

OECD Global Conference
“Enhancing the Role of SMEs in Global Value Chains”
Keynote Speech

**Development of Small and Medium Enterprises Abroad
- The Case of Japan -**

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Hiroyuki Ishige

Director-General, Small and Medium Enterprise Agency,
Ministry of Economy Trade and Industry

Contents

1. Background

2. Development of SMEs abroad

3. Challenges faced by SMEs abroad

4. Directions of future policy

1. Background

- The Bologna Charter on SME Policies adopted at the Ministerial-level meeting on SMEs (June 2000).
- The Tokyo Conference, originally proposed by METI, is joined by officials not only from OECD member countries but from Japan's neighboring countries and regions.
- Three questions raised in the presentation:
 - How do SMEs respond to globalization?
 - What are the challenges faced by SMEs?
 - What measures should be taken in order to overcome those challenges?

2. Development of SMEs abroad

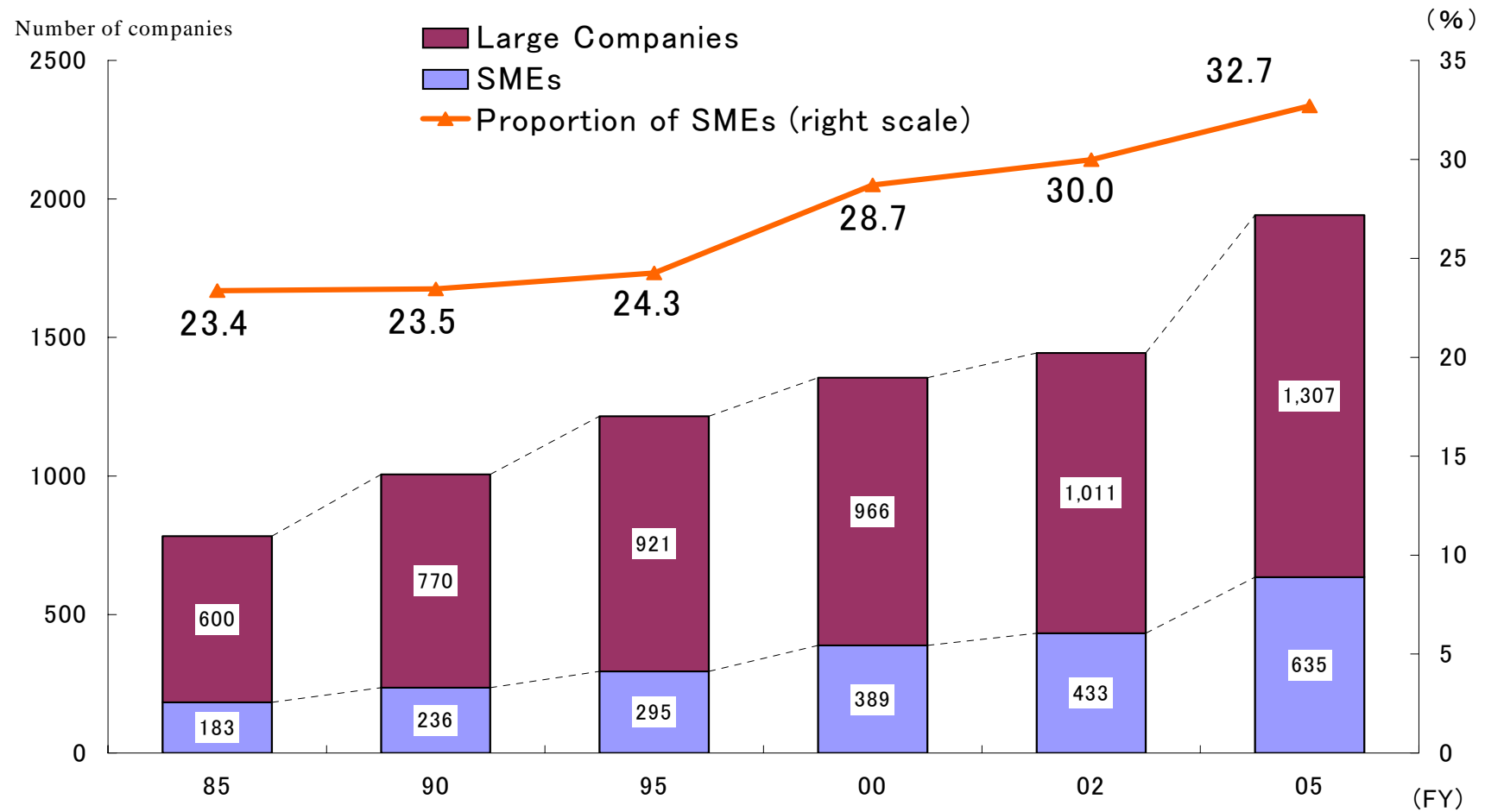
(1) Historical development of Japanese SMEs abroad

| Period | development abroad |
|------------------|---|
| Until the 1970s | <p>Large firms</p> <ul style="list-style-type: none"> - Establishment of joint ventures with local capitals - Domestic market-oriented - Assistance provided for the development of local industries <p>SMEs</p> <ul style="list-style-type: none"> - No significant foreign direct investment |
| 1980s | <p>Large firms</p> <ul style="list-style-type: none"> - Full-fledged foreign direct investment (FDI) started following the Plaza Accord in 1985 <p>SMEs</p> <ul style="list-style-type: none"> - Medium-sized parts suppliers, often subcontractors for large assemble firms, were asked to undertake FDIs in order to fulfill the local content requirements |
| 1990s and onward | <p>Large firms</p> <ul style="list-style-type: none"> - Increased the amount of FDIs in response to the sluggish demand in Japan after the bubble burst <p>SMEs</p> <ul style="list-style-type: none"> - Faced with shrinking domestic business, small and medium sized manufacturers launched independent efforts for development abroad |

