

Cambridge University Press

978-0-521-66471-4 - Small Firms in the Japanese Economy

D. H. Whittaker

Excerpt

[More information](#)

# 1 Introduction

---

Japan's giant firms are household names. Toyota and Nissan, Hitachi and Toshiba, Canon and Nikon are known in all corners of the globe. An enormous literature has been produced to explain why, ranging from Japan Inc. and industrial policy, corporate finance and long-termism, to production technology and just-in-time, employment and industrial relations practices, and of course culture. By contrast, very little is known about the small firms which make up the backbone of the Japanese economy, which employ the vast majority of workers and which are every bit as representative of modern Japan as the giant corporations. In fact, Japan ranks alongside Italy as having the highest proportion of small firms – and employees in them – amongst OECD countries. It provides a distinct contrast to the UK, especially in manufacturing, despite the latter's small firm 'resurgence'.<sup>1</sup>

Japan's giant firms also colour our perceptions of its small firms. What little is known about them is in their role as subcontractors. Yet there is much more to Japan than Toyota and *Toyota-ism*. Over 40 per cent of manufacturing SMEs (small- and medium-sized enterprises) do not subcontract at all, and some subcontractors have other income sources as well. Even dedicated subcontractors are not simply large firm appendages. This bias, on top of the knowledge gap, has unfortunately resulted in Japan's small firms remaining peripheral to the new competition and small firm resurgence debates elsewhere (except, as a particular case, within subcontracting networks).

Within Japan there has been a very lively debate about the role of small firms, in part stimulated by the resurgence debates abroad, in part by

<sup>1</sup> Direct comparison is difficult since statistics are collected differently. Census of production figures suggest that the proportion of British workers in manufacturing units of less than 100 employees doubled between 1975 and 1990 to over 30 per cent, but this was still only half the Japanese figure. Conversely, twice as many people were employed in units of 1,000+ employees. The actual gap may be smaller, but is still significant. Cf. Sengenberger *et al.* (1990); Storey (1994).

Cambridge University Press

978-0-521-66471-4 - Small Firms in the Japanese Economy

D. H. Whittaker

Excerpt

[More information](#)

## 2 Small firms in the Japanese economy

domestic economic circumstances. Large firms have been busy moving production abroad and restructuring. Hopes that they can rejuvenate the Japanese economy have steadily faded, but can SMEs take up the mantle in their place? One school claims they can, or will eventually, and in the process Japan will experience a 'paradigm shift' towards entrepreneurial SME activity similar to that experienced by other industrialised countries. A more pessimistic school points to rising small firm closures and declining startups, deep-rooted barriers to unleashing new entrepreneurial energy, and predicts 'hollowing out' rather than a paradigm shift. Both schools would agree that Japan is turning a new page in its economic history, and that the role of small firms is undergoing significant change.

This book explores the changing role of small firms in the Japanese economy, the controversies surrounding them, and ultimately Japan's status as a particular – or peculiar – case. With the exception of the final chapter, it focuses on small firms in the machine industries, which have been the powerhouses of the Japanese economy in recent decades. Hopefully it will go some way towards filling the knowledge gap, rectifying the large firm bias (which applies to the way small firms are viewed as well) and adding a Japanese perspective to the small firm resurgence debates of Western countries.

### Another Japan

The world of small firms in Japan is a fascinating one. In the *machi koba*, or small factories packed into back alleys and narrow streets in the metropolitan centres, you will find antique machines and tools cluttering one side of a workshop, and gleaming laser cutters and machining centres on the other. The figures bent over them may sport caps and overalls from other companies. Some are spontaneous and outspoken in their views, others are more withdrawn, but they are hardly stereotypical 'company men', and their informality is a refreshing contrast to the order and predictability within the large corporation.<sup>2</sup>

Indeed, the rise of the large corporation and their 'company men' represents only one branch in the evolution of Japan's industrial culture. The identification of workers with their craft rather than company and the ambition of workers to start their own business, evident and documented at the beginning of the century, persisted long afterwards in small firms. As Florence once said of small firm owners: 'They prefer power over their own little works to having a small share, with possibly very little power, in a large

<sup>2</sup> It is a world with which British small firm owners can readily identify, often to their surprise, judging from the comments of returning delegations.

