

# Changes in Business Environment of SMEs and System of Creating the Corporate Creditworthiness

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## Introduction

Academically, ‘limited liability system’ is one of the most important components of the joint stock company system, and utilization of the limited liability system in the business world is one of major purposes to establish a joint stock company. And yet, Japanese joint stock companies have not precisely adopted the limited liability system. For this reason, we can call this system “Japanese-style joint stock companies.” In Japan, the joint stock company system has been only superficially put into place, but basically it has not been functioning<sup>1</sup>. During times of recession, such as aftermath of the collapse of the bubble economy, some people used to advocate, “Let’s allow venture to take roots in Japan; promote creation of venture; and thereby revitalize our economy,” although such an argument has been hardly heard these days. Typically the term “venture” used to be closely associated with stories of such successful people. But, as a matter of fact, venture is otherwise known as “Sen Mittsu (three out of a thousand),” which means only three companies out of a thousand venture will survive. Therefore, it would be all right for the three surviving companies, but basically in the context of Japanese organizations, it would be extremely difficult, if not forever, for the remaining 997 companies to challenge again. How could you foster any ventures in Japan, where the joint stock company system has been placed in

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<sup>1</sup> Yamashita, S. (2014a).

a situation similar to an unlimited liability?

## 1. SME Policy for the Construction of Financing Support

In line with the structural changes experienced in the Japanese economy, the management environment surrounding the medium-small enterprises has been greatly fluctuating. The conditions for keeping the existence of medium-small are also in a course of a change. In order to maintain the viability of medium-small enterprises, handling of issues based on the types of enterprise, form, category of business and area respectively is required. In addition, broad range of management strategies of medium-small enterprises and their implementation measures for medium-small enterprises are also required. In other words, such change in the management strategies of medium-small enterprises has been observed as the second inauguration of business of medium-small enterprises and the inauguration of ventures themselves have been aspired after through venture type management strategies.

A system replacing the collateral-oriented compensation system, which is what we call “system of creating the corporate creditworthiness,” will become an enormous factor for the growth of SMEs and regional development<sup>2</sup>. The turning point came in 1998 when the measures of “special credit guarantee for stabilizing business management (or ‘safety net’ to put it in more modern terms)” were issued during the Obuchi Administration. With the aim of stimulating the economy, the central government issued guidelines under the recognition of the need for creating a system to evaluate companies in a fair manner. At that time, the government referred to “financing system,” but nowadays we need to construct not only the financing system but also what can be called a system of creating the corporate creditworthiness. Various systems have changed since 1998. The revision Basic Law of SME (enacted in 1963) in 1999 is considered as the underlying cause for these changes. Before the revision of the basic law, everyone received sufficient protection equally under the policies that targeted entire regions or production areas, although it had both advantages and disadvantages. However,

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<sup>2</sup> Satake, T. (2008).

with the recognition that such a time was over, this basic law was revised. The policy direction changed to that of measures focused on companies with growth potential and high aspirations, while reserving a part of the safety net intact amid the economic crisis<sup>3</sup>.

Those changes gave birth to various new policies. They were oriented in the direction of moving forward with management innovation<sup>4</sup>, enhancing the quality of management, pursuing collaboration, or utilizing regional resources. More specifically, those companies that are recognized as promoting management innovation, or as possessing high management quality, will be considered as companies with high aspirations. Once a company is recognized as such, various systems are to be involved: getting a larger credit facility; declining interest rates on its debts, becoming more likely to receive subsidies, increasing line of credit guarantees, etc. Looking at the lineup of measures provided by Hyogo Economic Development Center, for example, we can see the phrase “no collateral and no guarantors” in its institutional loan program. In accordance with the financial law, however, uncollateralized financial transactions are illegal. On the other hand, there is absolutely no need for collateral to be confined to real estate. Therefore, “no collateral and no guarantors” in the economic development center’s loan program means that the center does not collect guarantee or collateral in the sense of our preconceived notion. In the loan program, required conditions are also mentioned, such as the recognition of the management innovation plan and participation in the agriculture-commerce-industry collaboration. This, in fact, functions as collateral instead. The above-mentioned and other systems have been established by the Japanese government with great purposes. One of them is to formulate a financing system that does not rely on the so-called collateral-oriented compensation system. This can be said as a system of creating the corporate creditworthiness.

Such changes in the measures for medium-small enterprises have been observed as the shift of emphasis in the medium-small enterprises measures, such as a revision of Basic Law of SME in 1999 and reinforcement of supportive measures

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<sup>3</sup> Teraoka, H. (2010).