(2) Direct Foreign Investment by SMEs

- Number of SMEs overseas increased.

SME manufacturers with foreign subsidiaries



Data: Ministry of Economy, Trade and Industry "Basic Survey of Overseas Business Activities"
 (Note) SMEs are defined as having less than 100 million yen capital before 1995, and less than 300 million yen after 2000.

(3) SMEs in East Asia

- **Drastic shift in SMEs' objectives through their development abroad**

Commencement of operation : Reduce cost; Follow their large customers in East Asia

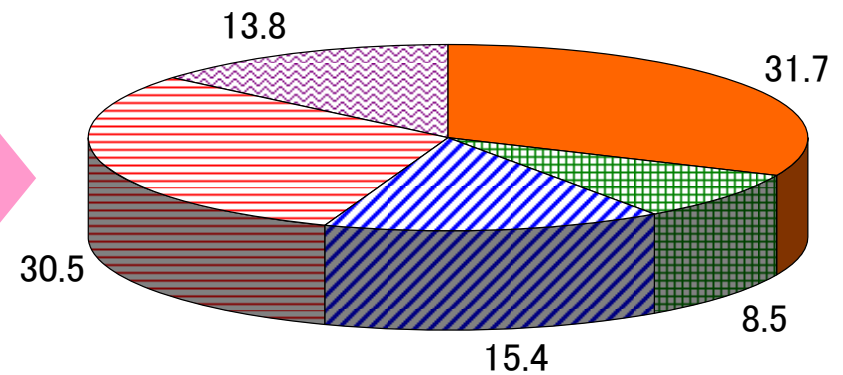
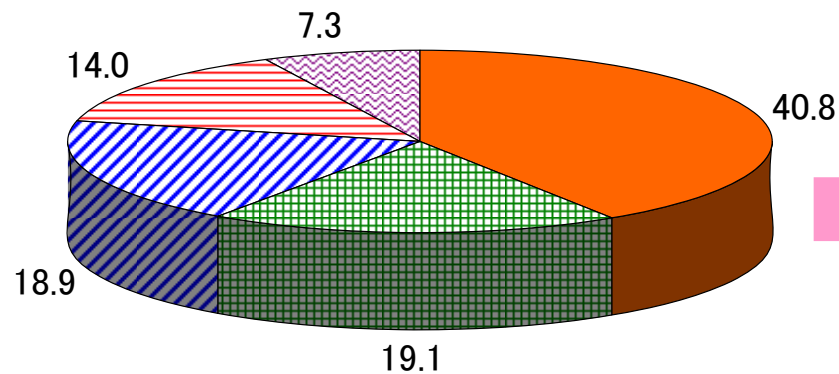
Now : Develop local sales

(Commencement of operation)

(Now)

- Reducing costs
- Following request by customer for investment
- Company's own decision to follow a customer's expansion overseas
- Developing local sales
- Others

- Reducing costs
- Following request by customer for investment
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- Developing local sales
- Others



Data: Mitsubishi UFJ Research and Consulting "Survey on the Situation of Recent Business Environmental Changes for Manufacturers" (November, 2005)

(Case Studies) Advantages from Direct Foreign Investment for SMEs

(Case A)

Mold design and polymer processing (80 employees, 30 million yen capital)

- By expanding business to Shanghai, it has become possible to obtain estimates from European makers that have also entered the Chinese market.
- Dealing with manufacturers from across the world in China gives a big advantage for the company.

(Case B)

Precision mold manufacturing (32 employees, 50 million yen capital)

- The fact that the company has a factory in Tianjin is a big selling point in marketing activities and for placing of orders.

(Case C)

