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“The Challenges in Internationalization of Japanese SMEs in the Food Manufacturing Industry”

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Recently, I was shocked to learn that democracy was not working well. Last year, Sweden’s V-Dem Institute published its Democracy Report 2022. According to the report, democracy in the world is declining considerably. First, the level of democracy enjoyed by average global citizens in 2021 fell to the level recorded in 1989. This decline is particularly pronounced in the Asia-Pacific region, Eastern Europe, and Central Asia. With a total of 42 countries, the number of democracies peaked in 2012, but by 2021, this number dropped to 34. Currently, only 13% of the world’s population lives in democracies. The number of dictatorships is on the rise, increasing from 25 to 30 between 2020 and 2021, and covering 2.8 billion people. More states have become dictatorships in the past 50 years than in any other period.

Japan, following the lead of the U.S. after World War II, has developed through both the

political system of “democracy” and the economic system of “capitalism.” Many people in Japan firmly believe that these twin mechanisms of politics and economics are the basis for ensuring freedom and equality through the rule of law and bringing about economic growth. However, the data presented above show that non-democratic countries are growing in number and that former democracies are shifting from democratization toward non-democratization. Why is democracy not spreading around the world? Why do many countries choose the path of obedience to authoritarian leaders over the rule of law? Has democracy ever functioned as a mechanism to bring happiness to our societies?

With these questions in mind, I examined past research on how democracy has affected the world we live in. To my surprise, I found that past studies have not proven, either conceptually or empirically, that democracy has a positive impact on society¹. First, I

¹ I have not done a thorough literature reviews here and may have overlooked important arguments and evidence to discuss.

examined the relationship between democracy and economic growth. A series of past studies have concluded that it has not yet been possible to identify a systematic positive effect of democracy on economic growth. In theory, democracy may promote, hinder, or have no effect on economic growth, but research does not provide firm support for either viewpoint (Sirowy & Inkeles, 1990). Nonetheless, it has been widely confirmed that democracy has an “indirect effect—” either positive or

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negative, on economic growth. For example, Helliwell (1994) showed that democracy has a positive indirect effect on economic growth through education and investment. Similarly, Doucouliagos and Ulubaşoğlu (2008) show that democracy has a positive indirect effect through a high level of human capital, low inflation, low political instability, and high economic freedom. Tavares and Wacziarg (2001), by contrast, found that democracy hinders economic growth by reducing the rate of physical capital accumulation and showed a negative indirect effect of democracy. Moreover, studies have shown that the net effect of democracy on economic growth after controlling for indirect effects is likely to be negative. Barro (1996) showed that the overall effect of democracy on economic growth is weakly negative when known indirect effects are removed. More recently, Narita and Sudo (2021) showed through careful causality analysis that democracy was a major cause of the GDP loss in 2020.

Next, I examined the relationship between democracy and health and welfare—the foundations of social life. It is often assumed that democracies are

better able to improve the welfare of the poor than non-democracies. This is because democracies are believed to be more effective than non-democracies in generating public benefits and redistributing income (see Ross, 2006, for a review). However, detailed analysis reveals that democracy has little positive or even negative effect on health and welfare. For example, Ross (2006) found that democracy had no effect on infant and child mortality rates. Narita and Sudo (2021) found that a stronger democracy led to higher COVID-19 mortality rates. They explained that this was because democracies were unable to implement containment policies as extensively as non-democracies in the early stages of the pandemic.

Another question that arises is—what is the relationship between democracy and technological development? In a democratic world, individuals are allowed to constantly develop and maintain diverse and free contact with others with different values and interests. Thus, innovations that result from connecting diverse knowledge are more likely to be realized in democracies. However, few empirical studies have examined whether democracy can be a direct driving force behind innovation. Among these, Gao et al.’s (2017) study concludes that democracy has no direct positive effect on innovation, as measured by patent counts, patent citations, and patent originality.

