Small Business Financing in Japan, from the Prewar to High-Growth Periods: An International Comparison of the Financial History of Small Businesses

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ABSTRACT

This study outlines Japan's policies with regard to small businesses and small business financing, from the prewar period and throughout the postwar reconstruction period, from the viewpoint of international comparisons.

The stance of the Japanese government vis-à-vis small businesses in the prewar period was that it should strengthen product competitiveness and credit by organizing them. However, the connection between those policies and finance was weak. Nonetheless, many small businesses made active use of informal transactions or private financial institutions that served small businesses.

During wartime, the government forced small businesses to join the munitions industry or face closure. To facilitate changes or closures in small businesses, a governmental financial institution was established. On the other hand, the provision of loans for small businesses via private financial institutions or informal transactions quickly dissolved.

During the postwar reconstruction period, the government established the Small Business Agency, resumed policies by which to rationalize and modernize small businesses through better organization, created new financial institutions that served small businesses, and launched government-funded financial assistance packages for small businesses. It is clear that essential institutions and policies supporting small businesses during the time of high economic growth stemmed from the postwar reconstruction era.

Keywords: small business finance, small business policy, organizational and financial measures, characteristics of small business financing, international comparison
JEL Classification Numbers: N20, N25

1 Introduction

The objective of this study is to examine the development of small business financing in Japan from the prewar period to its high-growth period. In so doing, this study will shed light on the characteristics of each period and position Japan among its international contemporaries vis-à-vis small business financing, especially from an historical perspective.

Carnevali (2005) conducted a comparative review of the development of small business financing in Britain, France, Germany, and Italy, from the beginning of the 20th century to the 1970s. Her principal aim was to illuminate the cause of decline in the British manufacturing industry, particularly from World War II to the 1970s. This was then compared to the economies of France, Germany, and Italy, which had achieved manufacturing industry-centered growth throughout the same period. Through this review, Carnevali found that in Britain, the continued passivity of the government and banks towards fostering small businesses from the early 20th century to the mid-1970s led to the postwar decline of their manufacturing industry. On the other hand, the governments of France, Germany, and Italy developed measures to foster small businesses, with the aim of developing a financially and politically stable middle class. Moreover, the financial institutions' continuous funding of small businesses within such a political environment led to economic growth that contrasted favorably with the stagnation in Britain.

Carnevali focuses on the stance taken by the governments and financial institutions of each country towards small businesses, as well as the financial institutions that provide funding to small businesses under various conditions. In so doing, Carnevali succeeds in analyzing the financial development or decline of small business financing in each country, all from the same perspective. Although Carnevali's work does not focus on the World War II period or the postwar reconstruction period, it is important to shed light on these periods when considering the issue from the perspective of Japanese financial history. In terms of Japan's financial history, the impact of World War II and the postwar reconstruction period are important factors that must be considered when examining the shift from the prewar financial system, which was based on the Anglo–Saxon model, to the financial system of the high-growth period, which centered on *keiretsu* finance (i.e., financing to affiliated group companies) (Takeo and Kashyap 2001). In light of this, when considering the development of small business financing in Japan between the prewar and high-growth periods, it is indeed essential to examine the World War II and postwar reconstruction periods.

In line with the work of Carnevali, this study presents an outline of Japan's policies with respect to small businesses and small business financing, during the prewar, World War II, and postwar reconstruction periods. Specifically, this study examines each of these periods separately, in terms of the Japanese government's stance on small businesses, the degree to which small business policies and small business financing were connected, and the ways in which financial and nonfinancial institutions were involved in small business financing.

This historical analysis of small business financing in Japan—a factor that had indeed been responsible for bringing about Japan's manufacturing industry-centered economic growth during its high-growth period—will make a considerable contribution to international comparative research done within the context of the history of small business financing.

2 Origins and Development of Small Business Financing during the Prewar Period

2.1 Implementation of Organizational and Financial Policies, and Their Limitations[1]

Table 1 shows the Japanese government's stance on small business, the degree to which small business policies and small business financing were connected, and the various forms of small business financing, during the prewar, World War II, and postwar reconstruction periods.