<sup>4</sup> “Innovation” includes “management innovation”. Such as the “2nd Inauguration” and “Management of Innovation”, the term is included in the innovation are manifold.

for medium-small enterprises in their inaugurations and second inaugurations, which have been directly linked to the diversification of the medium-small enterprises management strategies and the measures for such enterprises. As such, the medium-small enterprises in the present Japan are facing with a point of great change. The Japanese economy in the present days in 21st century after the end of 20th century is facing with a reconstruction of economic structure and a mega-competition. It is facing with a point of change in the industrial structure representing the viability of business type and industrial organization representing the enterprise activities. Such a point of change is a so-called structural change in the Japanese economy.

## **2. Support for Type of Venture and SME Management Innovation Support**

Modern medium-small enterprises are required to play their role as a “Nursery bed”, “Leader in innovation”, “Leader in the employment opportunity creation” and “Leader in the regional economic development”. At the same time, it was intended also that those medium-small enterprises not in charge of management activity only viewing to respond to the movements of large enterprises, namely independent medium-small enterprises should become the entities to play above roles. Therefore, it will be possible to position the modern medium-small enterprises as “Diversified and vigorous” entities based on such a modern medium-small enterprises’ concept. It is also necessary to foster them and let them grow. As a precondition to that end, the objectives of medium-small enterprises policy have been set to seek for “Respect and improvement of the market mechanism”, to promote “Self-motivating efforts toward expansion of new creative value such as the innovation or inauguration of medium-small enterprises management”, and to improve various conditions to that end. In view of such medium-small enterprises concept, it was determined to plan a medium-small enterprises policy. Based on the systematic improvement in accordance with the revised Basic Law of SME, the Medium-small Enterprises Management Innovation Support Law which was established by merging the Medium-small Enterprises Modernization Promotion Law, which was promoted mainly through medium-small enterprises modernization policy in

accordance with former Basic Law of SME with the Medium-small Enterprises New Field Entry Smoothing Act which supports entry by medium-small enterprises in new business and new product development was developed, and at the same time, new industry inauguration program/capital of which application/approval became possible at prefecture and city governments level and various policies such as human resource level-up support program, etc. were improved.

When we look into the medium-small enterprises policy in Japan after the World War II, systematic policies started implemented after the Basic Law of SME was issued in 1963. In order to attain modernization and correct disadvantages, the issued “Basic Law of SME” was put into effect as a core post of medium-small enterprises policy until the period around the transition (1980) to low economic growth after 1st oil crisis (1973)<sup>5</sup>. However, in the course of formation of a concept of medium-small enterprises proposing the generation of medium-small enterprises or venture, a policy, which was different from the modernization policy and/or disadvantages correction policy which had been traditionally the core of the medium-small enterprises policy started introduced into the medium-small enterprises policy. It was a conversion into the policy to stabilize the basis to survive from a viewpoint of enterprise management strategy support policy.

With respect to the “Venture boom” which appeared to represent the growth and development of venture, its 1st boom arrived in the early part of 1970s and 2nd boom arrived in the early part of 1980s. Furthermore, under the present circumstance the business is still bad, foundation of venture is expected as a detonating agent of economic structure reformation in Japan. As such, the traditional medium-small enterprises policy was forced to change. The role of medium-small enterprises modernization policy has become ineffective and changed to a policy aiming for “Amalgamation and inauguration”. In the “About actual situation of medium-small enterprises and direction of measures taken for medium-small enterprises during 1980s”, which was an opinion expressed by the advisory board of the measures for medium-small enterprises in 1980s, the venture were recognized as a group of enterprises expected to develop. Fostering measures

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<sup>5</sup> Kiyonari, T. (1994).

of venture became weighing heavy to attain conversion into new industrial fields in new age.

When we roughly look into the medium-small enterprises policy after 1980s, “Medium-small enterprises technology advisor system” started in 1980, “Medium-small Enterprises Technology Exchange Plaza Holding Program” started in 1982 which developed into different fields exchange policy, and further in 1984, such guidance and training program as “Regional frontier technical development program” started. In 1985, “Medium-small Enterprise Technology Development Promotion Act on Temporary Measures (Medium-small Enterprise Technology Act)” was issued. As a result, technical development, commercialization, technical information provision, etc. started implemented, of which target was to improve the technology development power utilizing advanced technology and system technology. Further, entering 1990s, “Vision of medium-small enterprises during 1990s” was published by the advisory board of the measures for medium-small enterprises. In that vision, it was proposed that “Free and open market economy is the basis of advancement and development of economic society which will foster creativity, etc. In order for medium-small enterprises to respond to these demands, it is vital for medium-small enterprises to take an active part in the market economy as the leaders in the independent many competitions.” When implementing medium-small enterprises policy, such points were placed in the basic direction of the policy to enrich the network and soft management resources based on the self-reliant effort support policy with the market economy as its principle, promote inauguration and promote in a positive manner conversion policy. In addition, “An interim report of the basic policy studying committee of the advisory board of the measures for medium-small enterprises” was published in July, 1993, in which traditional medium-small enterprises policy was converted and the policy implemented at that moment was systematized.