We cannot conclude from the short review above that democracy has a clear positive impact on an economy, society, or innovation.

Hereafter, I will examine the data with reference to these findings to see how democratization has contributed to global economic growth and social development in the recent years. Democratization is measured using the liberal democracy index score from the Democracy Report 2022 (V-Dem Institute, 2022, (<https://www.v-dem.net/data/>)). Economic growth is measured by the

annual GDP growth. Social development is measured using the COVID-19 morbidity and mortality rates, the Program for International Student Assessment (PISA) achievement test results, and the number of Olympic medals won. Note that the analysis conducted in this essay does not represent a strictly causal relationship. This essay only presents stylized correlations obtained from cross-sectional statistical analysis.

Economic Growth

Figure 1-1 shows a scatterplot of average annual GDP growth from 2010 to 2020, and the degree of democratization in 2022. GDP growth rates were derived from The World Bank's World Development Indicators

(<https://databank.worldbank.org/source/world-development-indicators>). The figure shows that countries and regions with higher levels of non-democratization have had higher economic growth rates over the past decade. The three factors that support economic growth are labor input, capital accumulation, and technological progress. I used the Conference Board data (<https://www.conference-board.org/us/>) to examine the relationship between the average shares of labor input, capital accumulation, and technological progress in GDP, and the level of democratization over the period 2012-2021. Figure 1-2 shows the scatterplot of the relationship between labor input and democratization. It can be seen that the degree of democratization is negatively related to hours worked per worker and positively related to productivity (output per hour worked). Figure 1-3 shows that the degree of democratization is positively related to ICT-related capital stock and negatively related to non-ICT capital stock. In other words, non-democratizing countries have grown their economies mainly in traditional non-ICT industries that are labor intensive. No clear pattern was found in the relationship between technological progress, measured by the average annual growth rate of Total Factor Productivity (TFP), and democratization.

Figure 1-1 Democracy and Economic Growth

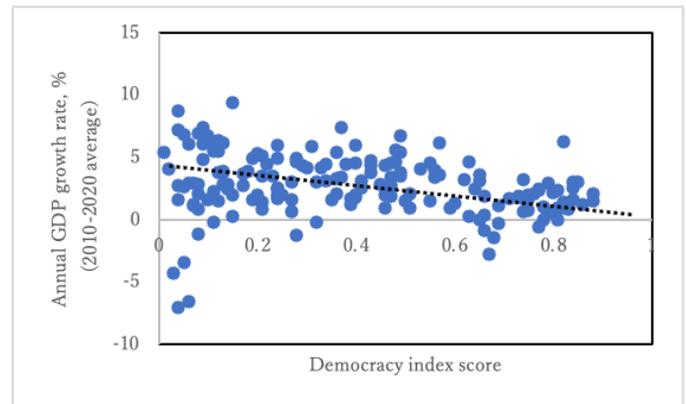


Figure 1-2 (a) Democracy and Average Hours Worked

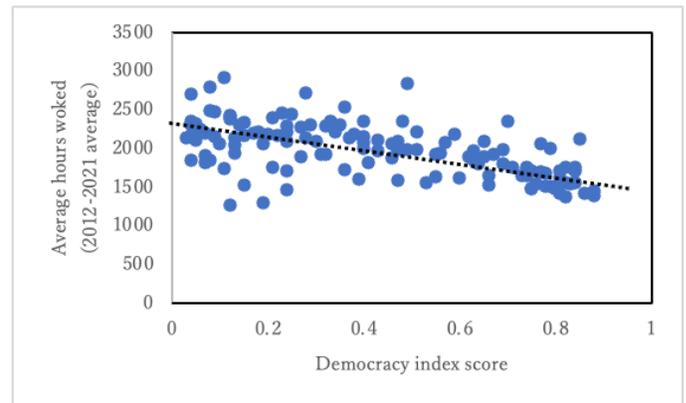


Figure 1-2 (b) Democracy and Labor Productivity (output per hour worked)

