finance system. A lot of finance policies are not well implemented because only few SMEs reach the required standards. Special Banks assisting SMEs should be set up and Credit Guarantee Fund Reserve System should be organized to support SMEs that are lack of tangible collaterals.

Third, innovation should be incorporated into national SME policies. SMEs are a vital part of the National Innovation System. In line with the National Middle and Long-term Plan, innovative and high-tech SMEs should receive more financial as well as S&T incentives than their counterparts.

Reference


