

# ***Recent Development in SME Finance in Japan***

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**JASME**  
 **中小企業金融公庫**

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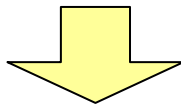
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# 1. SME Policy in Japan

## (1) The Position and Role of SMEs in the Japanese Economy

• **SMEs as a foundation of Japanese industry**

- accounting for over 99% of all businesses in Japan
- accounting for over 70% of all employees in Japan
- exceeding large enterprises in annual value added

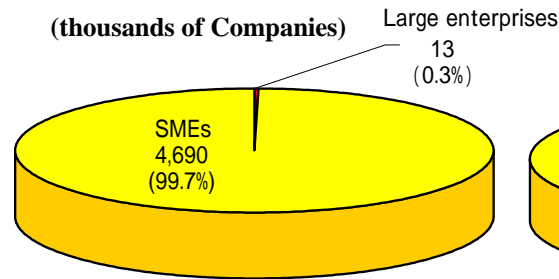


• **Expected Roles of SMEs in Japan**

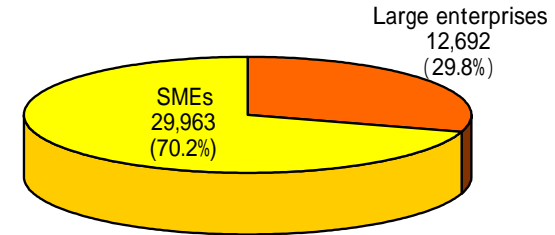
- (1) creating new industries
- (2) increasing employment opportunities
- (3) encouraging competition in the market
- (4) vitalizing regional economies

source: "The New SME Basic Law"

**Ratio of SMEs to Total Number of Enterprises**  
(thousands of Companies)

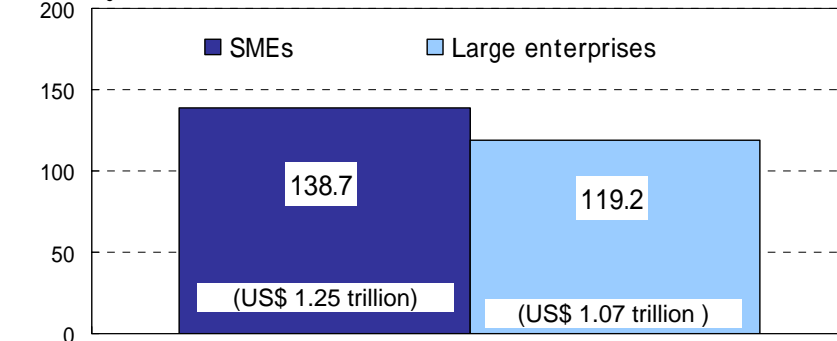


**Ratio of Number of Employees in SMEs to Total Number of Employees**  
( thousands of people)



Source: Ministry of Internal Affairs and Communications' Establishment and Enterprise Census, reorganized by the Small and Medium Enterprise Agency.

**Sum of Value Added (Fiscal 2002 , All Industries)**  
(trillion yen)



Source: MOF "Financial Statements Statistics of Corporations by Industry"

\*Note: Figures expressed in US dollars are based on the exchange rate of US\$1 = 110.94 yen (as of July 1, 2005)

# 1. SME Policy in Japan

## (2) - 1 SME Policy and Policy Financing for SMEs

· SMALL AND MEDIUM ENTERPRISE BASIC LAW (Amended in December 3, 1999)



**Changing its basic policies from “Rectifying Disadvantages ” to “Promoting Diverse and Vigorous Growth and Development of Independent SMEs”**

### Article 3 (Basic Principles)

In the light of the fact that SMEs, by engaging in distinctive business activities in a variety of fields of business and providing diverse employment opportunities where individuals can demonstrate their abilities, form the foundations of the Japanese economy, and that many SMEs, which display originality and resourcefulness and engage in business activities with the aim of improving business, have a particularly important role to play in maintaining and strengthening the vitality of the Japanese economy by, among other things, creating new industries, increasing employment opportunities, encouraging competition in the market, and vitalizing regional economies, the diverse and dynamic growth and development of SMEs must be encouraged by promoting business innovation and start-ups among them, strengthening their business fundamentals, and smoothing their adaptation to changes in social or economic conditions so as to foster the autonomous efforts of independent SMEs.

### Article 23 (Facilitation of financing)

In order to facilitate the financing of SMEs, the State shall strengthen the functions of governmental financial institutions, develop a credit insurance system, foster proper lending to SMEs by private-sector financial institutions, and take any other necessary measures.