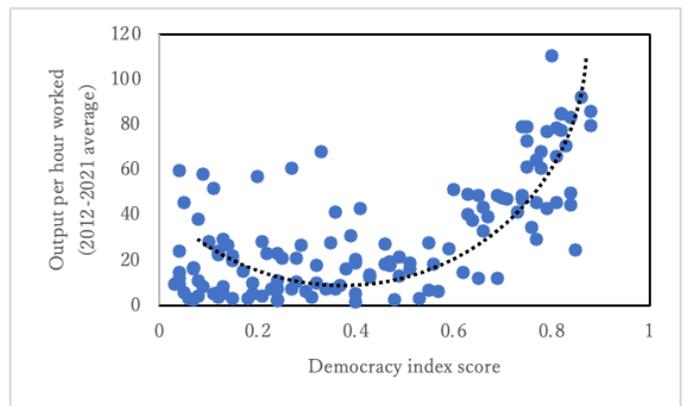


Figure 1-3 (a) Democracy and Capital Growth in ICT

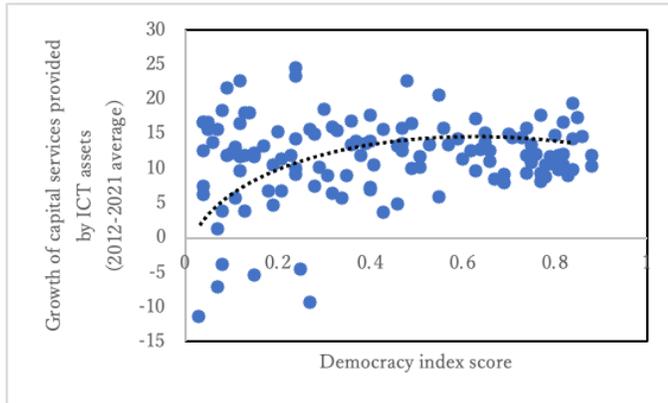
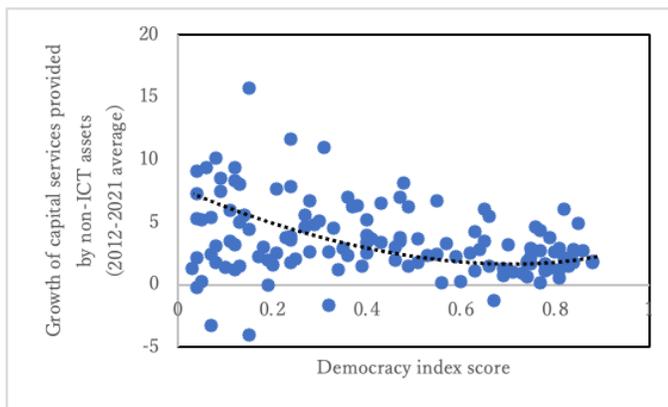


Figure 1-3 (b) Democracy and Capital Growth in non-ICT



COVID-19

The COVID-19 pandemic has had a significant impact on the global economy and people’s social lives. Figures 2-1 and 2-2 show the relationship between the percentage of people affected by the virus per population, their mortality rates, and democratization levels at the end of October 2022. Data were obtained from The Johns Hopkins Coronavirus Resource Center (<https://coronavirus.jhu.edu/region>). The figures show that countries with higher levels of non-democratization have lower rates of COVID-19 morbidity and mortality. This result is consistent with the analysis of Narita and Sudo (2021), using the same data. It should be noted, however, that the data used here do not reflect the spread of infection since China effectively eliminated

its zero-COVID policy in January this year. Therefore, using the most recent data may yield different results.