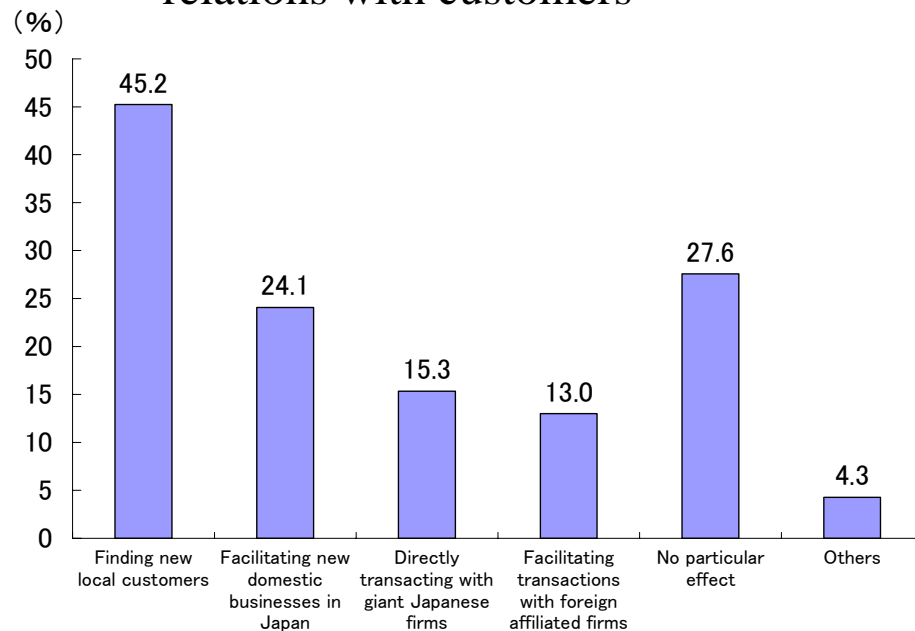
Welding and thermal spraying (70 employees, 30 million yen capital)

- Synergistic effect through the collaborating factories in Japan and China
 - Japan : R&D to produce prototypes
 - China : Mass production and Exports
- Sizable cost reduction
- Increase of customers in Japan

• **Benefits of FDIs for SMEs include ①increasing local sales, ②facilitating new businesses in Japan, and ③transacting directly with giant Japanese firms that would otherwise be impossible.**

• **A smaller portion of SMEs report negative impacts on production back in Japan.**

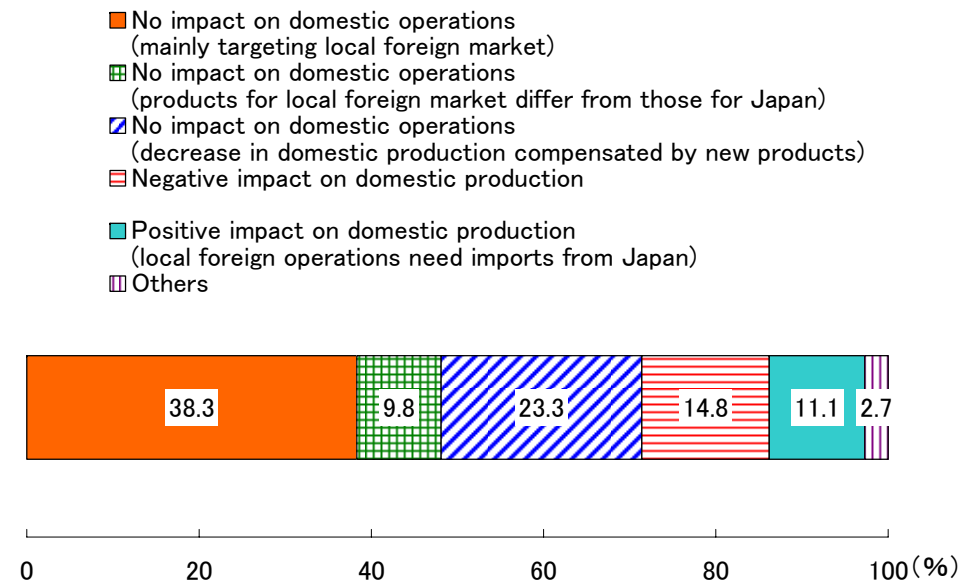
Impact of FDIs on relations with customers



Data: Mitsubishi UFJ Research and Consulting “Survey on the Situation of Recent Business Environmental Changes for Manufacturers” (November, 2005)

