

# THE DEFINITION AND RANGE OF THE SMALL-MEDIUM BUSINESS

By TOKUTARO YAMANAKA

*Professor of Economic Policy and Labour Problems*

## I

It is more than desirable for us to establish some objective measures by which the small-medium business is properly defined, especially where the problems of this particular group of firms are to be dealt with in public policies. It is for this reason that in our manufacturing industries, for instance, every firm having less than 300 employees and for its capital less than ¥10,000,000 is now classified as such. In practice, however, this definition of its range involves various difficulties. As a result of the recent development of our industries a firm of the size of 300 employees is usually run with a capital of about ¥30,000,000. The small-medium business, as it comprises both 'small' and 'medium', is bound to be heterogeneous in its composition. Moreover, it is a concept relative to that of large business. Consequently it is only to be expected that its range should vary as the latter moves.

Apart from such administrative definitions, there is no uniformity of academic opinions as to how its range should scientifically be established, though abundant researches have been done in our country in this particular field. I have already made a survey of various views adopted in these researches.<sup>1</sup> For my part I held and still hold the opinion that the small-medium business should be defined as a group or groups of heterogeneous firms of a small or medium size, surrounded by the 'space' where the law of capital development operates culminating in the formation of monopolies, and consequently encumbered with some economic dilemmas of its own. In short, its range in my view is not merely the problem of the smallness of its size, but it is the matter to be determined in relative terms to the development of the large business, therefore to be dealt with historically, to embody some real problems, and to allow for varieties in its character.

Although we could not hope for more than a conventional definition for administrative purposes, such a definition, it is needless to say, should nevertheless be based on some scientific views of the small-medium business. It is true that administrative purposes require the establishment of certain objective measures of its range which no subjective views of any individual can alter, and yet there still remains a gap between factors available for such measures and those for some scientific definition of the quality of the small-medium business. But is there any appropriate method or solution to ascertain its range in accordance with its scientific definition so that the gap itself might as far as possible be narrowed down? This article is an attempt to find out such a solution.

---

<sup>1</sup> See my article, 'Nature of Small Industries' in *Small Business in Japan*, edited by T. Yamanaka, Tokyo, 1960.

## II

It cannot be denied that the small-medium business, if taken empirically, is a concept of size, and the size can conveniently be measured by the number of employees. It is true that certain ambiguities are involved in counting heads of those employed in trading and service industries, but compared with such an index as the amount of capital which can be obtained only for incorporated firms, it has advantage of being comprehensive: its data, though rough and irregular for some, can be supplied from all industries and all firms. It has, however, an important qualification. Whereas a manufacturing firm employing 300 men, as I said before, is technically included in the small-medium business to-day, the same firm must have fallen into the range of the large business in the 1930's. Therefore, the quantity shown by the number of 100 or 300 employees has certain common 'quality' behind its varying figures, and it is this 'quality' that distinguishes these firms from those belonging to the large business. In other words, it is not quantity without but quality within that differentiates the small-medium business from the large. Consequently what we should do is to determine what quantity really reflects such a difference in quality.

No doubt the small-medium business is distinguished from the large because of its size. If we ignore the size, they are all firms. Yet there arises the distinction of large and small-medium. In order to find out the causes of this distinction, we must go into the sphere of quality, i.e. qualitative characteristics equally shared by these firms.

The quality of a firm as a going concern lies in the fact that it is an economic unit distinguished from domestic economy and has a mechanism intended to maintain its economically rational nature. Thus its quality may be called 'rational calculation'. Besides distinction from domestic economy, 'rational calculation' can be illustrated by the total absence of any dependence on unpaid family labour and by the practice of careful examination of cost, sales volume, location and other relating factors. The equipment of book-keeping by double entry (or organisation as corporate bodies) is the minimum condition for such calculation. This condition may be regarded as a requisite—indeed a classical requisite as it should be to-day—for the formation of a firm.