Figure 2-1 Democracy and COVID-19 Confirmed Cases

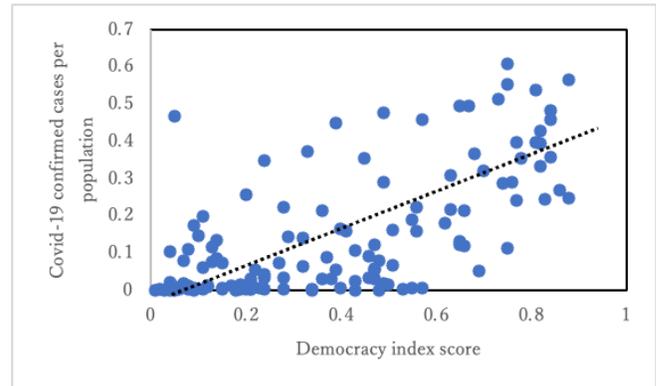
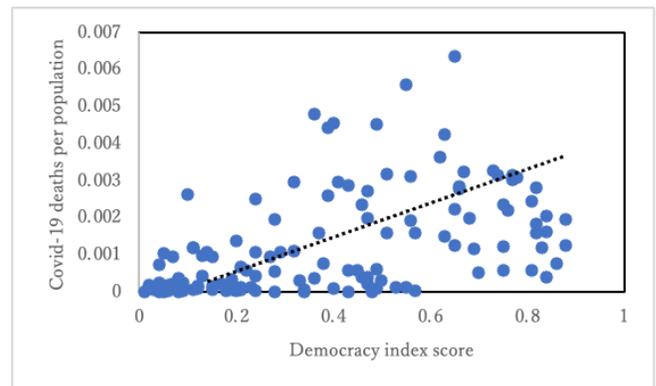


Figure 2-2 Democracy and COVID-19 Death Toll



Education

Let us now examine the impact of democracy on educational outcomes. Educational outcomes were measured using two indicators: the number of Olympic medals and average score in the PISA achievement test. The data on the former were obtained from the International Olympic Committee (IOC) (<https://olympics.com/en/olympic-games/olympic-results>) and those on the latter, from OECD’s PISA database (<https://www.oecd.org/pisa/data/>). Figure 3-1 shows the relationship between the number of Olympic medals won and level of democratization. Figure 3-2

shows the relationship between PISA scores in reading, mathematics, and science in 2018 and the level of democratization. A common feature of both relationships is the polarization of the results in countries with high and low levels of democratization. In terms of medal counts, the Olympics seem to have become a site of proxy war between democratic and non-democratic camps, as symbolized by the medal war between the United States and the Soviet Union in the past and the United States and China in the recent years. The polarization of math and science scores between democracies and non-democracies seems to foreshadow a fierce competition in science and technology between the two camps in the future.²