The government's stance on small businesses during the prewar period was characterized by its wish to improve product competitiveness and company creditworthiness, by imposing organizational measures. The first governmental law regarding the organization of small entrepreneurs was the Manufacturers' Cooperatives Act for Important Goods (*Jyuyo Bussan Dogyo Kumiai Ho* 〔重要物産同業組合法〕), which was enacted by the Ministry of Agriculture and Commerce in 1900. Cooperatives were established with the aim of eliminating inferior goods, mainly through product inspections, and they were able to compel members of relevant trade unions to join. However, because the control of products was entrusted to the cooperatives, product inspections gradually became mere formalities. Under the recession that followed the Russo–Japanese War, the government sought to foster joint enterprises through the Industrial Cooperatives Act (*Sangyo Kumiai Ho* 〔産業組合法〕), enacted in 1900 to improve the productivity of small businesses and reduce their production costs. The government also recommended the establishment of credit associations, based on the same law, as a measure against the financial difficulties that small businesses typically face. However, the prosperity engendered by World War I meant that organizational and financial measures were never fully implemented.

From 1925, the Manufacturers' Cooperatives Act for Important Export Goods (*Jyuyo Yusyutuhin Kogyo Kumiai Ho* 〔重要輸出品工業組合法〕) became the main organizational measure with respect to small entrepreneurs and manufacturers in particular. As a background to the enactment of this Act, since the 1920 recession, the fostering of export-related small businesses, improvements in product quality and productivity, and costs reductions had become important issues in improving the balance of payments. The manufacturers' cooperatives set up joint facilities, made joint purchases and joint sales,

[1] Unless otherwise noted, the following is based on chapters 1–4 of Tsunehiko (1964).

Table 1. The Changing Pattern of Small Business Finance in Japan.

Time period	Stance of government	Connection between policy and finance	Forms of small business finance
Before 1937	Improve product competitiveness and creditworthiness through organization	Weak (cooperative finance, but weak policy effect)	• Informal transactions e.g., loans made by traders or families • Savings banks • Mutual loan company • Credit cooperatives
1937 to 1945	Change business to munitions industry or close down	Strong (Help small businesses change, or initiate closure)	• Public financial institutions
1945 to mid-1950s	Support for rationalization and modernization	Strong (Foundation of the Small Business Agency, application of government funds, legislation to organize small businesses, and set up private/public financial institutions for small businesses)	• Ordinary banks • Private/public financial institutions for small businesses • Mercantile credit
Mid 1990s~	Support for growth companies (e.g.,) amendment of the Basic Act for Small and Medium-sized Enterprises	Strong (?) (Legislation to promote of Growth firms)	(mainly) • Ordinary bank, financial institutions for small businesses • Mercantile credit (partly) • Domestic capital market • Venture capital

Source: Created by author.

carried out product inspections and controls, controlled production and sales, and controlled outsiders when necessary. With the establishment of the Provisional Bureau for Industrial Rationalization in the Ministry of Commerce and Industry in May 1930, during the Showa Depression, manufacturers' cooperatives started implementing more stringent controls, all with the guidance and supervision of the government. The Act was amended in April 1931, to make it applicable to industries that targeted the domestic market, making it possible to carry out financial business as part of a cooperative. From 1932 onwards, the number of manufacturers' cooperatives grew rapidly, helped also by the easing of government criteria in the foundation of cooperatives. Many of these cooperatives sought to implement various types of restrictions.

The connection between government small business policy and financing during the prewar period was rather weak. For example, loans of business funds for manufacturers' cooperatives were granted in 1928 using the Deposit Bureau Fund of the Ministry of Finance, but even after the budget for this program was curtailed in 1932, the program's annual budget was never fully spent until 1935 (Ibid., pp. 290–91). Immediately after the Great Kanto Earthquake of 1923, the Deposit Bureau of the Ministry of Finance and the Industrial Bank of Japan offered relief loans to small entrepreneurs in disaster-hit areas, but the loans were not used by small entrepreneurs in ways that the government had intended (Ibid., pp. 106–109). To mitigate the financial difficulties that small entrepreneurs faced, the Deposit Bureau of the Ministry of Finance offered loans from 1928 to 1929 and from 1930 to 1932, though in neither period was the Ministry able to spend its entire planned budget (Ibid., pp. 164–72). Most of the loans offered through the Deposit Bureau Fund that took effect between 1932 and 1937 with the intermediation of various cooperatives and banks were spent, but funding did not actually reach the small entrepreneurs whom the government had considered a priority.[2]