(Note) Multiple responses allowed

Impact of FDIs on domestic activities in Japan



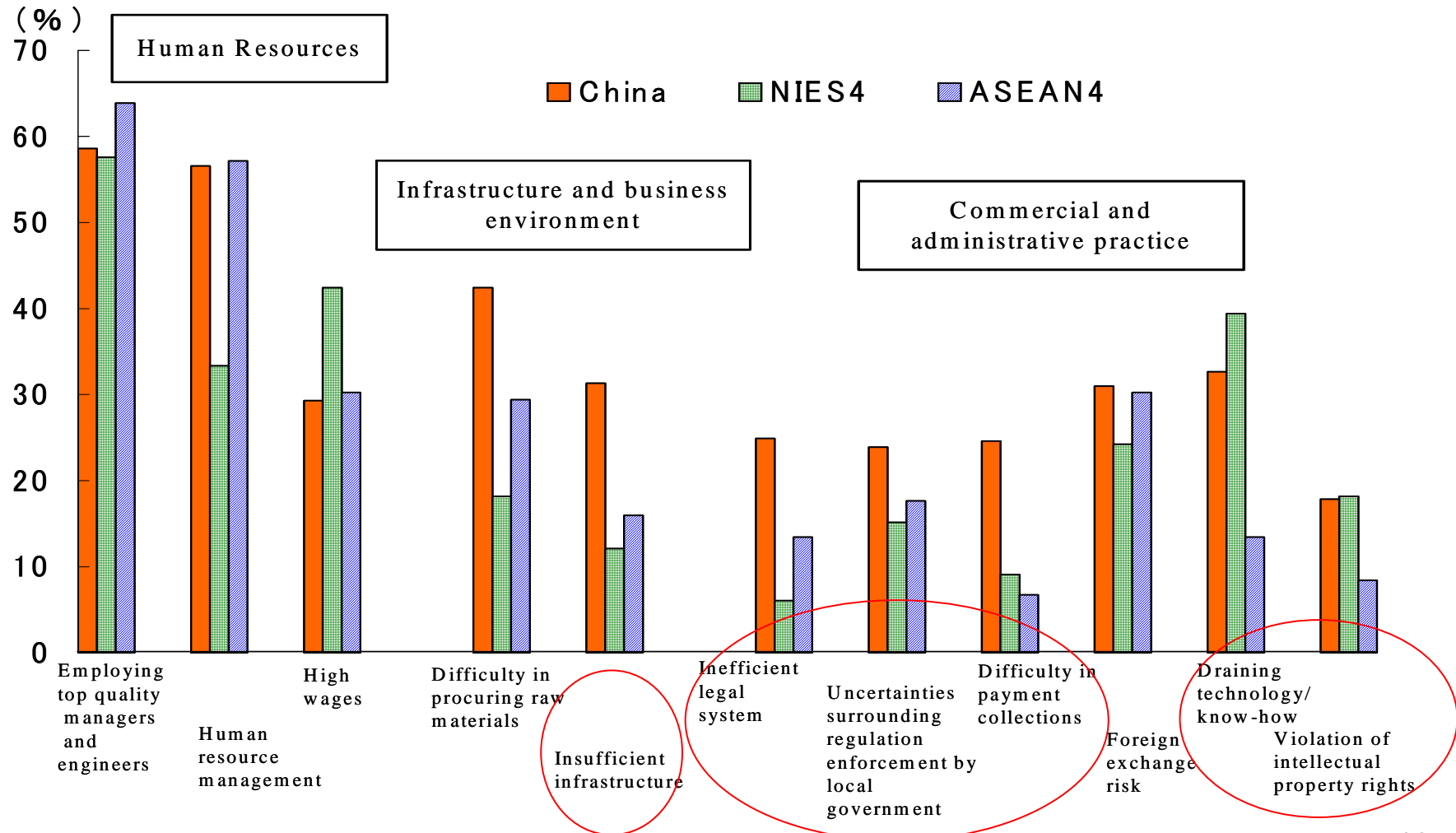
Data: JBIC “FY2005 Survey on Direct International Investment”

3. Challenges faced by SMEs abroad

(1) Various Challenges

- SMEs that pursue business operations overseas are faced with a wide variety of challenges.

Challenges for SMEs that have expanded business overseas

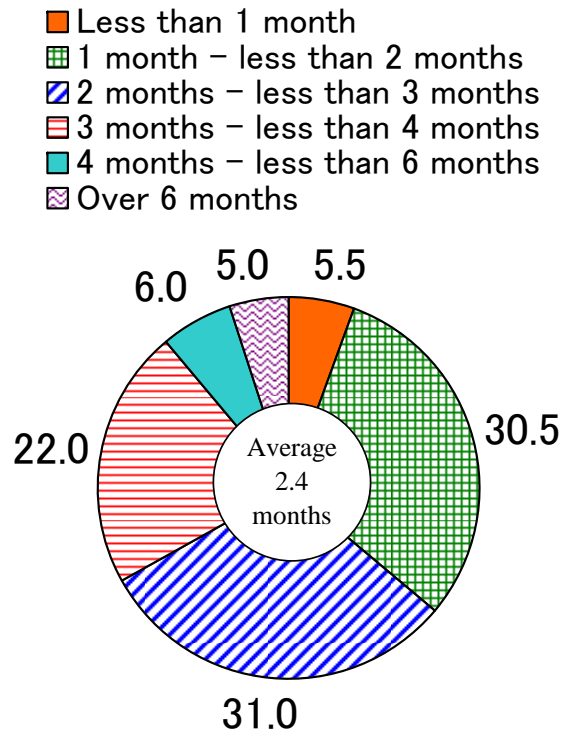


Data: Mitsubishi UFJ Research and Consulting "Survey on the Situation of Recent Business Environmental Changes for Manufacturers" (November, 2005)
 (Note) Multiple responses were possible

(2) Collection of Payment

- Difficulties in payment collections in China
- The lengthy payment period for accounts receivables
- Frequent delays in payment due to perverse incentives for procurement officers