Figure 3-1 Democracy and Olympic Medals Won

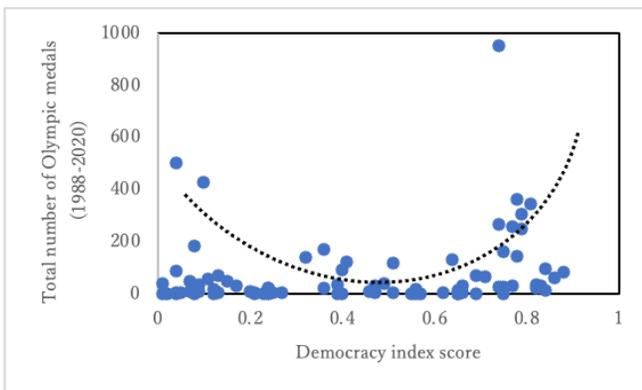


Figure 3-2 (a) Democracy and PISA Score in Reading

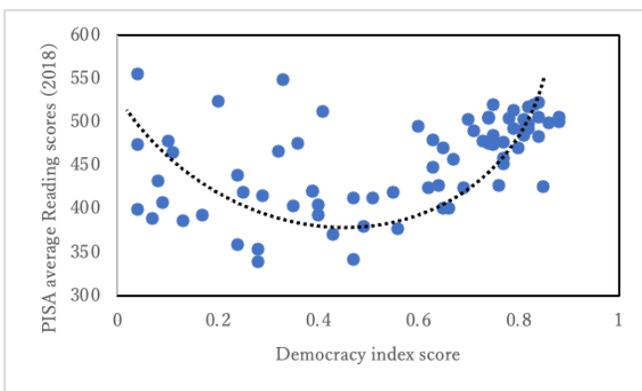


Figure 3-2 (b) Democracy and PISA Score in Mathematics

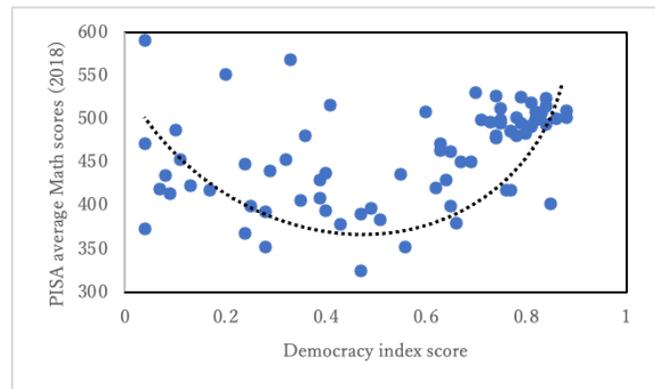
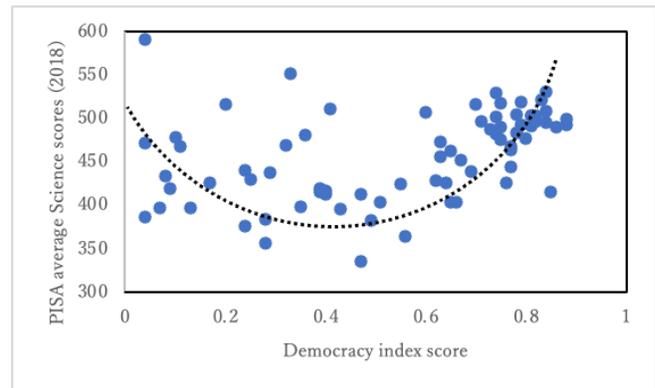


Figure 3-2 (c) Democracy and PISA Score in Science



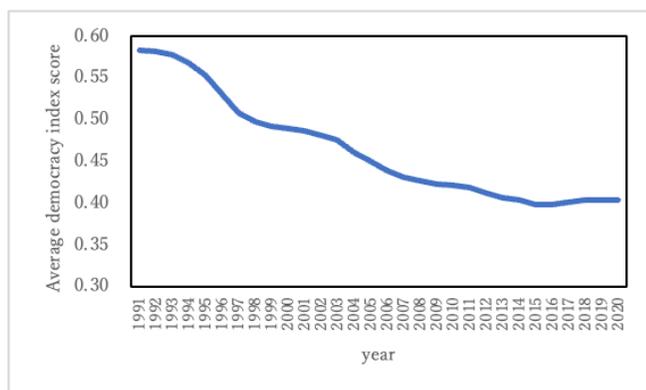
Implications for the International Business of Japanese Firms

The above stylized data analysis indicates that democracies do not clearly outperform non-democracies in economic growth or social development. With the rise of non-democracies, the global economy seems to become fragmented as democracies and non-democracies fight for supremacy. How have the Japanese firms responded to these developments? Figure 4 shows the time series of the average democratization scores of the host countries for Japanese firms’ direct investments. The host countries were identified using Toyo Keizai’s *Kaigai Shinshutsu Kigyo Soran* (Overseas Japanese

² This polarization may reflect the educational effects of freedom and control that underlie democracy and non-democracy, but it may simply indicate the influence of other national factors (such as country size). Further research is needed to elucidate the mechanisms linking democracy and education.