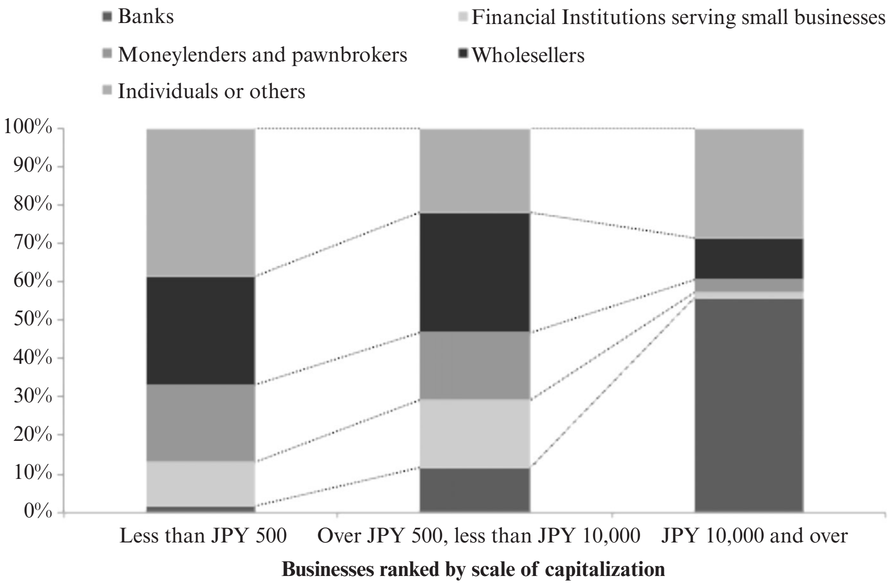
2.2 Characteristics of Small Business Financing

Figure 1 is a conceptual diagram of the relationships between small businesses, broken down by scale of business, and the various lender types, in the first half of the 1930s and within Japan's five major cities.[3] That diagram is driven by data captured through comprehensive surveys of commerce and industry that were carried out by the respective City Offices of Tokyo, Yokohama, Nagoya and Kobe from 1930 to 1935, and a questionnaire survey carried out by the Osaka

[2] Ibid., pp. 254–61. Savings banks that had stronger relationship with small businesses than ordinary banks or special banks were excluded from intermediation.

[3] Unless otherwise noted, the following is based on Toru (2008).

Figure 1. Relationship between Commercial and Industrial Businesses, by Scale of Business, and the Various Lender Types in Japan's Five Major Cities in the 1930s.



University of Commerce (currently, Osaka Municipal University) in 1931 and 1932 among commercial and industrial firms.

The relationships between small businesses and various lenders in Japan's five major cities have similarities, but differences exist among cities and between the commercial and industrial sectors. The vast proportion of borrowing by businesses with capital of less than JPY 500 was from noninstitutional sources of finance, e.g., moneylenders, pawnbrokers, wholesalers, or individuals such as friends or relatives. The group comprising firms that owned capital in excess of JPY 500 but less than JPY 10,000 borrowed from a mixture of places such as noninstitutional sources of finance, savings banks, mutual loan companies, and credit unions. Although others borrowed from ordinary banks, this group's use of financial institutions that serve small businesses was greater than that of either less highly capitalized or highly capitalized groups. We can also confirm that the importance of noninstitutional sources of finance decreased, thus bolstering the role of ordinary banks with respect to this group. It is clear that banks have become the main providers of loans for the group of firms with capital of JPY 10,000 or more.

If we look at the case of Osaka to determine which of the various lender types were the main sources of loans for commercial and industrial firms, we find that a high proportion of firms, regardless of scale, depended on ordinary banks as their main finance source. Noninstitutional sources of finance also accounted for a high proportion of the main lenders in each group, but not as high as that of ordinary banks.[4] In many cases, when a firm in one of the five major cities borrowed from an ordinary bank or noninstitutional source of finance, that lender became its main source of loans. This was because ordinary banks were more convenient than other financial institutions or noninstitutional sources of finance in terms of financial services, and more competitive in terms of the interest rates offered. Noninstitutional sources of finance, especially wholesalers, played an important role in supporting the continued operations of small businesses.

On the other hand, the proportion of small businesses whose main lender was a financial institution that serves small businesses was low, compared to ordinary banks or noninstitutional sources of finance. For each commercial and industrial firm group, the larger the scale of businesses, the lower that proportion became. Based on the conclusions shown in Figure 1, we can say that the financial institutions that serve small businesses in Japan's five major cities were used as temporary funding sources by a limited number of small businesses. Although this does not apply to urban credit unions, this was because the savings banks and mutual loan companies were not permitted to engage in current account dealing or the discounting of bills. This meant that their lending was in principle limited to a single transaction (e.g., benefit or mutual loan to the contracting party) within the contract period.