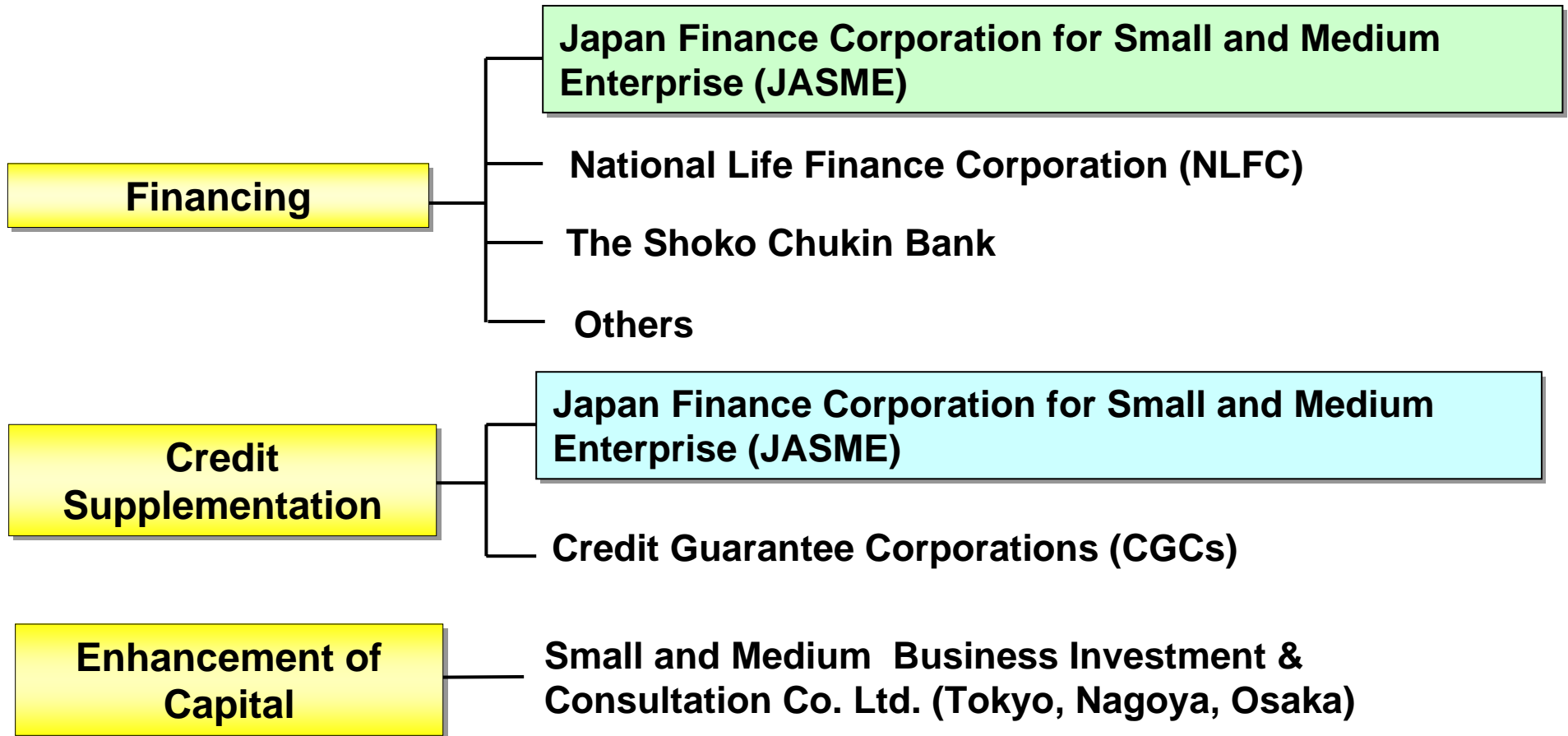
# 1.SME Policy in Japan

## (2) - 2 Definition of SME (Capital, Number of employees)

<b>Manufacturing Construction Transportation</b>	<b>Capital</b>	<b>less than 300 Million yen ( US\$ 2.70 million )</b>	<b>or</b>
	<b>Number of employees</b>	<b>fewer than 300</b>	
<b>Wholesale</b>	<b>Capital</b>	<b>less than 100 Million yen ( US\$ 0.90 million )</b>	<b>or</b>
	<b>Number of employees</b>	<b>fewer than 100</b>	
<b>Retail Trade</b>	<b>Capital</b>	<b>less than 50 Million yen ( US\$ 0.45 million )</b>	<b>or</b>
	<b>Number of employees</b>	<b>fewer than 50</b>	
<b>Services</b>	<b>Capital</b>	<b>less than 50 Million yen ( US\$ 0.45 million )</b>	<b>or</b>
	<b>Number of employees</b>	<b>fewer than 100</b>	