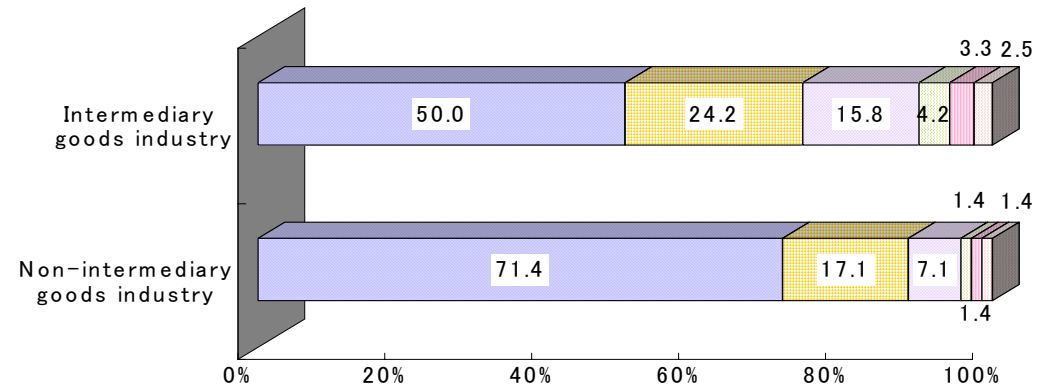
Payment period of accounts receivables



Data: Mizuho Corporate Bank "Domestic sales and payment collection in China" (March, 2007)

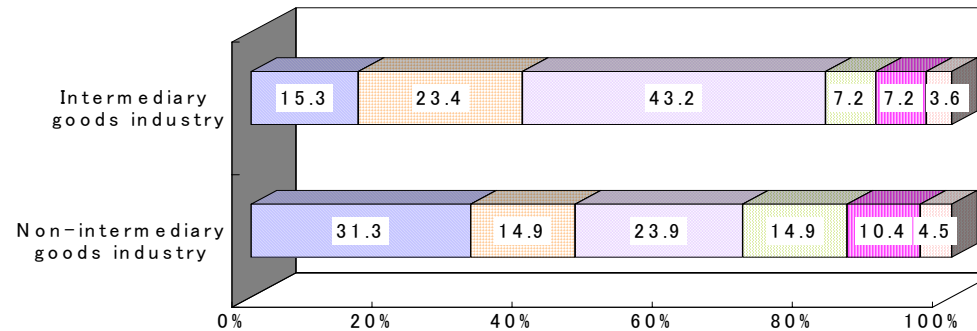
Ratio of Late Payment collections in China

■ Less than 10%
 ■ 10%-less than 20%
 ■ 20%-less than 40%
■ 40%-less than 60%
 ■ 60%-less than 80%
 ■ Greater than 80%



Length of Late Payment Period

■ Less than 2 weeks
 ■ 2weeks-less than 1 month
 ■ 1month-less than 3 months
 ■ 3months-less than 6 months
■ 6months-less than 12months
 ■ Longer than 12 months