3 "Change Your Business to the Munitions Industry, or Face Closure": Policies for Small Businesses and Small Business Financing during World War II[5]

With the outbreak of the Sino–Japanese War in July 1937, Japan plunged into a wartime command economy. The extent of government control rapidly increased, and it continued until August 1945. During the war years, government policies towards small businesses were designed to subsidize the conversion of small businesses to munitions and export industries, or to help those businesses unable to make such a conversion close down and relocate unemployed workers to defense industries. As the war situation

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[4] Kazumasa, Kusumi (1934–36) *Osaka-shi ni okeru chusho shokogyo kin' yu chosa [Survey of the financing of small and medium businesses in Osaka]* (5 volumes), Osaka Shoka Daigaku Keizai Kenkyusho.

[5] Unless otherwise noted, the following is based on chapter 5 of Yui (1964), and on Ministry of International Trade and Industry (1963).

worsened, policy became more focused on the latter solution, rather than the former one.

Through the National Mobilization Act (*Kokka Sodoin Ho*〔国家総動員法〕), enacted in April 1938, the government took systematic control of supply and demand for the purpose of substantially expanding munitions production and maintaining the balance of international payments. At the time, the conversion of small businesses not involved in munitions or exports to those who were became a significant issue. To resolve this issue, the Ministry of Commerce and Industry set up the Business Conversion Department in September 1938 (known as the Promotion Department, as of June 1939); from October 1938 until May 1943, this department implemented funds to subsidize small business conversion, using the Deposit Bureau Fund of the Ministry of Finance. The funds were mainly loaned to manufacturers' cooperatives with the aim of encouraging the conversion of small entrepreneur groups.

Because of an alliance formed in September 1940 among the Axis powers of Japan, Germany, and Italy, the United States banned exports of metal and machinery to Japan, and Japan's foreign trade plummeted as a result. To prop up Japan's wartime economy, it became necessary to have even tougher controls. Therefore, starting in October 1940, the government implemented a policy supporting the closure of small businesses and promoting the redeployment of the unemployed to munitions work. To smoothly advance this policy of closure and redeployment, the government founded the National Transformation Fund in December 1940.[6] The principal work of the National Transformation Fund was to manage or dispose of the business assets of those companies that had closed or changed their business, assume their liabilities, act as the guarantor of such businesses, and to provide such businesses with loans.

In July 1941, the United States and Britain froze all Japanese assets. In December of the same year, the Pacific War began. Based on an Imperial ordinance, in May 1942, the government forcefully closed down small businesses and redeployed the unemployed into munitions work. To smoothly subsidize changes to businesses, the government increased the capital within the National Transformation Fund and then carried out other measures, such as raising the issue limit of Transformation bonds and offering tax exemptions or tax reductions to those who had closed or changed their businesses. By this stage, regulation had already become the main work of the manufacturers' cooperatives and trade associations.[7] After the Commercial and Industrial Cooperatives Act (*Syoko Kumiai Ho*〔商工組合法〕) took

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[6]Ministry of International Trade and Industry (1963), p. 244. The National Transformation Act was enacted in July 1941.

[7]The cooperative associations of small traders were based on the Commercial Cooperatives Act implemented in October 1932.

effect in March 1943, the commercial and industrial associations compelled the membership of small entrepreneurs and carried out regulatory work. In June 1943, with the war situation becoming much worse, remaining resources were allocated to ultra-high-priority industries;[8] even large industries became subject to screening. In November 1943, the Ministry of Commerce and Industry and the Planning Board, which had been responsible for small business policy, were abolished, and the Ministry of Munitions was founded. As a result, the importance of small business policy began to diminish rapidly.

As mentioned, the wartime government implemented the policy of converting and closing small businesses by linking policy with financing. Through this connection, along with the National Transformation Fund, the governmental financial institutions that supported small business policy during the war included the Central Bank for Commercial and Industrial Cooperatives[9] (hereafter the Central Bank for Commerce and Industry). The Central Bank for Commerce and Industry was founded in November 1936 as a financial institution by which to promote small business through manufacturers' cooperatives and trade associations. However, corresponding to the situation in which the wartime economy led manufacturers' cooperatives and trade associations were becoming regulatory institutions, the Central Bank for Commerce and Industry carried out measures such as reforming fundraising methods, expanding its business scope, and increasing its capital. While doing so, it used the government's loss-compensation system and the Deposit Bureau Fund of the Ministry of Finance; it also proactively provided business-conversion funds and distribution-control funds to these two cooperatives.