# 1. SME Policy in Japan

## (2) - 3 System of Financial Measures for SMEs

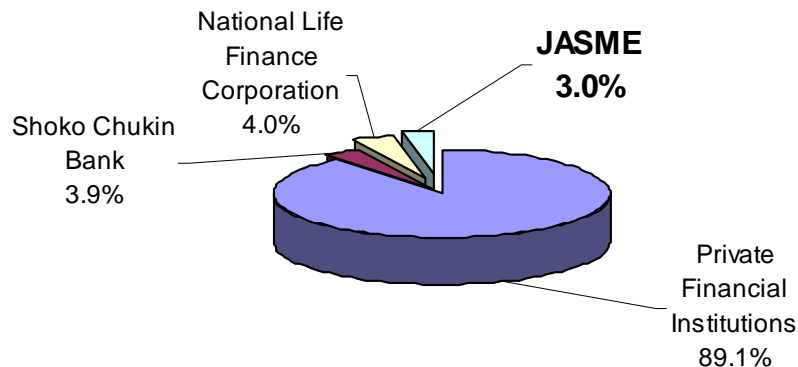


# 1 . SME Policy in Japan

## (3) Outstanding Loans to SMEs

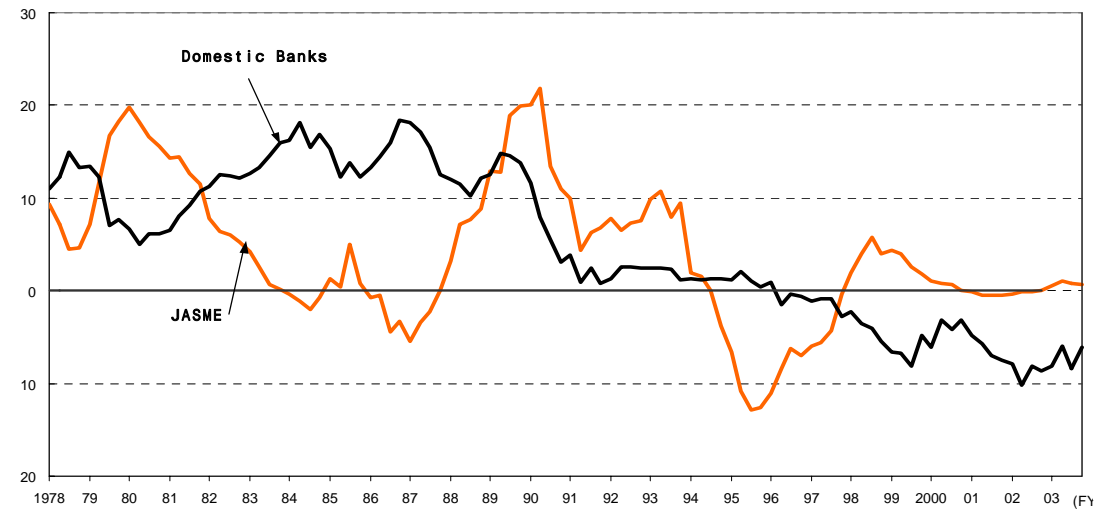
- Inverse correlation trend of lending growth to private financial institutions.
- Supplementing the activities of private financial institutions, which inevitably find themselves having to change their lending stance under the impact of business conditions.

Share of JASME in Total Outstanding Loans to SMEs  
(Fiscal 2003)



**Total Amount of outstanding loans**  
**252 trillion yen (US\$ 2.27 trillion)**

(%) **Rate of Growth in Outstanding Loans to SMEs (yr-on-yr change)**



Source: Bank of Japan, Monthly Report of Recent Economic and Financial Developments

Source: Bank of Japan "Monthly Report of Recent Economic and Financial Developments"

## 2. Profile of JASME

### (1) Overview

( as of March 31, 2005 )

**Established** : August 20, 1953

**Objectives** : 1. JASME's objectives are to itself provide small and medium sized enterprises (SMEs) with the long-term funding necessary to promote their businesses when general private financial institutions are not in a position to do so, or to support general financial institutions by taking over loan claims and guarantees debts provided by them.  
2. JASME supports the guarantee activities of Credit Guarantee Corporation (CGCs) by providing insurance for their guarantee liabilities and extending them loans.

**President** : Koichi Minaguchi (Former President & CEO of Nomura Research Institute Ltd.)

**Scope of Business** : Loan Programs , Securitization Support Programs , Credit Insurance Programs

**Capital** : 1,568,772 million yen (US\$ 14.13 billion )

(Breakdown) Loan Programs	461,915 million yen (US\$ 4.16 billion )
Securitization Support Programs	4,265 million yen (US\$ 0.04 million )
Credit Insurance Programs	1,102,592 million yen (US\$ 9.93 billion )

**Outstanding loans and insurance acceptance** :

Loan Programs 7,500 billion yen (US\$ 67.60 billion )

Credit Insurance Programs Small Business Credit Insurance 29,997 billion yen (US\$ 270.83 billion )

**Number of employees** : 2,109

**Branches** : 61 loan offices and 1 Overseas Representative Office (Kuala Lumpur, Malaysia)

## 2. Profile of JASME

### (2) Mission Statement

#### Mission Statement

The mission of JASME is to promote, in accordance with national policy, the growth and development of small and medium sized enterprises - the driving force behind Japan's economy at both the national and regional levels.

To this end, JASME works together with private financial institutions and regional public agencies to ensure a stable supply of business funds through a variety of schemes and instruments, and provides a wide range of consulting services.

## 2. Profile of JASME

### (3) Business Programs

#### Loan Programs

- Loans to SMEs.
- Purchase corporate bonds (with subscription rights to newly-issued shares) issued by SMEs.

##### Flow (Fiscal 2004)

1,611billion yen (US\$14.5 billion)

#### Securitization Support Programs

- Support for private financial institutions in using securitization methods.
  - (1) The business of securitizing loan claims, etc., taken over from private financial institutions (“Purchase-type”)
  - (2) The business of guaranteeing part of the loan claims of private financial institutions , or partially purchasing/guaranteeing asset backed securities (“Guarantee-type”)
  - (3) Securitization of Unsecured Loan Claims and Bonds(Synthetic CBO Program).

##### Flow (Fiscal 2004)

- Purchase-type  
Scale of operations  
13 billion yen (US\$ 117 million )
- Guarantee-type  
Scale of operations  
64 billion yen (US \$ 577 million )
- Synthetic CBO  
Pool Amount  
25 billion yen (US\$ 225 million )

#### Credit Insurance Programs

- Provide insurance for the guaranteed liabilities of CGCs.
- Loans to CGCs.

##### Flow (Fiscal 2004)

Amount of Small Business  
Credit Insurance acceptance  
12,181billion yen (US\$ 110 billion)