Table 1.1 *Small establishment contribution to the Japanese economy, 1983, 1993 (manufacturing, %)*

| 1983      |           |           |        |             | 1993      |           |        |             |
|-----------|-----------|-----------|--------|-------------|-----------|-----------|--------|-------------|
| Est. size | Est. size | Employees | Output | Value added | Est. size | Employees | Output | Value added |
| 4–9       | 58.7      | 14.6      | 5.5    | 7.9         | 55.4      | 12.6      | 4.8    | 6.8         |
| 10–19     | 19.5      | 11.2      | 6.2    | 7.5         | 19.8      | 10.4      | 5.6    | 6.8         |
| 20–99     | 18.6      | 29.9      | 22.4   | 23.2        | 20.9      | 30.8      | 22.3   | 23.9        |
| 100–299   | 2.4       | 16.5      | 17.8   | 17.4        | 2.9       | 18.0      | 19.0   | 19.3        |
| 300–999   | 0.7       | 13.7      | 22.7   | 19.7        | 0.8       | 14.6      | 22.1   | 20.9        |
| 1000+     | 0.1       | 14.0      | 25.5   | 24.2        | 0.2       | 13.6      | 26.2   | 22.4        |

Notes:  
Est. size = establishment size by number of employees  
*N* = 446,942 (1983) and 413,563 (1993)  
Figures do not necessarily add up to 100 because of rounding.  
Source: Chusho kigyo cho (ed.) (1992a, 1995a), statistical appendices; orig. *Kogyo tokei hyo* (Census of Manufactures).

amalgamation. . . . [T]he most important reason for their wishing to cling to their own little businesses is the feudal idea of handing it on to their family.<sup>3</sup> This ‘feudalism’ may have disappeared in Birmingham (along with many small firms), to which he was referring, but it has persisted in Japan and is one reason for the continued high proportion of small firms, despite expectations that they would disappear as Japan modernised.

The world of small firms is not simply different and fascinating, but, and this is worth stressing, it is every bit as representative of modern Japan as that of large firms. Almost three quarters of Japanese employees work in SMEs (defined in manufacturing as having less than 300 employees or capitalised at less than ¥100 million) and only a quarter in large firms. More are employed in establishments with less than ten employees than those with over 1,000 (table 1.1, table 2.2)! Small firms are crucial to the Japanese economy, and always have been. Revenue from their exports played a crucial role in funding early industrialisation and reconstruction after World War II. They have provided employment for the majority of the labour force, easing the social transition as Japan industrialised and enabling an effective mix of capital and labour resources. They still supply a significant share of the value added in Toyota and Nissan, Hitachi and

<sup>3</sup> Cited in Hannah (1983, 129).

Cambridge University Press

978-0-521-66471-4 - Small Firms in the Japanese Economy

D. H. Whittaker

Excerpt

[More information](#)

#### 4 Small firms in the Japanese economy

Toshiba, Canon and Nikon products. And they are critical for Japan's economic future.

Yet they have been ignored. The debates on industrialisation, on Japanese capitalism and management, about whether Japanese firms are quasi employee-controlled, under the dual control of financial institutions and employees, and so on, have largely referred to the minority of giant firms. Where they have not been ignored, they have received a 'bad press'. They threatened to delay Japan's modernisation. While large firms made rapid technological progress, small firms inhabited stagnant backwaters, engaged in atomistic competition and eked out a precarious existence with sweated labour. Their machinery was seen as primitive or pathetic, not clever improvisation in the face of limited resources. Long hours of toil were evidence of backwardness and exploitation, not efforts to build up skills and financial resources to establish a viable business.

Views of small firms in Japan have undergone pronounced change in recent years, but subtle biases persist. They still tend to get lumped into a uniform box labelled 'SME, subcontractor'. In the 1980s subcontracting relations came to be seen as economically rational, not exploitative, but if a subcontracting relationship was severed, it was attributed to the subcontractor being unable to keep up with the large customer's requirements, not because of a decision to resist new cost cutting pressures, or to take the plunge and launch its own product. They are said to have improved their position, after all, through the transfer of technology from 'parent' firms rather than through their own efforts.