The traditional policy was survival basis enforcement/management stabilization policy through “Modernization policy” and “Disadvantages correction policy” since the “Basic Law of SME” in 1963 was issued. These policies were changed to such policies aiming for advanced industry fostering/inauguration promotion as policies to support creative

self-innovation of medium-small enterprises. “Smoothing Act of Adaptation to Economic Structural Change caused by the Entry into New Fields by Specific Medium-small Enterprises on Temporary Measures (Medium-small Enterprise New Field Entry Smoothing Act: Restructure Support Act) was issued in 1993, and “Medium-small Enterprise Creative Business Activity Promotion Act on Temporary Measures (Medium-small Enterprise Creative Activity Promotion Act)” was issued in 1995. In 1998, “New Business Creation Promotion Act” was issued, and “Basic Law of SME” was revised in 1999 after 35 years since its issuance. The concept of the revision aimed for a change from fostering and encouraging policy of medium-small enterprises mainly composed of traditional “Modernization” and “Correction of disadvantages” to medium-small enterprises inauguration policy mainly composed of “Inauguration” and “Development of competitive condition”. Instead of taking traditional uniform medium-small enterprises as social/economic underdog, it was intended to position medium-small enterprises as a post to overcome the difficulties prevailing in a long period depression and further to establish a foundation to develop Japanese economy by focusing the attention on the diversity, creativeness and mobility.

In the new Basic Law of SME revised in 1999, it was intended to establish medium-small enterprises policy to promote smooth pursuit movement toward adaptation to the promotion of management innovation and inauguration, reinforcement of management basis and change in the economic and social environments. To define venture as the typical type of medium-small enterprises for the new age, it can be said that this was a revision of a law established by recognizing that medium-small enterprises were no longer the controlled entities in a control-subordination relationship and instead they were the entities able to establish a business relationship with large enterprises in which equivalent exchange should be possible<sup>6</sup>. In 2005, “Medium-small Enterprise

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<sup>6</sup> The definition of venture is organized as follows. (1) Classification of company size: whether it is a large enterprise or small business as prescribed in the “Basic Law of SME”. (2) Classification as to whether it is early in the growth stage which is still relatively short from new start-up, rather it is a company that has reached the second term from the middle stage of growth stage. (3) Classification of whether the maturity level in the main business field is a new industry field or a mature industrial field (traditional industrial field) that combines existing technologies and know-how. However, in the system of promotion measures of venture in Japanese small and medium enterprise policy, not only these three points are policy subjects: (1) small business, (2) early stage of growth, (3) Business “is not subject to policy objectives.

New Business Activity Promotion Act” was issued as a new supporting act for medium-small enterprises. The goal of the “Medium-small Enterprise New Business Activity Promotion Act” was to support medium-small enterprises within 3 frameworks of inauguration support, management innovation support and new collaboration support as a result of the reorganization and unification of “Medium-small Enterprise Creative Activity Promotion Act”, “Medium-small Enterprise Management Innovation Support Act” and “New Business Creation Promotion Act”<sup>7</sup>. Namely, while Japanese economy is still kept under slower growth situation, the management environments surrounding enterprises are en route to change largely<sup>8</sup>.

Among medium-small enterprises, especially those enterprises regarded as venture are expected to play a role in leading the activation of economy. On the other hand however, the existing medium-small enterprises will no longer be permitted to let their self-reliant efforts rely on the existing business or existing products/services. Instead, they are required to direct their management activities themselves toward new and innovative direction. Therefore, by figuring out potential customer needs, they must develop new products and new services which are not found on the market and create customer needs for the developed new goods. Especially for medium-small enterprises when creating market, they are required to select “Niche” sectors large enterprises cannot enter, exploit the market by themselves, secure new customers and dealers and start innovative corporate activities possible to create innovation. It is of

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Enterprise that has the possibility to satisfy any of the conditions classified into the six categories shown above shall be defined as “venture in a broad sense”. Since the revision of the Basic Law of SME in 1999, “broad-based venture” is commonly used.