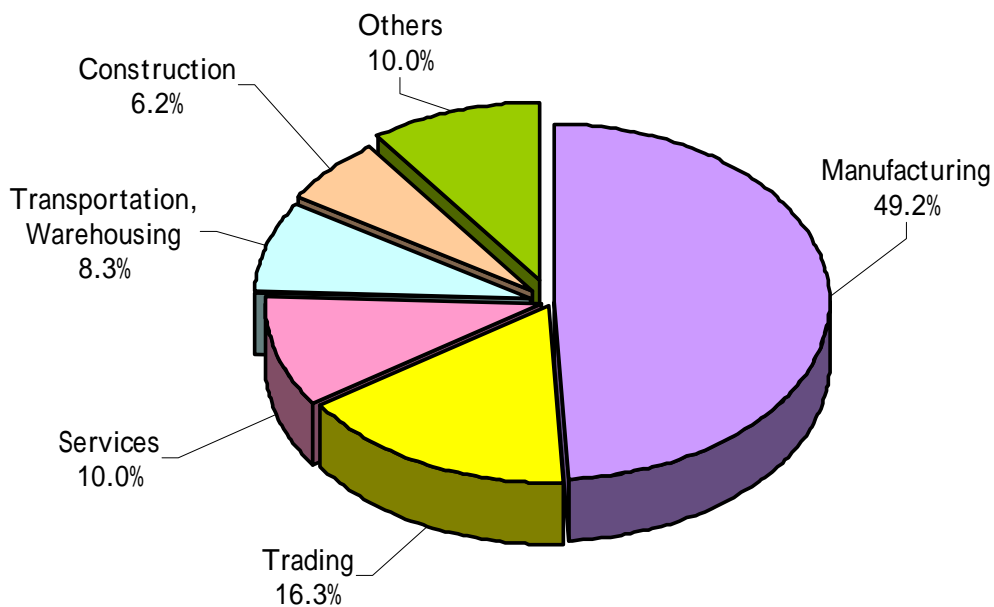
Loan amount to CGCs  
472billion yen (US\$ 4 billion)

### 3. Loan Programs

#### (1) Outstanding Loans and Flow of JASME

##### Outstanding Loans (Fiscal 2004)

7,500 billion yen (US\$ 67.6 billion)



##### Flow (Fiscal 2004)

1,611 billion yen (US\$ 14.5 billion)

##### Average Figure of JASME Clients

Number of Clients	20,108
Average amount of Loan	80 million yen ( US\$ 721 thousand )
Average term of Loan	8.0 years
Average amount of Capital	47 million yen ( US\$ 424 thousand )
Average no. of Employees	74

### 3. Loan Programs

#### (2) Relationship Banking

##### 1. MOU and other cooperation frameworks (as of end-March 2005)

	Number of Banks	Of which Number of MOU Banks
Regional banks	110	110
Shinkin banks	297	244
Credit unions	177	54

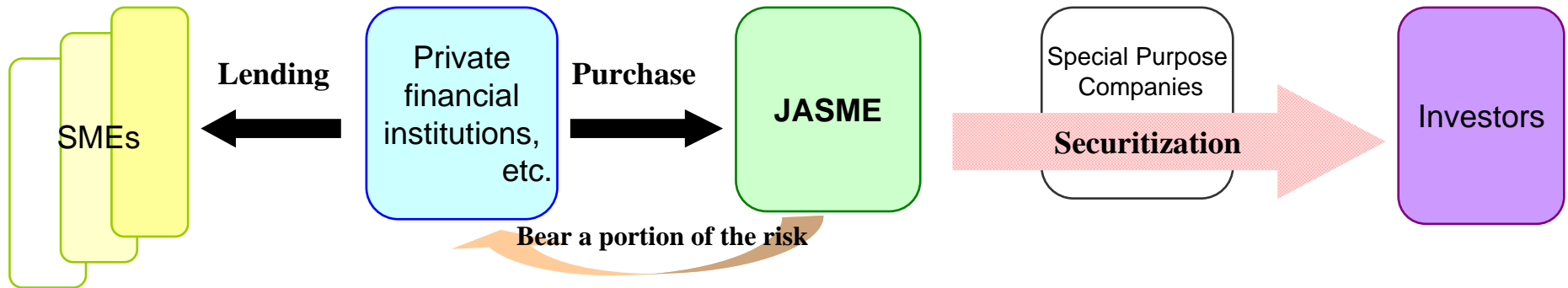
##### 2. Co-financing with other banks (April/May 2005)

Size of project	100-300 million yen	Over 300 million yen
Total	189	9
(co-financed)	(117)	(8)
Share of co-financed	62%	89%
[FY2004 (April-March)]	[ 30% ]	[ 72% ]

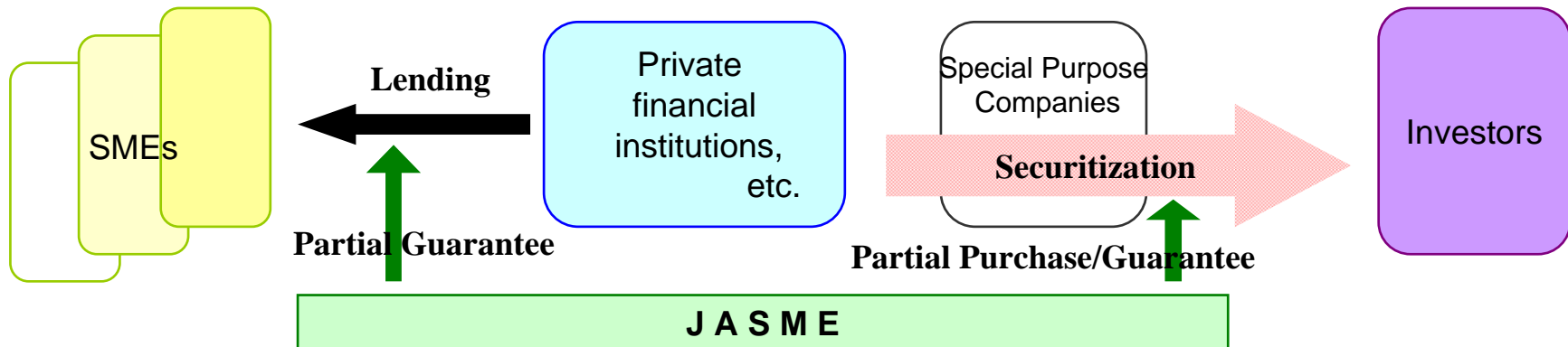
## 4. Securitization Support Programs (since July, 2004)