Such views are reinforced by the way small firms are approached, which is often through a large firm they subcontract for. As a result, we get a picture of relations focused on the large firm, and how the subcontractor fits into this, but a hazier view of the web of relations focused on the SME subcontractor, and its development strategies. Moreover, the subcontractor is frequently a first tier, medium-sized company. Below this stratum lies a lumpen mass: 'The bottom of the supplier pyramid is made up of small sweatshops which are ready to submit to outside pressures and accept long-term risks and cutbacks to existing firm goals. Their "passive pliability" is very different from the "active versatility" for which small firms are commonly celebrated.'<sup>4</sup> Even within the new competition, flexible specialisation, post-Fordism . . . literature, which hails the new role of small firms in industrialised countries, Japan's leading actors have been large assembler firms and first tier suppliers their supporting cast.<sup>5</sup>

<sup>4</sup> Grabher (1993, 18).

<sup>5</sup> Even for Best, for instance, the entrepreneurial firm in Japan is primarily the large firm. He does note in passing (1990, 163) that many SMEs 'have responded to the pressures from the parent companies and are pursuing product-led strategies in ways that can ultimately increase their independence', but does not pursue the point.

Cambridge University Press

978-0-521-66471-4 - Small Firms in the Japanese Economy

D. H. Whittaker

Excerpt

[More information](#)

## Introduction

5

My point is not to criticise subcontracting studies *per se*; some are excellent and have extended our knowledge of Japan's small firms.<sup>6</sup> But small firms also need to be studied in and of themselves, explicitly looking at the views and motivations of the people who own and work in them and how interfirm relations work from their perspective. We might then find less passive sweat and more active versatility. This is not an invitation to engage in small firm romanticism, but to work towards a balanced view of the Japanese economy which includes small firms, and a balanced view of small firms themselves.

Within the small firm world there is a tremendous diversity, according to size, sector, business activities, and management. This makes it difficult to develop an alternative model to those advanced for large firms. A widely cited *management typology* is that of Kiyonari, who sees four types of small business: enterprise-type businesses, enterprise-type family businesses, livelihood family businesses (in which profits and wages are not distinguished and separate accounting books are not kept), and side businesses or house-based pieceworking. He estimated that the first two types accounted for less than a third of all small businesses in the late 1960s, but the proportion progressively rose to over half during the next two decades.<sup>7</sup>

The rising proportion, Kiyonari suggested, was the result of twin dynamics: the Darwinian replacement of stagnating firms with more dynamic ones, which was happening at a brisk pace, and upgrading within a portion of existing firms as a result of innovative management. He and others criticised dual structuralists for their failure to recognise these dynamics. High startup rates relative to closures did not perpetuate Japan's dual structure – disguising unemployment, maintaining low wages, and hindering resource accumulation and modernisation – but led to its dissolution, was their argument, based on surveys which showed startups being founded for positive reasons, with relatively high levels of remuneration, and responsive to new market opportunities. Likewise, wage differentials between small and large firm blue-collar workers did not necessarily indicate misery and exploitation; viewed dynamically, these workers had a good chance of becoming white-collar workers or independent, where their lifetime wages might be every bit as good if not better than their large firm cousins (even if their average hourly incomes were still less).<sup>8</sup>

These assertions of course provoked a vigorous debate, but they rightly point to the need for a dynamic rather than a static, snapshot view of small firms. The dynamics they portray, too, are very different from those used to

<sup>6</sup> See, for instance, Smitka (1991); Sako (1992); and Nishiguchi (1994).

<sup>7</sup> Kiyonari (1972, 1990a, 1990b).

<sup>8</sup> Koike (1981), was the most vigorous exponent of this thesis, which has become less persuasive as startup rates have declined, although diminished prospects for startups may contribute to labour shortages in SMEs.