<sup>7</sup> “New collaboration” (referred to as “the development of a new business field in a different field in terms of legislation”), which is subject to policy, means that “businesses with different business fields organically collaborate and their management resources Effective combination of equipment, technology, knowledge and skills possessed by individuals and other business activities), and by conducting new business activities to explore new business fields “. We must take into consideration three of new business activities, different field collaboration, and sales. The conditions of “collaboration body” include (1) the existence of core SMEs, (2) the participation of SMEs of two or more companies (adding large companies, universities, research institutes, NPOs, unions, etc. to the members However, if the degree of contribution of small and medium enterprises is less than half, it is not covered by support), and (3) role sharing and responsibility system etc. are clear among participating companies according to the rules etc.

<sup>8</sup> The Law for Strengthening Management of SME, enforced in July 2016, is a revision of the Law “Medium-small Enterprise New Business Activity Promotion Act” . Similar to the previous, to promote management innovation of small and medium-sized enterprises, it is a measure to encourage improvement of management ability by carrying out management innovation. Refer to Yamashita, S. (2017a-b).

course essential for medium-small enterprises to draw effective ability or activity from such management resources as corporate information capabilities, technical capabilities, market developing capabilities, human capacity, financial power, etc. through entrepreneur's capabilities or entrepreneur's spirit as the leader of such medium-small enterprises and let the management resources function best. To that end, introduction and improvement of equipment in the research/development or production process pertaining to technology, products and market and employment and fostering of talented manpower in order to manage them effectively will be required. We can find a venture which has a possibility of growth and was established only recently. On the other hand, It is a fact that the roles of existing medium-small enterprises are important in certain aspect and that 2nd inauguration by existing medium-small enterprises is developing further. As a matter of fact, as the term of venture boom means typically, almost of growth and development of venture is only a transient phenomenon. Therefore, a drastic study of the thought of medium-small enterprises policy will become necessary. Under such a circumstance, the necessity of 2nd inauguration is attracting attention in the medium-small enterprises policy.

### 3. Issues of SME Policy

As a result of the revision of this law, the core entities which should be the target of the policy were imaged as venture. Namely, it was a policy intended to support with priority those medium-small enterprises with high possibility of growth. It is completely different from the concept of the former Basic Law of SME which intended to modernize those medium-small enterprises which had been under the dual structure. Such a point was taken into account that the medium-small enterprises of foundation/inauguration type with high possibility of growth should be the center of American type venture<sup>9</sup>. As such, it is meant that policies will be planned and implemented according to the Basic Law of SME,

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<sup>9</sup> There are following three general forms of companies that take venture strategic actions. (1) Independent venture of entrepreneurial type which is considered to be typical in the American economy. (2) Second Inauguration type venture by management innovation of existing small and medium enterprises. (3) Innovative type venture in in-house organization such as existing large enterprise. Refer to Satake, T. (2002).

which was revised mainly based on the foundation/inauguration policies. Such a principle in planning the medium-small enterprises policy is of course needed. Namely, human resource development and fostering of entrepreneur as an industry foundation infrastructure is needed for the entrepreneurs at the stage before inauguration for fostering creativity and the enterprises/entrepreneurs at the initial stage of inauguration.

In addition, we can mention the “Collateral principle and guarantee principle” which is pointed out as the particularity of Japanese management environment. The funding method from external source by medium-small enterprises has been substantially limited to the borrowing from bank. Scheme or system to procure necessary fund from the market was not established and such an issue of funding practice in Japan was involved. Such an issue was the “Collateral principle and guarantee principle”. Therefore, for those medium-small enterprises whose management basis was weak, past profitability was poor and had no asset suitable for collateral, the possibility to receive funding was very low even if they had established a reasonable business plans. In addition, when any funding should be provided to a medium-small enterprise, the owner top executive of such enterprise was required to provide personal surety. In fact, such an owner was required to hold unlimited liability. The purpose of the required medium-small enterprises policy involving such issues as above should not be limited to the fostering, guidance and reinforcement of venture to be provided by very limited number of entrepreneurs. As a policy to that end, medium-small enterprises policy for the management innovation (2nd inauguration) of medium-small enterprises becomes necessary. If we should desire the actual survival of medium-small enterprises and aim for a reinforcement of the basis for medium-small enterprises to survive, it goes without saying that fostering of medium-small enterprises of venture type is required in line with the management innovation (2nd inauguration) of medium-small enterprises. The medium-small enterprises policy for the management innovation (2nd inauguration) in order to maintain the viability of existing medium-small enterprises satisfies the policy principle of revised the Basic Law of SME and cannot be always considered that it is against public interest. Therefore, a medium-small enterprises plan giving its

consideration to such viewpoints as recognition of current situation of the basis for existing medium-small enterprises to survive and the regional encouragement through fostering medium-small enterprises will become more important<sup>10</sup>.