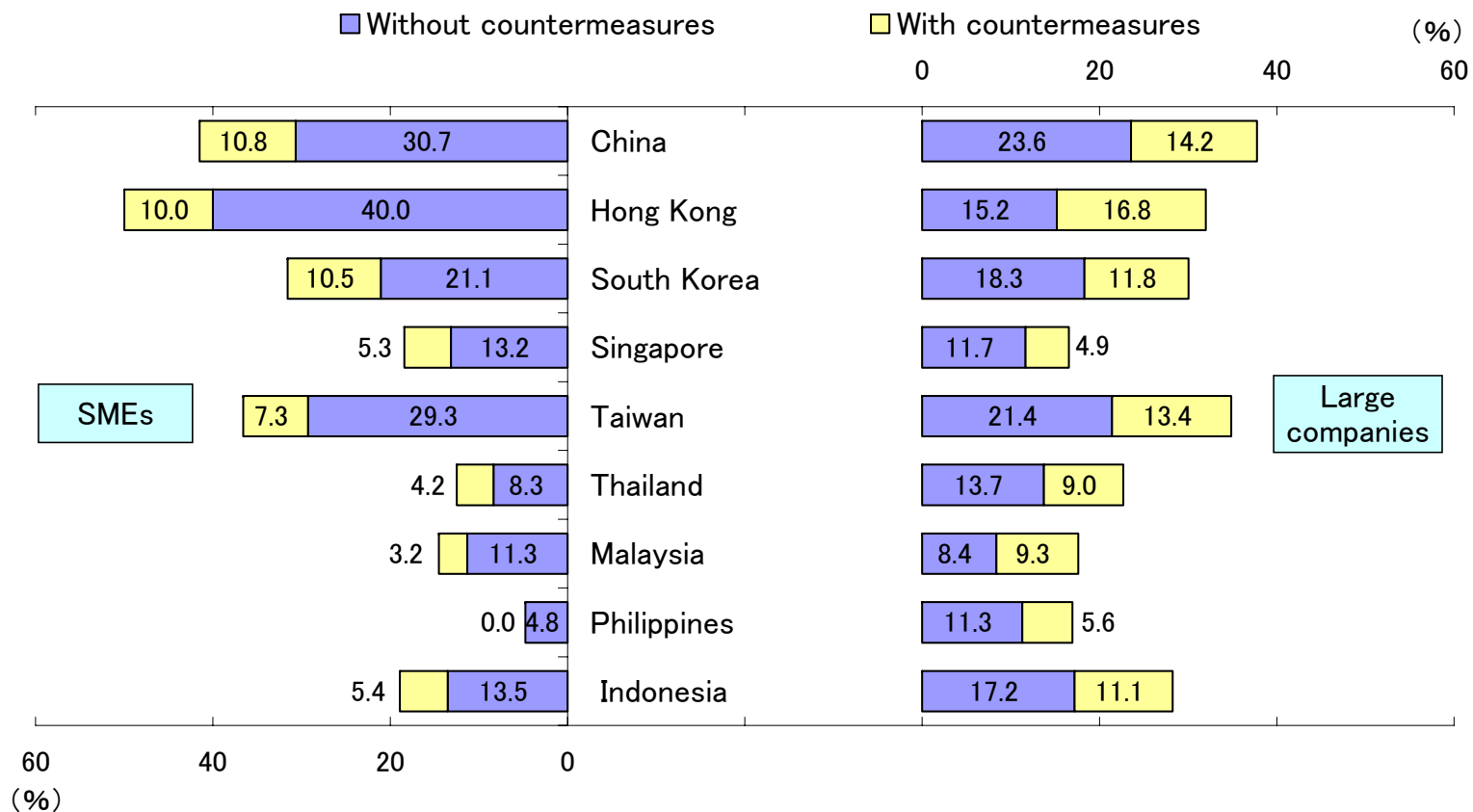


Data: JETRO Shanghai Center "Survey report on situation of payment collection issues for Japanese companies in China" (2004)

(3) Problems with Intellectual Property Rights

- Much of the trouble on intellectual property rights exists in China, Taiwan, Hong Kong, and the Republic of Korea.
- SMEs unable to take countermeasures reluctantly concede.

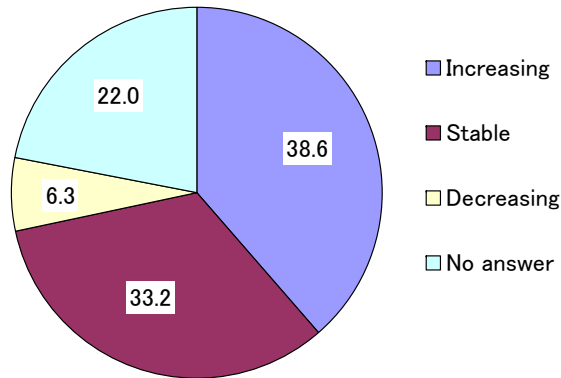
Frequency of Intellectual Property Rights Trouble



Data: Ministry of Economy, Trade and Industry “32nd Basic Survey on Overseas Business Activities”
 (Note) Large manufactures have domestic headquarters with capital of over 300 million yen and over 300 employees. SME manufacturers have domestic headquarters with capital of less than 300 million yen or less than 300 employees.

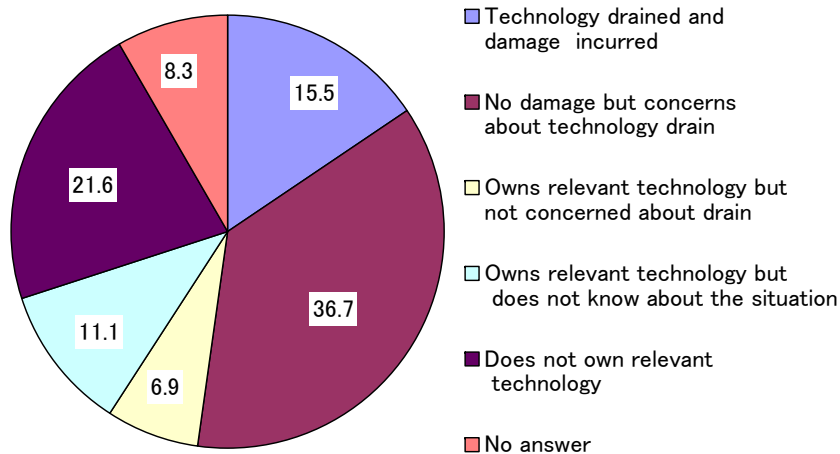
- Damages caused to Japanese firms from counterfeit goods are on the rise
- Strong concerns regarding the drain of technology overseas
- Undeveloped legal systems and inadequate regulatory systems seen as factors for counterfeit damages