As we consider the small-medium business from this point of view, we may find it of some interest that even in the United States of to-day little (or extremely small) firms are reported to exist in the retail trade and service industries and these firms are more or less notorious for the absence of the above condition (e.g. rational calculation) as well as the prevalence of a high death-rate among those engaged in them. Their size can be called 'little' (as distinguished from small), for such a firm mostly employs only one worker and in some cases almost none.<sup>2</sup> Little business is indeed predominant in our country. According to an estimate at the end of 1957, among 405,426 firms in 184 kinds of manufacturing industries, about 198,453 are of the size of 1 to 3 employees and 101,921 of the size of 4 to 9. Almost all of the former group and the bulk of the latter are not separated from domestic economy

---

<sup>2</sup> See Kurt B. Mayer and Sidney Goldstein, *The First Two Years: Problems of Small Firm Growth and Survival*, Washington, D.C., 1961, pp. x, 233.

and not equipped with an account book to say nothing of book-keeping by double entry.<sup>3</sup> In short, those firms of the size of less than 9 employees in our industry are not simply—speaking quantitatively—very small, but what is really significant is that the very pettiness of the size is nothing but a reflection of certain qualities: the lack of economic calculation of capital, the absence of rational calculation, and the retention of many characteristics of an economic unit that existed before the rise of business management.

What the German historical school of the late nineteenth century meant by *Klein Betrieb* was exactly this pre-managerial type of an economic unit. If we restrict ourselves to industry, we may say that the little business of the size of less than 9 employees, marked as it is by the above qualitative characteristics, widely exists at the base of the small-medium business and forms its lower limit.

Yet the industrial firms of the size of more than 10 employees are as a rule equipped with book-keeping by double entry and mostly take the form of corporate bodies. In this sense there is no distinction between large and small. Then we are led to ask why those firms of the size of less than 200 or 300 employees are to be differentiated from larger business. The answer to this question should be found, apart from details at any rate, in some other place than the sphere of rational calculation, though this is the *raison d'être* of a firm.

### III

A firm, after equipping itself with the means for rational calculation, should be constituted on a scale that is neither too large nor too small for competitive society. This we may call the second condition or nature of a firm, for it is a prerequisite for the survival of a newly created firm. It is a condition particularly significant for this article as it deals with the size or scale. Now taking the 'size' to be a measure for differentiation between large and small, there are at least two interpretation of it.

According to the first, all firms smaller than a 'prevailing size' are called small-medium business. Standards that are normally used for deciding on a prevailing size are the number of employees, value of products, value added, and the ratio of prevalence in a particular industry which can be measured from the amount of investment and other relevant factors. Assuming that the ratio of prevalence by the firms of the size of more than say 300 employees in a certain industry is more than 50%, firms smaller than this prevailing size are all classified as small-medium business. This is quite an empirical method of differentiation, and does not concern with the problem of why those firms of the size of more than 300 employees provide such a high ratio of industrial prevalence. It only maintains that the firms smaller than that size are not big enough, in other words not of an appropriate size. In those industries where concentration and monopoly can quantitatively be marked out, this particular ratio may be used for ascertaining genuinely monopolistic firms and thereby providing a standard which would contribute to the elaboration of measures against monopolistic competition. Nevertheless, if we adopt this method, we shall be confronted with the

---

<sup>3</sup> See my article 'The Problems of Little Business in the Japanese Manufacturing Industry' in *Small Business in Japan* cited above.

dilemma that in an industry where the ratio of control by the firms of the size of less than 100 employees is high, the small-medium business, normally accepted as it is, cannot be classified as such. It has other difficulties. It is true that we can easily give a judgement on what is prevailing when a high ratio of control is provided by firms of a particular size. But when various firms, both large and small, show an equal ratio of control, or when the ratio varies without any regularity from firms of one size to those of another, it is hard to discover any 'prevailing size'. If we look for a high (more than 50%) ratio of industrial prevalence by firms of the size of less than 50 employees or by those of more than 200, we shall see from a business survey taken in this country in 1952 that none of 92 kinds of industry out of 411 reviewed in it does belong to such as these two particular groups of firms of high ratio of concentration.

The second interpretation assumes that certain firms in a particular industry which are more profitable than the others have a fit size, and all firms having the size less than that are classified as small-medium business. This method perhaps goes deeply into the core of our qualitative problem. Yet, objective data for discovering firms of a fit size are harder to obtain than those for a prevailing size. Usually a fit size is derived from the comparison of 'value added' not of firms but of establishments. 'Value added', however, is nothing more than a figure obtained by subtracting costs for raw and other materials (mostly material costs) from value of products. This is not an appropriate measure for ascertaining a fit size. Indeed, we can arrive at a more exact measure of a fit size by comparing 'gross' profit obtainable by subtracting wages and salaries from 'value-added', and the value of investment per head of employees derived from an annual value of investment divided by the number of employees. Even so, the curve that shows transition of varying sizes is not necessarily regular in western experience. Even if the curve of varying sizes indicates a fairly regular trend either upwards or downwards, it is not easy to tell from what point on the curve as fit size should begin.