With regard to private sector financial institutions during the war, the large banks proactively financed munitions companies as financial syndicates and designated financial institutions. On the other hand, the primary role of financial institutions with scales smaller than those of regional banks switched to deposit inducement, and bond subscriptions that centered on government bonds; thus, their lending to small businesses dropped sharply. Indeed, savings banks, mutual-aid credit companies, and credit associations that had provided funding to small businesses in the prewar period also became financial institutions that carried out deposit inducement and bond subscriptions.

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[8] Ministry of International Trade and Industry (1963), p. 249. These industries included steel, coal, light metals, shipping, and aircraft.

[9] The following details concerning the Central Bank for Commercial and Industrial Cooperatives are based on Asobu (1991).

4 The Foundation of the High-Growth Era: Policies for Small Businesses and Small Business Financing during the Postwar Reconstruction Period[10]

During the postwar reconstruction period, the government established a specialist government office for small business policy and then carried out organizational and financial measures, just as in the prewar period. It also attempted to nurture and promote small business by setting up government and private sector financial institutions that specialized in small business and actively made use of government funds. Organizations that handled small business policy during the high-growth period and the policies that formed the foundation policies all had active roles during this period.

Unlike in the prewar and World War II periods, however, in the postwar reconstruction period, a specialist government office for small business policy was set up. The Ministry of Commerce and Industry, re-established in August 1945, drew up a plan to promote small businesses immediately after the end of the war. In November 1947, the cabinet decided that the basis of the plan would be to set up a specialist government office for small business policy, provide guidance on technology and management, and make various assessments with respect to small businesses. Based on this plan, the Small Business Agency Establishment Act was drawn up, and in August 1948, the Small Business Agency was established as an external bureau of the Ministry of Commerce and Industry. From this time onwards, the Small Business Agency was considered central to the planning and implementation of small business policy.

After the war, small business policy development moved forward in earnest, beginning with the Small Business Cooperatives Act (*Cyusyo Kigyo To Kyodo Kumiai Ho*〔中小企業等協同組合法〕), which took effect in July 1949. In December 1946, the new Commerce and Industrial Cooperatives Act (*Syoko Kyodo Kumiai Ho*〔商工協同組合法〕) came into effect, with the aim of fostering and promoting small businesses; it was designed to replace the wartime Commercial and Industrial Cooperatives Act. However, because the majority of commercial and industrial cooperatives reorganized into new cooperative partnerships, as during the war, these commercial and industrial partnerships became regulatory associations for the purpose of allotting materials. This did not conform to the General Headquarters' (GHQ) policy, which aimed to encourage business activities through economic democratization by banning monopolies, establishing business autonomy, and allowing free competition. The Small Business Cooperatives Act, which was a compromise between the GHQ plan and the government plan, was a basic law for the organization of

[10]Unless otherwise noted, the following is based on the Ministry of International Trade and Industry (1963).

small businesses in the majority of industrial fields. The main cooperatives were business cooperatives, credit cooperatives, and enterprise cooperatives. Members were able to join and withdraw voluntarily, the establishment of cooperatives did not require authorization from the government office, and the government office did not supervise their operation. After the Small Business Cooperatives Act came into effect, the Small Business Agency proactively guided the establishment and management of cooperatives and subsidized them for the cost of setting up or maintaining common facilities and modernizing machinery and equipment.

Small business financing through the disbursement of government funds during the postwar reconstruction period began in September 1948, when loans for small businesses were provided by the Reconstruction Finance Bank. This bank provided financing to small businesses for equipment funds and working capital, via banks that acted as agents and made financing decisions. In January 1950, after loans from the Reconstruction Finance Bank were stopped due to the implementation of the 1949 Dodge Line, the government initiated financing by using funding that had been secured for aid to Japan. This financing involved financial institutions that provided equipment funds to small businesses by combining their own funds with collateral funds. It also involved an increase in the number of those eligible for financing and an easing of conditions, until US aid to Japan ended in June 1952. Beginning in September 1952, the Japan Development Bank—which took over both the loans provided by the Reconstruction Finance Bank and collateral funds from US aid to Japan—carried out the lending of equipment funds for small businesses, adding its own money to the repayment of the above loans. This credit was then taken over by the Small Business Finance Corporation, which started operations in September 1953 as one of three governmental financial institutions that has served small businesses. This corporation provided long-term equipment funding to small businesses at low interest rates. In addition, from 1948 to 1955, the Bank of Japan lent small business loans via the Industrial Bank of Japan, the Industry Promotion Bank of Japan, and the Central Bank for Commerce and Industry. The government also provided small business loans through the use of Trust Funds Bureau funds of the Ministry of Finance and provided deposits from the treasury surplus to financial institutions specializing in small businesses.