In addition, a policy is being planned giving its weight on the market mechanism as its point of view. In the revision of the Basic Law of SME, of this instance, reinforcement of management basis of medium-small enterprises through “Management innovation and promotion of inauguration” and enrichment of the management resources held by medium-small enterprises and establishment of safety-net plan in view of the failures in the market which deviated from effective competitive state in order to smoothen the management adaptation capacity of medium-small enterprises against rapidly changing management environments are also composing the main part of the policy scheme in accordance with the revised the Basic Law of SME. In the revision of this instance, a weight is placed on such a viewpoint to evaluate medium-small enterprises in a positive manner regarding them as economic entities having a possibility to grow up through innovative management activities instead of regarding them as the weak subject to the disadvantage correction. Therefore, the policy was planned up based on such an idea to implement business support policy to medium-small enterprises as entities possible to try a management innovation and implement safety net policy to those medium-small enterprises whose management had declined due to any competition or decline in business, under a philosophy to apply market competition principle to medium-small enterprises under a condition that no medium-small enterprises issue held by any medium-small enterprises arising from the gap with large enterprises remained. The issue in this respect can be summarized in following 2 points<sup>11</sup>.

The 1st point is that, although those management resources for medium-small enterprises to foster are regarded as the “equipment, technology, private owned knowledge, skills and other resources to be put in practical use for business activities”, the positioning of these items is not clear enough. As a policy to enrich these resources, industrialization by means of promotion of competition

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<sup>10</sup> Fukushima, H. (2006).

<sup>11</sup> Satake, T. (2002).

through simple self-reliant effort, namely a business support plan through market competition principle has been exhibited only. The 2nd point is that a weight has not been placed on the realization of partnership/grouping nature through organization as provided for traditionally in the medium-small enterprises policy as a manner to put these management resources in practical use. The purpose of organization policy is the adequacy of the scale in order to enjoy the economy of scale, which however has been experienced already in the past. The inter-enterprise relationship aiming for an amalgamation of management resources has become a strategy essential for the present medium-small enterprises to survive. In order to foster and grow up medium-small enterprises of venture type having possibility of self-independence by filling up the management resources, promoting management innovation activities and having existing medium-small enterprises depart from the control-subordination relationship, it will be necessary to establish a network among entities of present medium-small enterprises in a variety of sectors, types and scales and let them act in an independent and coordinated manner under an equal inter-entity relationship as far as possible.

Thanks to the revised the Basic Law of SME, the SME policy is stepping into a new age. In addition, the medium-small enterprises modernization policy, which used to be the main part of traditional medium-small enterprises encouragement policies, was succeeded by Medium-small Enterprise New Business Activity Promotion Act from Medium-small Enterprise Management Innovation Support Act, which was converted into the management innovation of medium-small enterprises<sup>12</sup>. Such a stream is based on such a policy principle that corporate self-reliant effort of an enterprise must be guided toward new and innovative direction in order to make it possible for it to succeed as a leader in the future economic activation under such an environment that venture related policies are well established and management environment is changing largely. However, such a stream is a movement started after 2005 only and it is still at a stage just started. It will be required to develop encouraging policies further for the medium-small enterprises which occupy the major part of enterprises presently existing in

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<sup>12</sup> Yamashita, S. (2017b).

Japan. Medium-small enterprises are regarded as entities of different and diversified nature having both of problematic characteristic and efficiency. However, it is required for medium-small enterprises to draw out efficiency from those entities having problematic characteristic. From the viewpoints of nation economy and public interest, it is required for existing medium-small enterprises, having a possibility to exhibit efficiency regardless of their problematic characteristic, to start 2nd inauguration through management innovation. The medium-small enterprises policy which is planned and implemented from above viewpoints is considered as an effective policy to get the existing medium-small enterprises start 2nd inauguration and convert them into venture-type medium-small enterprises. The medium-small enterprises policy that can involve not only a simple foundation/inauguration policy but also traditional policy principle of modernization and disadvantage correction is an industrial policy to cope with new medium-small enterprises issues. A policy that can compensate any failure in the market will be sought after further in the future. To that end, it is required to seek after a method to fill up the management resources in various sectors. Therefore, it is required to seek after a medium-small enterprises policy to amalgamate fostering and growing up policies of medium-small enterprises, considering a market mechanism in the innovation creation support policy mainly composed of foundation/inauguration support policies.

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