Cambridge University Press

978-0-521-66471-4 - Small Firms in the Japanese Economy

D. H. Whittaker

Excerpt

[More information](#)

## 6 Small firms in the Japanese economy

explain the success of Japan's large corporations, such as the 'three pillars' of lifetime employment, *nenko* (seniority plus merit), wages and promotion, and enterprise unions, with a fourth pillar – social norms within the enterprise – sometimes added as well.<sup>9</sup> They are, in essence, 'centrifugal' rather than 'centripetal'. Small firm owners – and many of their workers – have traditionally been motivated by the desire to be their own boss. They have gone to great lengths to build and maintain their little businesses or 'castles', no matter how small, and are very reluctant to abandon them. The expression *ikkoku ichijo no aruji* neatly sums up this proclivity (and is similar if not as exclusionary as the adage cited by Marshall: 'An Englishman's home is his castle').<sup>10</sup>

### Industrial communities and districts

The drive to be 'lord of a castle' is essentially individualistic, but it is nurtured in industrial communities or districts.<sup>11</sup> As Marshall wrote: 'The strong individuality of the British race may find its highest development under the guidance of the spirit of constructive cooperation.' This was most fully developed, he argued, in industrial districts: 'The broadest, and in some respects most efficient forms of constructive cooperation are seen in a great industrial district where numerous branches of industry have been welded together almost automatically into an organic whole.'<sup>12</sup> Such industrial districts enable the proliferation of small, specialised firms which can make use of economies of scale external to them, with the result that average firm sizes are smaller in industrial districts than outside them.<sup>13</sup> Like Florence, Marshall would find more evidence of this in the Japanese than in the British economy today.

Marshall believed that high social standards and altruism on the part of individuals improved the environment, with beneficial consequences.<sup>14</sup> High social standards and altruism are similar to Dore's concept of goodwill, with which he explored interfirm relations in Japan. As he notes, neo-classicists and transaction cost analysts have considerable difficulty with this concept in its common meaning, but it was well understood 'back in

<sup>9</sup> The fourth pillar comes from OECD (1977). <sup>10</sup> Marshall (1923, 583).

<sup>11</sup> 'Community' does not imply strong self-governing or coordinating institutions, but at least, widely shared norms and common interests. <sup>12</sup> Marshall (1923, 577, 599).

<sup>13</sup> Florence (1948). According to Florence: 'The localisation of a great number of medium-sized or small firms, each specialising in some single process or service and depending on a general background of metal and services is an alternative to a few larger firms integrating those processes and services.' In fact, in some respects it is superior (pp. 59, 79). The best example, he suggests, is the machine industries of Birmingham. This book is curiously overlooked by industrial district researchers.

<sup>14</sup> Marshall (1947); Wilkinson and You (1992).

Cambridge University Press

978-0-521-66471-4 - Small Firms in the Japanese Economy

D. H. Whittaker

Excerpt

[More information](#)**Introduction**

7

the old Marshallian days when economists took their concepts from everyday life rather than trying to take everyday life from their concepts'.<sup>15</sup>

Such altruism or goodwill may also reduce firm sizes, as the following everyday examples suggest. Owners may agree to support employees wishing to start out on their own on the understanding that they will not poach customers or engage in direct competition. They may channel orders to them (possibly taking a percentage in the process), with the expectation that their former employees will repay their favours (possibly with interest) by helping out with rush or overflow orders. Normally this expectation, which is seldom contractual, is met. Without such assistance, which can come from other sources besides employers, the number of startups in Japan would undoubtedly have been lower. As Sako's study suggests, it contrasts with common attitudes in Britain.<sup>16</sup> Second, firms are more likely to subcontract work out if they can be sure it will be done competently and on the basis of goodwill. A number of small firms in Birmingham cited problems in both respects as reasons why they do not subcontract out work. This reduces the opportunities for more small firms.<sup>17</sup>

Small firms in Japan are economically and socially 'embedded', to use Polanyi's popularised expression. In the case of Japan, this is commonly taken to mean embedded in subcontracting networks headed by large firms. In a neat dichotomy, Italy provides the industrial districts and Japan provides the subcontracting. Yet Japan has a large number of small firm industrial districts, some of them unmatched in scale by any other industrialised country, Italy included. These industrial districts figure prominently in this book for the following reasons.

The first is methodological: an alternative to approaching small firms through subcontracting relations is to look at them in the context of industrial districts. The result will be a more holistic and balanced view, which includes relations with other small firms as well as subcontracting. The second has just been noted. The drive to be 'lord of a castle' is nurtured in the broader context of such industrial districts, and small firms are embedded in them. They cannot be understood in isolation from this environment. Third, a voluminous literature has been generated on industrial districts in recent years, but with very little Japanese input. An exception is

<sup>15</sup> Dore (1987, 170); Dore and Whittaker (1994).