### Supporting Private Financial Institutions in Using Securitization Methods to Promote the Smooth Supply of Unsecured Funds

**(1) Purchase-type** ~ JASME accepts and securitizes no-collateral loan claims of private financial institutions made on condition of securitization ~



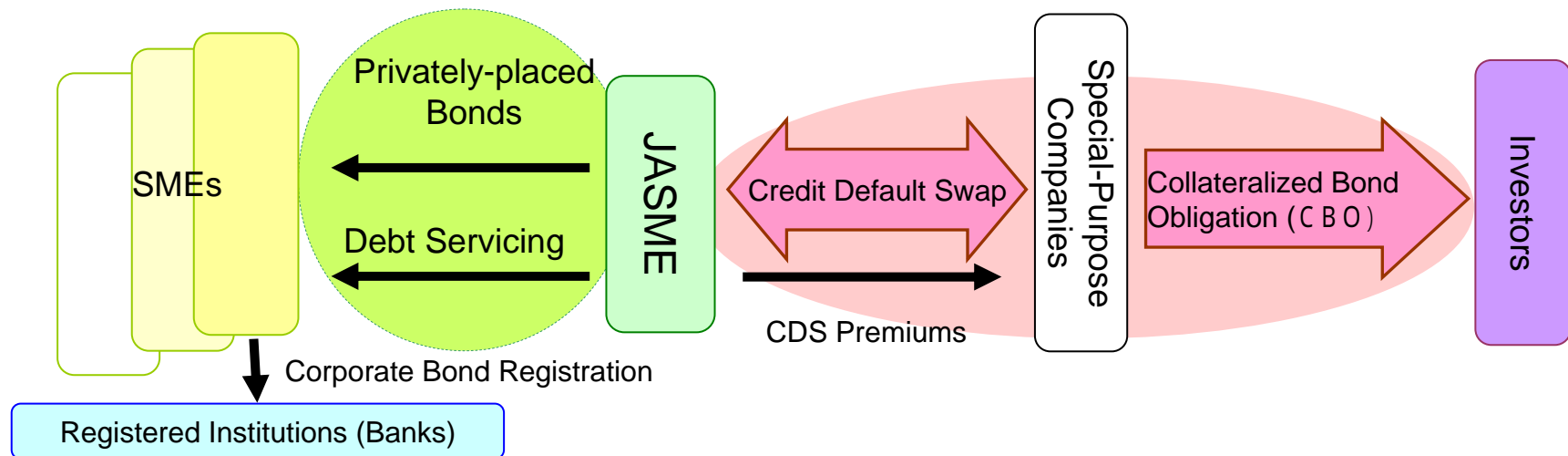
**(2) Guarantee-type** ~ JASME provides a partial guarantee at the time of the loan, purchases a portion of the securitized product or debt when private financial institutions undertake securitization of loans on their own ~



## 4. Securitization Support Programs (since July, 2004)

### (3) Synthetic CBO program (Securitization of Unsecured Loan Claims and Bonds)

· JASME accepts unsecured loans extended to SMEs or unsecured bonds issued by SMEs and securitizes them.



JASME received "Dealwatch Awards 2004 Asset-backed Securities Originator of the Year" from the THOMSON DEALWATCH in April 2005 through operation of the Securitization Support Programs. Although the year 2004 was the first year of its Securitization, JASME successfully operated three different types of Securitization Support Programs. JASME received acclaim because it contributed greatly to the development of CDO market in Japan, and it disclosed actively the information on its assets backing such ABS.

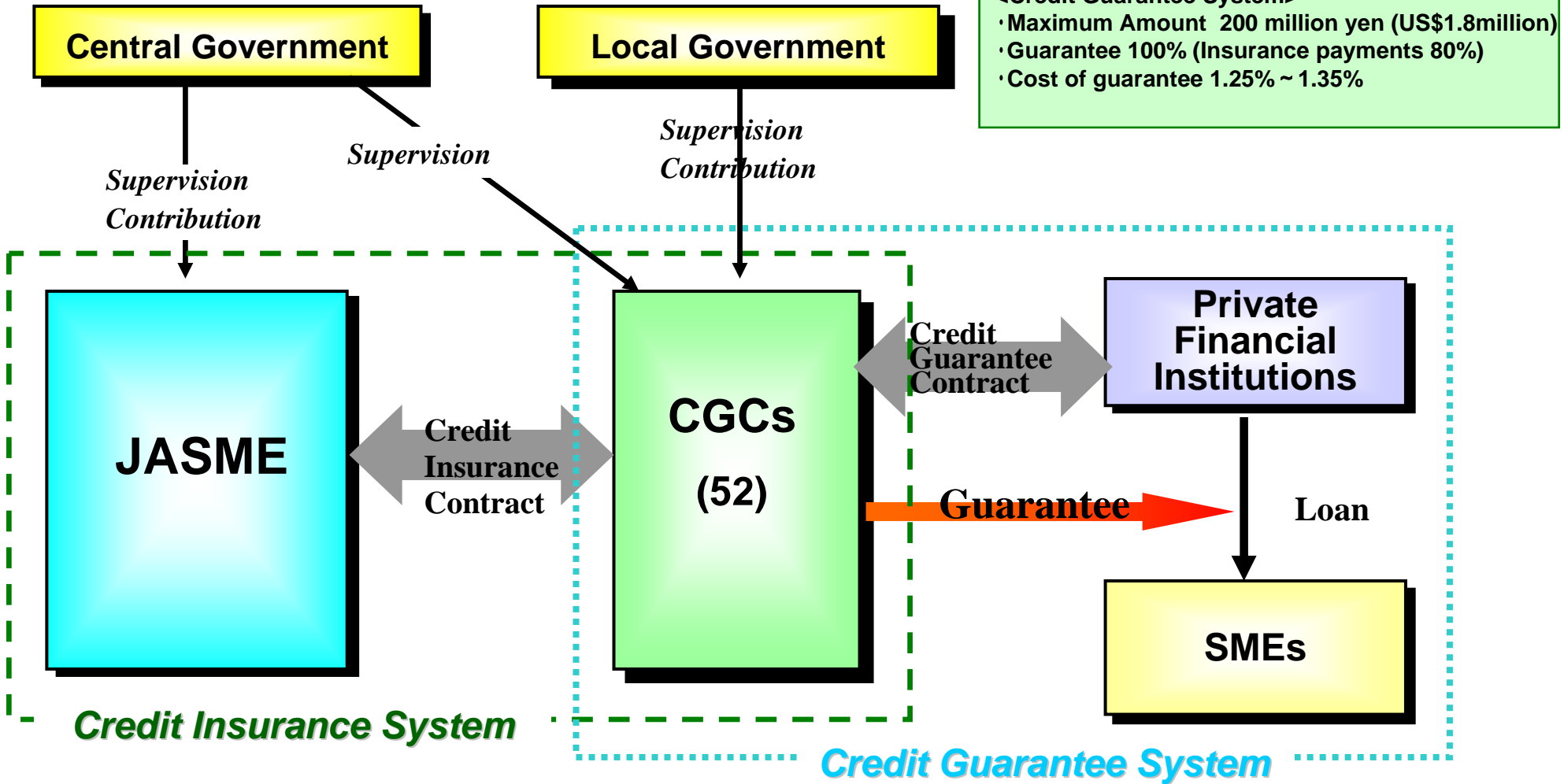
## 4. Securitization Support Programs (since July, 2004)