Trends in counterfeit damage



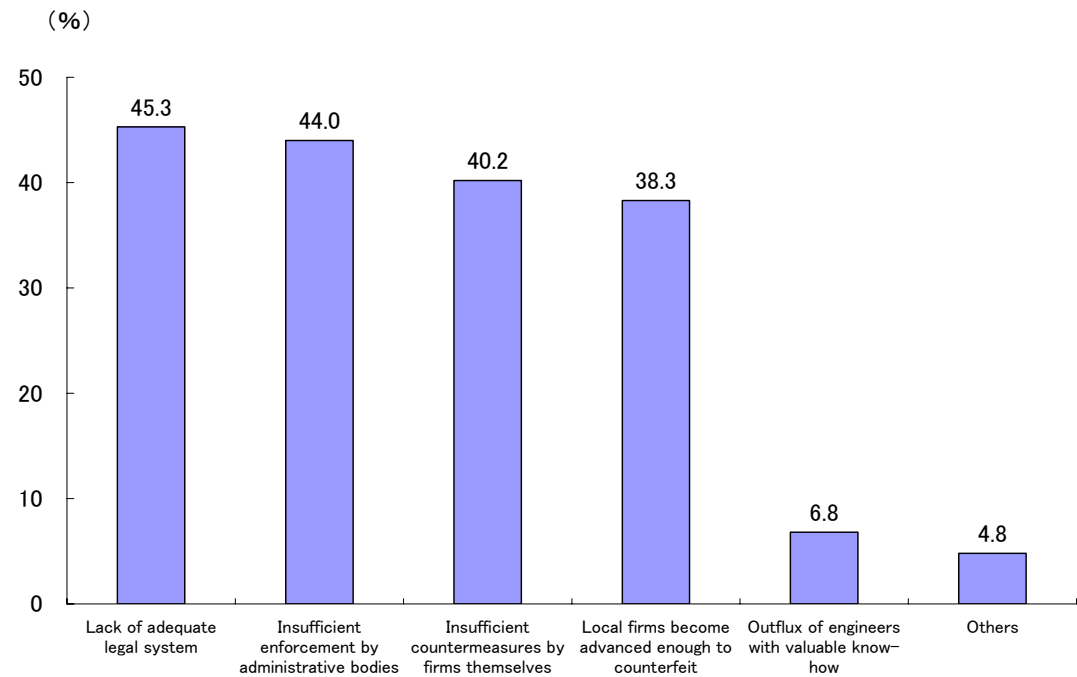
Data: Japan Patent Office "Survey report on counterfeit damages" (2005)

Concern about overseas technology drain



Data: JETRO "2005 Survey on Japanese Business Expansion Overseas" (March 2005)

Causes of counterfeit damage

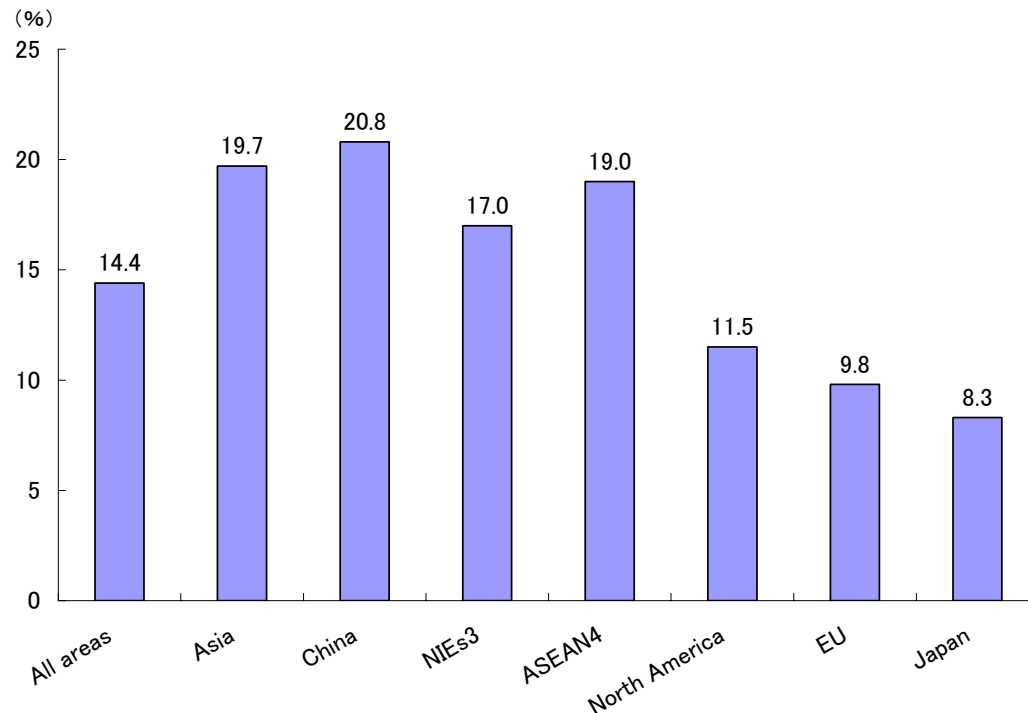


Data: Japan Patent Office "Survey report on counterfeit damages" (2005)

(4) Cost of Logistics

- **Japanese enterprises in Asia pay twice as much for logistics as they would in the United States or Europe**

Share of logistics costs in general administrative expenses



Data: Ministry of Economy, Trade and Industry “Basic Survey of Overseas Business Activities”, and the Japan Institute of Logistics Systems “FY2004 Survey on Logistics Costs”