As for our industry, there is much uniformity in the trend as it is shown by the fact that in about three kinds of industry out of four an average value added per head of employees is mostly high among firms of a large size.<sup>4</sup> Yet the curve of sizes itself does not tell what point on it would 'qualitatively' mark out the small-medium business.

#### IV

A firm cannot be called an economic concern if it is merely formed to exist. Economy is a social phenomenon whose inherent nature is development. Thus a firm, if it is to be an economic concern, should be capable of development or growth. Yet what is meant by the small-medium business in western Europe is often related to forms assumed by firms either before growing into big or after having decayed from maturity. Consequently it is apt to be looked at as something merely surviving.<sup>5</sup> It seems, therefore, that some indices which would show the growth and development of firms are more useful for our purposes than those indicating their formation and existence, though we have so far concentrated our

<sup>4</sup> See my article, 'Illogicality in Japanese Small Business' in *Small Business in Japan* cited above.

<sup>5</sup> For such an example, see G.C. Allen, *The Structure of Industry in Britain, a Study in Economic Change*, London, 1961.

enquiries on the latter. Then, where shall we find such new indices?

As we have already seen, there are various merits in measuring the size of firms by the number of employees, and one of them seems to be that an increase in the number of employees would show the development of those firms concerned. The number of employees, however, cannot be taken as the primary index for the growth of a firm, the essence of which is indeed capital. It is rather an expansion of capital that should represent the growth of a firm. Therefore, the predominant factor which indicates the development of a firm should be its capacity of forming or acquiring additional capital.

Nowadays, a firm can seek for an expansion of capital by means of internal accumulation derived from its own activities (or simply issuing additional stocks) or by adding to its own capital various funds obtained through the money market. It is indeed remarkable that the Stock Exchange has its own view of distinction for the size of firms. In other words, there are only a limited number of joint-stock companies whose shares can be quoted at the Stock Exchange or firms whose bonds can be floated at the open market. These firms are assured of the capacity of acquiring capital, and of whatever size they may be, cannot be called small-medium business. For the reason that the bond market is not sufficiently developed in our country, the capacity of floating bonds in the open market should be taken rather as a sign of demarcation distinguishing super-big business from other large business. In our inter-war period, the distinction of whether a firm had financial relations with a deposit bank was considered a line of demarcation between the large and the small-medium business. But this ceased to apply any longer after the end of the Second World War. It is true that various figures obtained for borrowed money per head of employees still show a fairly wide gap between these two types of business. From a survey of industrial firms towards the end of 1957 we can draw the following results: assuming that the figure of borrowed money for those of the size of 1 to 3 employees is equivalent to 1, the figures for the size of 100 to 199 and for the size of more than 1,000 are 123 and 9436 respectively. But even in this case it is hard to discover any qualitative distinction between the large and the small-medium business.

Yet we may ask whether the amount of capital invested in firms, including both owned and borrowed capital, might contain some element that would show differences in their capacity of development. According to the above survey of industrial firms towards the end of 1957, the value of fixed assets estimated for taxation such as land, building and other assets for depreciation is on an average about ¥100,000 for firms of the size of less than 49 employees, ¥130,000 for the size of 50 to 99, ¥180,000 for that of 100 to 199 and ¥230,000 for that of 200 to 299. Then the figure sharply increases: ¥330,000 for that of 300 to 499 and ¥430,000 for that of 500 to 999, that is to say with a difference of ¥100,000, and ¥770,000 for that of more than 1,000 with a much larger difference of more than ¥300,000. Of course, the last figure is an average relating even to giant firms, and cannot be compared directly with other averages for firms smaller than the size of 999 employees. It is again to be emphasized that differences of ¥100,000, 50,000 and 30,000 do not necessarily indicate qualitative distinction. From an empirical or simple point of view, however, the difference of ¥50,000 or 100,000 for the size of more than 100 employees seems to be so much barrier which firms belonging to the small-medium business should overcome when they are to grow into a larger size, for instance from the size of 100 employees to that of 200 or further to that of more than 300.