### (4) Performance (July 2004 - June 2005)

Type	Date	Number of SMEs	Amount	
			(billion yen)	(million US\$)
<b>Purchase type</b>	(No. of Banks)			
<b>No.1</b>	Sept.2004 (3)	58	2.6	23
<b>No.2</b>	Mar.2005 (14)	507	10.4	94
<b>Total</b>	(17)	565	13.0	117
<b>Guarantee type</b>				
<b>No.1</b>	Dec.2004	752	44.5	401
<b>No.2</b>	Mar.2005	635	19.7	178
<b>Total</b>		1,387	64.2	579
<b>Synthetic CBO</b>				
<b>No.1</b>	Sept.2004	372	24.5	221
<b>No.2</b>	Jun. 2005	322	19.9	179
<b>Total</b>		694	44.4	400
<b>[Total]</b>		[2,646]	[121.6]	[1,096]

## 5. Credit Insurance Programs

### (1) Credit Supplementation System



- 1.8million users
- Outstanding Insurance Acceptance 29,997 billion yen (US\$ 270 billion)
- <Credit Guarantee System>
- Maximum Amount 200 million yen (US\$1.8million)
- Guarantee 100% (Insurance payments 80%)
- Cost of guarantee 1.25% ~ 1.35%

## 5. Credit Insurance Programs

### (2) Credit Supplementation System Reforms Proposed by Sub-committee on Credit Supplementation System, SME Policy Council (June 20, 2005)

#### 1. Facilitation

Comprehensive review of the system to improve its service to SMEs

#### 2. Risk Sharing

Reinforced cooperation with the financial institutions

→ Introduction of partial guarantee system

#### 3. Financial Discipline

Sustainable financial management of the system

#### 4. Management

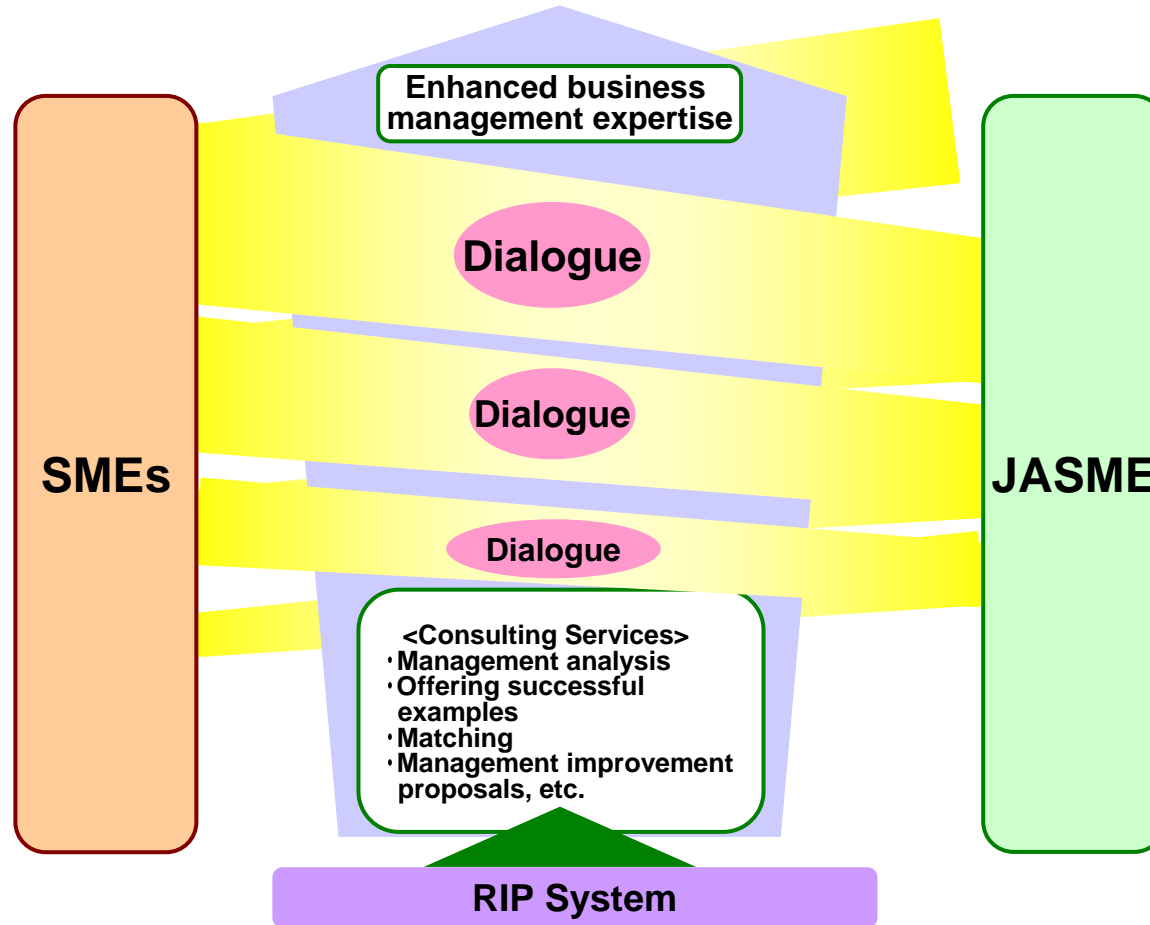
Enhanced operational discipline of the system