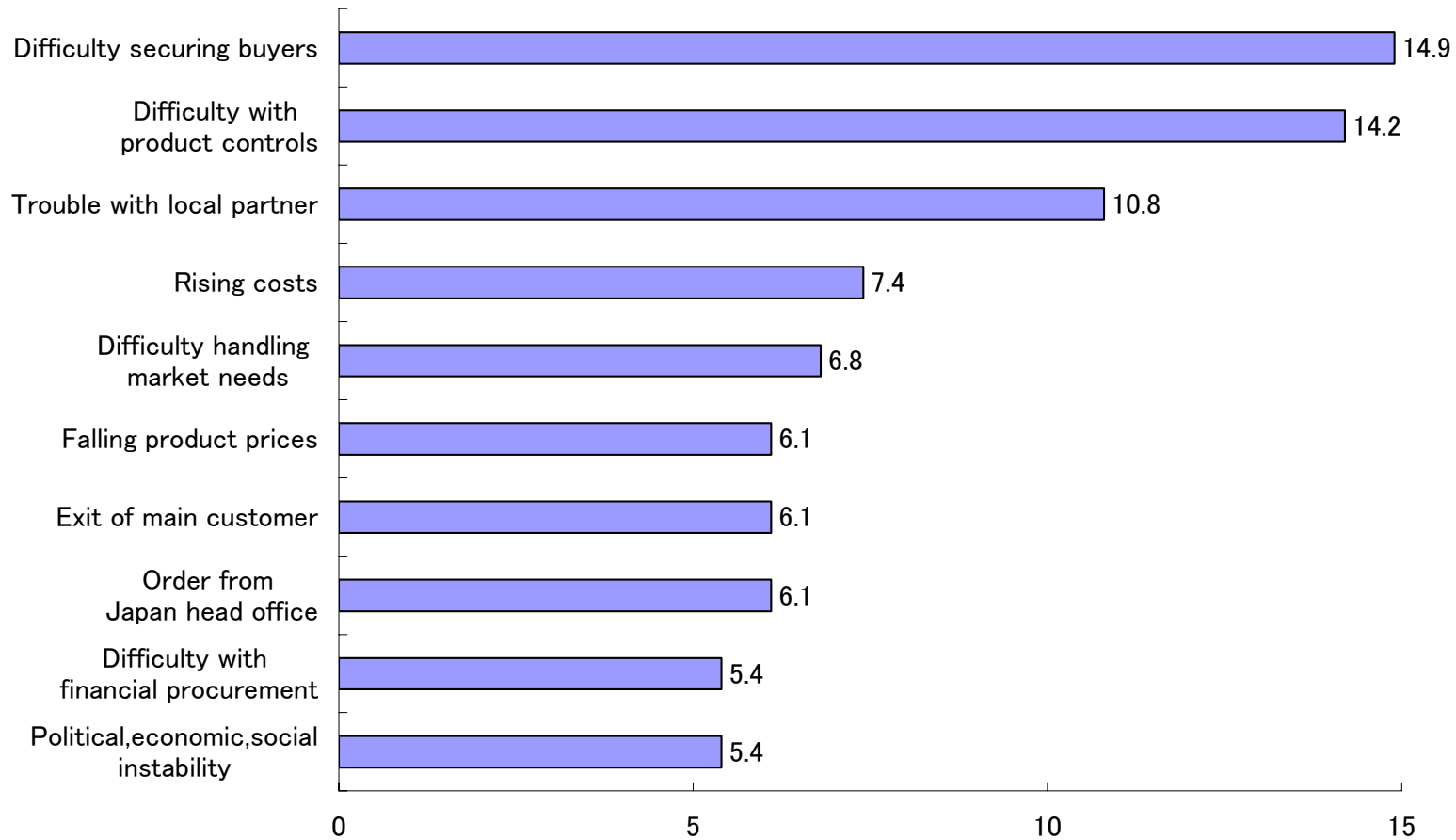
(Opinions from Japanese firms)

- **Insufficient information sharing among affiliated parties, and inefficient use of logistics resources including palettes and warehouses.**
- **Lack of understanding of how to use logistics resources in some countries and regions.**

(5) Sales channels

- Amongst the reasons for SME withdrawals from overseas markets, difficulties in securing buyers are the most important.

Reasons for SME withdrawals from overseas markets



Data: Organization for Small & Medium Enterprises and Regional Innovation, JAPAN "Survey on situation surrounding SMEs expanding overseas" (March 2006)

(%)

4. Directions of future policy

The following policies by the government should work to help overcome the problems faced by SMEs overseas.

1. Establishment of business practices to improve the reliability of transactions, more transparent administrative systems

Formulation of transaction guidelines, establishment of practices for payments without delinquencies, realization of one-stop administrative services

2. Prevention of intellectual property right violations, promotion of measures to deal with counterfeit goods

3. Standardizing protocol for SMEs

Internationally open procurement by user businesses, standardization of product specifications

4. Establishment of efficient distribution systems

Supply chain management with the use of IC tags

5. Support for expansion into overseas markets

“Reverse exhibitions” organized by JETRO.

In addition, the following contributions made by OECD are beneficial to SMEs

1. In-depth analyses of the relationship between SMEs and large enterprises.

2. Evaluations of the business environment for SMEs in developing countries.

Facilitating improvement of business environment

Conclusions

- We have discussed:
 - The development of Japanese SMEs abroad
 - A variety of challenges they face
 - Directions of future policy both for governments and international organizations (OECD)
- We look forward to:
 - Discussions among participants with different backgrounds
 - Sharing ideal practices for enhancing the role of SMEs in the global value chain