<sup>16</sup> Sako (1992, 215). See also chapters 7 and 10 in this book.

<sup>17</sup> Dore (1987, 1790); Sako (1992, esp. pp. 37–40). In transaction cost economics firm size is determined at the point in which internal transaction or governance plus production costs equals the cost of procurement in the market place. If the propensity to act opportunistically (or altruistically, if you take a different view of human disposition) differs, so will firm size. Williamson (1985, 122) concedes that 'the hazards of trading are less severe in Japan than the US because of the cultural and institutional checks on opportunism', but sheds little light on these externally imposed checks.

Cambridge University Press

978-0-521-66471-4 - Small Firms in the Japanese Economy

D. H. Whittaker

Excerpt

[More information](#)

## 8 Small firms in the Japanese economy

Sakaki, from Friedman's study, but this district is very small by Japanese standards, and there is no way of judging from his account how representative it is, or how it fits into Japan's broader industrial structure. For these reasons, perhaps, Sakaki tends to be referred to only in passing and with caution.<sup>18</sup>

Various types of industrial district exist within Japan. There are several hundred *sanchi*, or clusters of small firms making a particular consumer product, ranging from traditional foods, crafts, or cloth, to furniture, cutlery, and sophisticated spectacle frames.<sup>19</sup> Machine industry districts range from the so-called 'company castle towns' (*kigyo joka machi*), dominated by large assemblers such as Toyota and Hitachi, to medium-sized districts with comparatively self-contained, medium-sized manufacturers, and finally the vast concentrations of small factories in the metropolitan centres.

The book concentrates on the last type, which has been critical to Japan's machine industries and which is closest to the Marshallian concept (closer, perhaps, than some 'Marshallian' districts in the Third Italy in that district-wide collective, institutionalised cooperation and standard setting plays a more minor role).<sup>20</sup> Large firms used to be prominent in these districts, but they relocated their production factories in the hinterland, leaving behind purchasing departments and R&D facilities, as well as great numbers of small factories – *machi koba* – which began to forge a new industrial structure. Far from entering into decline, a combination of competition and cooperation, *sessha takuma* (friendly rivalry) and *nakama torihiki* (confrere trading) gave some of these districts tremendous vitality. Small product makers emerged, making use of the diverse subcontractor base, and new startups made use of external economies and niche opportunities, contributing to the extremely fine division of labour.

Although it is not my intention to defend or rebut the flexible specialisation thesis (or competing variants), Japan's industrial districts can inform such debates. A particular strength is in detailed surveys – of interfirm trading, for instance – which lend quantitative support to qualitative argument. This is often conspicuous by its absence in the wider debates. Proponents of flexible specialisation will find support for a very *liberal* interpretation of their ideas; critics will probably find support as well.<sup>21</sup>

<sup>18</sup> Friedman (1988). <sup>19</sup> See Dore (1986), for a discussion of textile *sanchi*.

<sup>20</sup> Wilkinson and You (1992), discuss the difference between Marshall's concept of industrial districts and modern 'Marshallian' industrial districts.

<sup>21</sup> By liberal I mean shorn of evolutionary determinism, utopianism, a prescriptive orthodoxy, and a recognition that industrial districts are often part of wider production structures. In their responses to criticisms by Amin and Robbins, Piore and Sabel appear to advocate such a liberal interpretation (Pyke *et al.* (eds.) 1992).