<http://www.chusho.meti.go.jp/kinyu/050623publiccomment.kekka.htm> (Japanese text only)

## 6. Consulting Services

· Supporting Management with Effective and Useful Information and Face-to-face Dialog

### Consulting Services Using the RIP System



### Results in fiscal 2004

#### Breakdown by type of information

Management analysis	33,058
Offering successful examples	2,422
Matching	2,528
Of which business interface meetings	984
Management improvement proposals	4,300

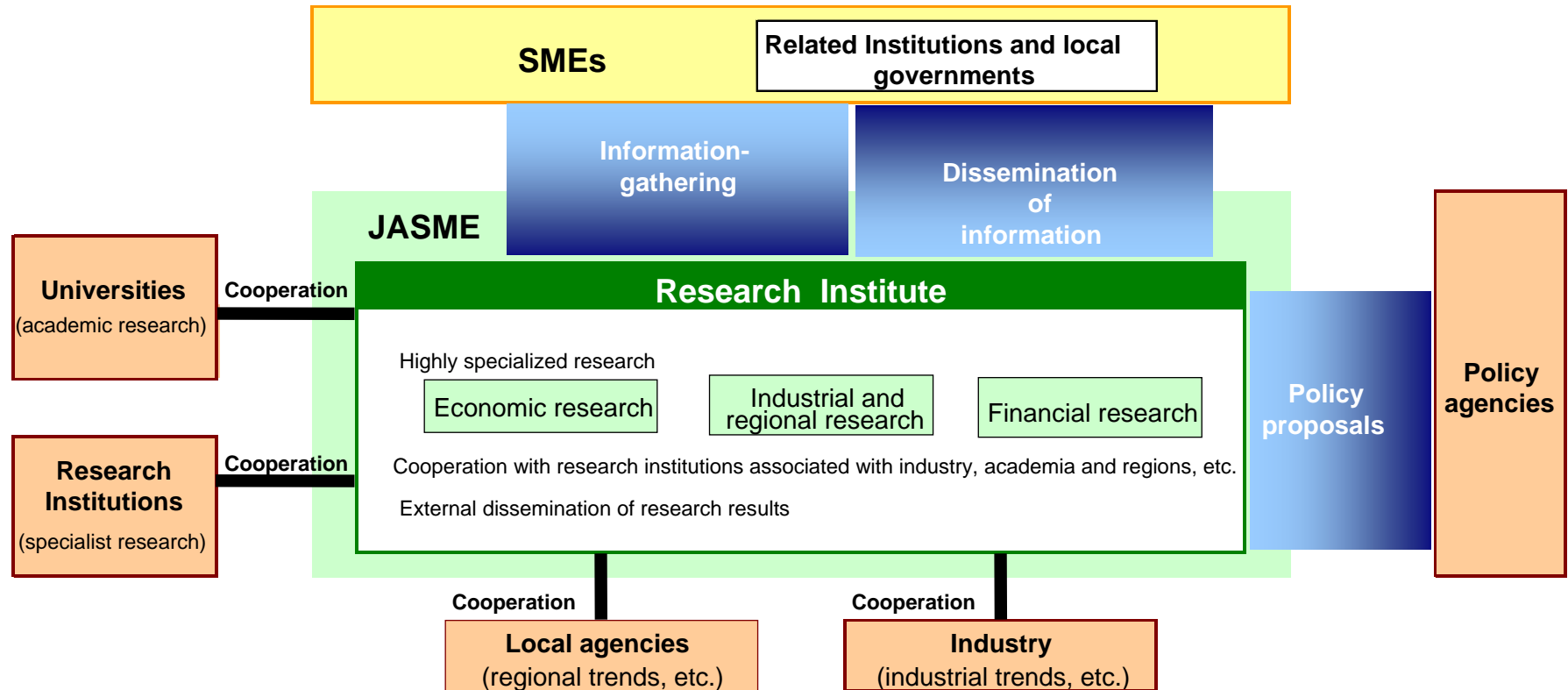
Approximately 50 thousands clients

**RIP** : RIP illustrates JASME's commitment to supporting the growth and development of SMEs by building mutual trust with clients through dialog (**Relationship**), exploiting to the full both parties' know-how (**Intelligence**) and proactively putting forward suggestions (**Proposals**).