Finally, let us look at the establishment and expansion of governmental and private sector financial institutions that specialized in small business finance during the postwar reconstruction period, and the improvements subsequently made to them. As mentioned, the Central Bank for Commerce and Industry—which began its activities in earnest during the war period—considerably reduced its capital following the Financial Institution Reconstruction Act (*Kinyu Kikan Saiken Seibi Ho*〔金融機関再建整備法〕) after the war; it recommenced its activities in 1948. In 1950, to financially support the organization of small businesses, the government expanded the capital and loan funds of the Central Bank for Commerce and Industry. Through law reforms in 1951, the bank was allowed to provide direct loans to individual cooperative members. In 1949, the People's Finance Corporation was established, which took over the work of the People's Bank and the Pensions Bank, both of which had been set up during World War II. This corporation used capital invested solely by the government, and money borrowed from the government served as loans to entrepreneurs at an even smaller scale.

In 1951, the mutual banks and credit associations were founded as private sector financial institutions that specialized in small business.[11] Based on the Mutual Bank Act (*Sogo Ginko Ho*〔相互銀行法〕), mutual banks were reorganized from the mutual-aid companies that had remained since the prewar period. In addition to mutual-aid financing, they were able to carry out banking services, including receiving deposits, providing loans, and discounting bills. However, large loans were restricted, and there was also a limit on the extent to which branches could be set up. The antecedent to the Credit Association was the Credit Cooperative of Urban Areas, which was based on the prewar Industrial Cooperatives Act. For a brief period after the war, these associations became credit cooperatives, based on the Small Business Cooperatives Act. However, the credit cooperative associations that fulfilled the conditions of the Credit Association Law (*Sinyo Kinko Ho*〔信用金庫法〕) and wished to reorganize eventually became credit associations. Although credit associations also faced restrictions with regard to large loans and the area of business, they developed as financial institutions that specialized in small business.

5 Conclusion

To understand the structure and function of small business finance in Japan's high economic growth period, studies of the country's experiences during the wartime and postwar reconstruction periods are just as important as those of the prewar period.

The stance of the Japanese government vis-à-vis small businesses was to strengthen product competitiveness and credit by duly organizing them in the prewar period. However, because the connection between policies and finance was weak, government assistance in utilizing credit cooperatives had a limited effect.

The government administrations of the prewar period did not set up governmental financial institutions to help small businesses, nor did they provide any particular support for small business loans through private sector financial institutions. However, many small businesses actively made use of informal transactions, such as loans made by traders, family members, or private

[11] The following details concerning mutual banks and credit associations reference Tadao (2009), pp. 53–55.

financial institutions that serve small businesses. In particular, these included savings banks, mutual-aid credit companies, and credit unions. Although these methods were by no means sufficient, they did offer support to Japanese small businesses.

During the wartime period, the government forced small businesses either to convert to the munitions industry or close down. As the situation in World War II worsened and the government's control of the economy became more severe, the authorities aggressively encouraged firms to abandon their businesses and shift to war-related industries as laborers. To facilitate the conversion or closure of small businesses, the National Transformation Fund was established as a government-affiliated financial institution in December 1940. The Central Bank for Commerce and Industry also quickly became the lender for industrial and merchant associations, to support wartime economic control. On the other hand, all private financial institutions invested in government bonds and financial debentures under the government's policy, excluding big banks. As a result, lending by savings banks, mutual loan companies, and credit cooperatives for small businesses diminished dramatically.

The Japanese government established the Small Business Agency in August 1948 and resumed policies by which to rationalize and modernize small businesses by reworking how they were organized. From 1949, the government also created new public and private financial institutions that served small businesses—besides the fact that the authority continuously launched financial assistance for small and medium-sized firms through the provision of governmental funds, beginning in 1948. We can conclude that essential Japanese institutions and policies that supported small businesses during the country's period of high economic growth had emerged during the postwar reconstruction era.

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