The value of fixed assets, the basis for the above estimates, is of course an average for all kinds of industry, and as the amount of fixed assets per head of employees varies from one kind of industry to another, a difference of ¥50,000 or 100,000 cannot be regarded as a strict line of demarcation. It shows nothing more than a tendency. Moreover, we cannot deal equally with capital-intensive industry and labour-intensive industry. Again, we cannot always assume that the value of fixed assets at a certain time is necessarily a reflection of the capacity of forming additional capital. Such factors as over-investment and obsolescence of capital should be taken into account. Just like *Konzern* as a form of monopoly, there are cases where an *entrepreneur* owns various firms engaged in more than two kinds of industrial and other economic activities, and an expansion of his aggregate capital is not directly reflected in an increase in the amount of capital in each firm. We can see many such examples in provincial industries especially when investment in small-medium business is dominated by a local magnate. Consequently, capital calculation of individual firms does not in itself provide a sufficient basis for measuring their capacity of development. In spite of these deficiencies, however, the above concept of the capacity of firms seems to contain a most important clue for differentiating the upper strata of the small-medium business from the large business. We need sufficient data objective enough for such an analysis. These are already available to some extent. Indefatigable collection of such data seems to me the effective way of ascertaining the upper limit of the small-medium business.

## V

We have so far seen factors that would distinguish the small-medium business from the large in three aspects, i.e., the formation, existence, and development of firms. But these are the distinctions derived from their internal character, and seem to be sufficient for practical purposes. Various definitions so far adopted by the administrative authority are also based on these distinctions. Yet we may have to ask whether these are really sufficient for our own purposes, in other words, whether the internal character of firms should be considered really adequate for our attempt to discover the line of demarcation between those two types of business.

It is needless to say that all firms exist in the market. Money, labour, raw-materials and sales of goods as well as competition with other firms within the same industry are all dependent upon the market outside each firm. In the adjustment and rationalisation of internal conditions of a firm *vis-à-vis* external conditions of the market, there is the possibility of a firm developing itself. The rationalisation of its internal conditions, however, does not always lead to its development, for the external conditions do play their part. The external conditions which make up the environment of a firm are enormously powerful and perplexingly entangled for an individual firm. Unlike the internal conditions it is extremely difficult to attempt to control or rationalize these conditions so as to facilitate the development of a firm. Accordingly these have long been regarded as something beyond the power of each firm.

We have, however, a good reason for not considering the internal character of the small-medium business to be the only sufficient explanation for its qualification. It is indeed

remarkable that this reason should have held good since the very beginning of its existence.

There is no doubt that handicrafts and domestic industry, the classical models of the small-medium business, are nothing more than little business to-day. But it is only as a result of the emergence of new large-scale firms based on the factory system that they came to be regarded historically as *Klein Betrieb*. In other words, such identification became inevitable on account of certain changes in their external conditions, the rise of the factory system among other things, rather than their internal quality. The small-medium business depends upon its external conditions—especially the existence of the large business—as well as its internal character for being what it is. Thus the small-medium business of to-day differs from the *Klein Betrieb* in the past, just as the large business is no longer based on the mere factory system of the old days. In short, our starting point for understanding the small-medium business is that its real significance cannot be derived solely from its internal character. Moreover, the external conditions themselves are not something fixed, but always moving. The large business, too, is not standing but moving and developing. This implies that a new kind of small-medium business is constantly created from outside, just as the rise of the factory system in the past gave birth to the *Klein Betrieb*.

The development of the large business, however, is not adequate as an explanation for the above. It is the changing external conditions, broadly understood, that affect the small-medium business. There are two reasons for this. The first is the growing tendency to adopt a larger scale in terms of the internal structure of a firm. Indeed, the large business is much larger in its scale than the firms newly created at the time of the Industrial Revolution on the basis of the factory system. This tendency may be reflected merely in a quantitative growth of a firm without any change in its qualitative structure, but this is rather an exception. For instance, the labour force employed in large firms to-day consists less in skilled labour supplied as it used to be by the workers themselves than in fit labour trained internally by the firms themselves for their own purposes. Again those firms do not idly wait for achievements of universities and other research centers in the field of technology. They often have their own research department in which a considerable amount of investment is annually made and on which they mainly rely for technical innovations. Just as horizontal 'cartels' and vertical 'integrations', previously left to operations of the external market, are now becoming the 'internal character' of firms, so the labour market and technical innovations are also revealing similar tendencies as we have seen above. It is true that a price of commodities generally changes in accordance with varying relations of demand and supply in the market, but the prices of services (transportation, insurance, and so on), powers and even commodities are often determined and maintained by the firms concerned. To such circumstances are usually traced the origins of big business. The conditions of business transactions between our large firms and their subcontract firms, such as particular prices specified by the former for the latter's products, are not determined in the market but by arbitrary calculation on the part of large firms. Such operation of the external conditions in the market as price determination is thus turned into the internal character of firms as part of their own activities which are properly intended to maintain or enlarge their profit.