## 7. Research Institute

As a “ Think Tank for SMEs,”  
JASME Engages in Research Activities from Various Angles

### The Functions of the Research Institute



## 8. Council

**Working to Ensure that JASME Adopts Fair Business Practices as a Policy-oriented Financial Institution.**

### **Council established in July 2004**

- Legally established under the revised JASME Law
- Discuss important matters relating to the management of JASME's operations
- To enhance transparency, details of council meetings are posted on the Japanese portion of JASME Website
- Held 4 times a year

### **Overview of the Council** (Article 16-2 of the JASME Law)

No. of members : Max. 10

Appointment : People of learning and experience in connection with SMEs and finance are appointed by the President with the approval of the competent Minister.

Term of office : 2 years ( reappointment possible)

## 9 . Reform of Policy Financing (Council on Economic and Fiscal Policy, December 13, 2002) (1)

December 13, 2002

Council on Economic and Fiscal Policy

### Reform of Policy Financing

The scale of policy financing in Japan is large compared to other countries and tends to expand over time, which has led to distorting capital distribution functions in the financial and capital markets. For our nation, efficiency of capital markets is of utmost importance, and it is necessary to perform a drastic reform of policy financing to maximize the private sector's engagement in free and spontaneous activities.

#### 1 The road map to achieving reform

In the light of the current severe financial situation, and considering the road map to normalize private financial functions, it is necessary to reform policy financing through the following three stages:

##### (1) Period of concentrated disposal of bad debts (until the end of FY2004)

Utilize policy financing to facilitate financing. Especially, in the rapidly changing financial environment, when there is the prospect for chain bankruptcies, make doubly sure to ensure smooth financing and safety net responses.

Appoint the right person in the right managerial position placing special emphasis on utilizing people who have high motivation towards the reform including private citizens, and set up facilities to implement the Reorganization and Rationalization Plan for Special Public Institutions (December 19, 2001 Cabinet Decision).

##### (2) From FY2005 to FY 2007

This is a preparatory period to move towards the ideal form of policy financing, while monitoring the restoration and strengthening of private financial institution functions. Implement reforms that can be launched as soon as possible, while strictly selecting subject fields for reform with an eye on intensifying organizational integration. Hold discussions with government and policy financing institutions on how to smoothly proceed the transition to its appropriate form.

##### (3) FY2008 and beyond

Promptly transfer to the new system.

Note : JASME translating and underlining.

## 9 . Reform of Policy Financing (Council on Economic and Fiscal Policy, December 13, 2002) (2)

### 2 Realizing the appropriate form of policy financing

#### (1) Stringent selection of subject fields

By the end of FY2007 at the latest, the nation must carefully select a policy financing approach that follows the guidelines in Attachment 1 while keeping in mind the issues that are raised in Attachment 2. In this regard, based on the policy characteristics of each financing field, and with close examination of the functions of each public financing institution after further classification of their businesses, and taking other public measures with similar objectives into full consideration, decisions must be made on the selection of the businesses that should take steps, such as discontinuance or transfer to the private sector.

#### (2) Reduction of scale

On the premise of normalizing private financial functions, the eight current public finance organizations aim to reduce the total lending balance as a percentage of GDP to half.

#### (3) Review of the organization

The eight public financing corporations will undergo review of their organizations in line with the points in (1), and by taking the resources provided by current policy financing into consideration, steps including discontinuation and privatization will be examined so that by the end of FY2007 the current form of special public institutions will be discontinued. Bold progress will be made in intensive consolidation of the organizations that continue afterwards to provide the policy financing functions that the nation needs. Rigorous governance will be established to ensure that the new forms of organization provide the necessary policy functions reliably and efficiently, particularly in the following areas.

Clarify management responsibility (This includes abolishment of subsidies that make up the differences in income and expenditures, which can obscure management responsibility. Interest subsidies and other measures may be used instead if deemed necessary.)

Improve efficiency of business operations

Appoint the right person in the right managerial position placing special emphasis on utilizing people who have high motivation towards the reform including private citizens

Thorough disclosure of information related to the necessity of the continuing existence of the organizations and operations, such as that related to costs and risks

## 9 . Reform of Policy Financing (Council on Economic and Fiscal Policy, December 13, 2002) (3)

Establish a system including examination by third parties to evaluate and monitor before and after the reforms (This would include establishing practical standards for measurement of results, adopting criteria to evaluate the state of supplementing private financial institutions, and participation of system users and representatives of private financial institutions.) Accounting should be principally based on corporate accounting principals.

### **(4) Innovations of policy financing methods, thorough correction of financing conditions, etc.**

While transitioning to the most appropriate form of organization, measures such as innovating policy financing methods and thorough correction of financing conditions should be implemented promptly as possible.

Innovations in policy financing methods

Referring to the cases the supplementation of private financial institutions in foreign countries, innovations in policy financing should be pursued moving towards methods such as indirect financing and loan guarantees, cooperative funding in cases of direct lending, and ensuring transparency of lending conditions.

Thorough correction of financing conditions

Promote continuous implementation of setting interest rates compatible to the private sector and matching risk levels. Reduce interest rate risk by eliminating the difference between periods for operating interest and funding interest through such steps as shortening the fixed interest rate period.

### **3 Point of concern**

Ensure smooth and efficient financing for SMEs through the reform process.

Promotion of upgrading capital markets and private financial functions such as expansion of securitization of loans and direct financing together with the reform. Integrate related government departments and agencies to that end.

Take appropriate care in utilizing policy financing during the process of the reform so that market functions will be maximized when policy financing is utilized during the reform process.

*(Attachments Omitted )*