Cambridge University Press

978-0-521-66471-4 - Small Firms in the Japanese Economy

D. H. Whittaker

Excerpt

[More information](#)**Introduction**

9

Before leaving the subject, a further comment on independence, dependence, and interdependence is probably in order. Small subcontractors are sometimes disparagingly referred to as ‘quasi firms’ because of their high degree of dependence on one or two customers. Yet the independence owners gain when starting out on their own (*dokuritsu kaigyō*) is not meaningless. First, though this may be a matter of degree, they have become their own boss, able to plan and adjust their own levels of earnings, and take on more work or employees if necessary. Second, they may now write ‘company president’ on their name card to indicate their new status. Third, initial dependence may be the first step towards greater substantial independence, through slowly diversifying order sources, accumulating resources, and ultimately launching a product. Many flourishing companies have grown from such humble beginnings. This illustrates not only the importance of a dynamic view of small firms, but also of taking into account the motivations and perceptions of the people involved.<sup>22</sup>

An important dynamic in the maintenance of large numbers of small firms in Japan has been the (individualistic) desire to be ‘lord of a castle’, no matter how small, but this is underpinned in many cases by dependence and interdependence in an industrial community or district. The culture of these communities or districts is very different from that of large firm ‘corporate communities’.

**Economy in transition**

The Japanese economy is in a state of transition, which is thrusting small firms into the limelight as never before. Large firms have been busy shifting production abroad and making their competitive presence felt globally, but they have begun restructuring within Japan. There is a growing belief, partly a product of the prolonged recession, that their contribution to domestic economic growth and recovery will decline. Can small firms step in and fill the void, or will they be the principal victims of the transition?

Optimists predict a new dawn. They point to small firms’ growing technological and managerial capabilities in the 1980s, market changes in their favour and the fact that dynamic small firms and OTC (Over the Counter)-listed companies rebounded much more quickly than large firms after the burst of the ‘bubble’ in 1991. They also point to changes in government policy which provide a much more supportive environment for such

<sup>22</sup> Aoki recognises this. His ‘quasi integration’ refers to the dual characteristics of integration and autonomy (1988, 214). Cf. also Penrose and her study of small firms in the ‘real world’ (1959, 1–14).

Cambridge University Press

978-0-521-66471-4 - Small Firms in the Japanese Economy

D. H. Whittaker

Excerpt

[More information](#)10      **Small firms in the Japanese economy**

firms, which have piqued established business leaders.<sup>23</sup> They concede that small firms which are unable to adapt to new conditions will fall by the wayside but that others will blossom in the new age, and they cite lists of examples to prove their point.

Pessimists have no shortage of material to work with. The reality facing many small firms is unprecedented tribulation. Large firms are placing fewer orders, on worse terms, and competition from abroad has become unbearable at current exchange rates. Closures have increased, while start-ups have decreased, undermining the first of Kiyonari's dynamics. In many sectors of the economy, including manufacturing, startups have dropped below closures, and, if the rising proportion of new firms started by existing companies is taken into account, the decline in 'independent' startups has been precipitous.<sup>24</sup>

Optimists predict that greater diversity and individuation if not individualism in Japanese society, combined with large firms restructuring and improved support structures, will lead to the sprouting of innovative new firms in tune with the times. The 'reserve army' of would-be founders stands at over a million, almost half of whom have made some preparations to become independent.<sup>25</sup> Pessimists, on the contrary, argue that social change has worked against small firms. It is not just a sharp rise in costs and fewer opportunities in a mature economy that has depressed startup rates, but increasing affluence which has undermined the 'hungry spirit' and raised the reserve wage needed to endure the privations of life in a small firm. In other words, 'stability-oriented social consciousness, as represented by progression through a single firm rather than founding a firm and developing it, has been one factor in stagnating startup activity'.<sup>26</sup>

Schools have become extremely refined as sorting mechanisms. In earlier decades people left school early for a variety of reasons, including family hardship, and went to work in small firms before finally establishing their own companies. Nowadays the academically able are likely to go on to further education, aiming as high up the finely graded hierarchy of colleges and universities as possible, from which they will tend to seek jobs in large companies, equally graded in terms of desirability. (Children of small firm owners are an exception, but where they have seen their parents struggling day and night at the expense of family life, the attractions of being their own boss and taking over the family business may not be enough to make even

<sup>23</sup> H. Okuda, president of Toyota, claimed: 'The government felt that if you drove up the yen high enough to destroy the car and electronics industries, it would be better for the economy because it would encourage the growth of new industries' (interview in *Financial Times*, 4 October 1995).

<sup>24</sup> Peoples' Finance Corporation (1994); Kokumin kin'yu koko (1992, 1995).

<sup>25</sup> Kamata (1995, 4).      <sup>26</sup> Kamata (1995, 4).