The second reason is related to the fact that this tendency of the external conditions becoming internal is never a product of whims of large firms. The strengthening of various economic policies on the part of a government and growing collectivisation in economy (these tendencies are often called *laissez-collectives-faire*) are indeed turning into internal con-

ditions what Adam Smith relegated to the work of the 'invisible hand', Here lies a new departure for economic development, for those conditions that would affect human economic activities from outside are to be integrated in economic organisations created by men. It is in this sense that large firms are now taking the initiative in the sphere of international competition and thereby introducing elements that would lead to fresh economic development.

The small-medium business which exists to-day is not immune from this tendency. Various forms of co-operation are being attempted with considerable success in production, marketing, stocking, or even labour relations. In Japan we have many such examples. Yet we can easily see that the small-medium business, so long as it remains in its own field, is much limited than the large business in its opportunities for changing external into internal conditions. Indeed, the former cannot ignore or neglect attempts made by the latter in this direction. Yet, difficulties confronted by the small-medium business in similar attempts are different in their nature than those for the large business, and from this arises a significant distinction differentiating the former from the latter.

## VI

In trying to differentiate the small-medium business from the large we have come to the conclusion that among three factors which would explain the internal character of the present-day firms, i.e., their formation, existence, and development, our attention should be focused upon the last factor, and at the same time we should take into account the new aspect of the character of firms, i.e., their capacity of changing external conditions into internal, the extent of which would distinguish between these two types of business. A few explanations, however, seem necessary before accepting the above conclusion.

Firstly, the distinction between the small-medium business and the large should be subjected to careful examination in every particular kinds of business in various fields of industry, commerce and services.

Secondly, an answer should be ready to the question of 'what the large business is' or at least 'what those modern firms are that are not the small-medium business' before defining the distinction which is largely dependent upon movements on the part of the large business. Moreover, both the large business and the genuinely small-medium business are not of a static nature but constantly moving, and should be understood as such.

From this second point, i.e. the recognition of mutual relationships between these two types of business is derived the third point, and this can be called our proper attitude towards a definition of the small-medium business. According to one view, as I pointed out before, either immaturity or senility of a firm should explain this particular type of business. According to another the small-medium business grows into a fit size while retaining its relative status *vis-à-vis* the large business. A third view, which is more or less dominant in this country, emphasizes its relations with the past development and present structure of our national economy, in which, according to this view, those firms whose gross profit, capacity of accumulating capital and level of wages and salaries are much inferior to those of the large business, are bound to remain small-medium, and indeed widely exist as such. This view, however, contains various opinions of different shades. According to one opinion, the



wide gap between the small-medium business and the large would gradually be narrowed down in view of the present high rate of our economic growth and also of the changing structure of our population. Even so, this gap would never disappear, insists another, but on the contrary would be widened, for our national economy would continue to grow with its present structure kept intact. Between these two poles of opinion there are various views of different nuances.

The fact that there are various views of the small-medium business suggest the complicated nature of the problem of recognizing it as distinguished from its larger brethren. In short there are different points of view to look at it. It is needless to say that its definition varies according to such differences. This difficulty is bound to become clear especially when we return to our starting point, i.e. the problem of defining the small-medium business for a public policy. Various policies dealing with various problems such as business cycle, conditions of the labour market, industrial relations within firms, or handicrafts, usually aim at improvement in certain aspects of the small-medium business, but what is meant by the small-medium business is not always the same in such public policies. This is due to the fact that the extent of the object on which a public policy is to be applied is commonly determined by the nature of particular problems rather than by any scientific foundation upon which the nature of the small-medium business should be understood. Therefore, unification of different views adopted in various policies is urgently needed in order to adjust practical policies to our scientific knowledge of the small-medium business. Where various policies affecting the small-medium business are already enforced, it seems even effectual to attempt this unification through codification of the existing relevant laws.

When we turn from the sphere of day-to-day policies to that of scientific knowledge, I still hold the same view that the nature of the small-medium business is not merely related to the problem of size but largely determined by the fact that it has its own dilemma to be overcome in its development. Consequently, the basic problem for determining the range of the small-medium business, in my opinion, lies after all in scientific and unified view of its nature.