Companies Data) (<https://biz.toyokeyzai.net/en/data/service/>). The figure shows that the average level of democratization in these countries has declined over the years. While previous studies have shown that the relationship between host country democratization and FDI inflows can be positive or negative (Jensen, 2003; Li & Resnick, 2003), thi analysis clearly shows that Japanese firms are increasingly dependent on non-democratic countries for their international business.

Figure 4 Changes in the Level of Democratization in Host Countries of Japanese FDI



How should Japanese firms, who have believed that maintaining and developing democracy is in a nation's interest, interpret this fact and face it? Here, I point out three strategic directions for the future development of Japanese firms' international businesses:

1. Pursue "Ally advantage."

This strategy involves uniting with democratic allies to compete monolithically against non-democratic firms and thereby expand business opportunities. Although it is difficult for firms to counter the policies of non-democratic countries on their own, they can become a major countervailing force if they work with their democratic allies. For example, as seen in the recent passage of the Creating Helpful Incentives to Produce Semiconductors

(CHIPS) and Science Act, the U.S. under the current administration is working to prevent the outflow of advanced semiconductor technology to China. Japanese firms can enhance their bargaining powers and expand business opportunities by partnering with firms in allied countries to compete with their rivals in non-allied countries.

2. Turn "Non-ally disadvantage" into advantage.

This strategy seizes business opportunities in non-democratic countries ahead of other democratic countries' firms. Many of Japan's non-allied countries are non-democracies and many of these are emerging economies. These countries have large markets and a high growth potential, although there are concerns regarding intellectual property protection and expropriation risks. By effectively liaising with local governments and building relationships with firms in these countries ahead of firms in other democratic countries who are hesitant to do business in non-democratic countries, Japanese firms can gain legitimacy among local stakeholders and grab business opportunities as first-movers.

3. Make competitive advantage independent of politics.

This strategy reduces dependence on a specific country or political system by developing unique technologies and services that the world demands. For example, in environment related fields, such as decarbonization, Japan's technologies and experience in environmental load reduction and the carbon cycle can make an important contribution. In addition, Japan's high-quality services are now highly valued in the ever-expanding global consumer market. Superior technologies, products, and services are widely accepted in society regardless of the political system. Firms accepted by society are less likely to be influenced by politics.

These three directions present trade-offs. The direction chosen by Japanese companies depends on a

variety of factors, including the type of business, technological capabilities, and brand recognition, but what is certain is that the influence of national politics has come to cast an ever-larger shadow on Japan's international business. This trend is expected to continue and Japanese firms may eventually have to make difficult choices.

Democracy is not a single political system and has many variations (Zakaria, 1997). There is no guarantee that democratically elected governments will always implement the most efficient policies (Cheung, 1998; Fung & Wright, 2001; Huntington, 1991). In any case, democracy is said to be a difficult political system to sustain. This is because democracy can only be rooted in a stable society. In unstable societies, authoritarian systems tend to emerge because authoritarian leaders gain power and support by presenting their vision to a populace whose future is uncertain. With the rise of non-democratic states, the global economy may become even more fragmented in the future. Japanese firms must squarely face the contradiction between the adherence to democracy as a political ideology, rise of non-democratic nations and increasing dependence on non-democratic nations. As the world undergoes systemic transformation, it will be interesting to see the direction that Japanese firms take in their global business activities.

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Special Essay:

The Challenges in Internationalization of Japanese SMEs in the Food Manufacturing Industry

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Promoting Japanese Food Products

Japanese food has become popular worldwide. More people have become health conscious around the world, and regard Japanese food as healthy and nutritious. Additionally, Japanese food restaurant chains, for example, Sushiro and Marugame Seimen, are expanding their business overseas. Consequently, the export figures of processed Japanese food products have been increasing in the past decade.

Given the rising export figures, the Japanese central and local governments have stimulated food export and promoted several activities, including international advertisement and participating in international food trade shows for Japanese food companies, especially small and medium-sized enterprises (SMEs). The Japanese government has currently conducted programs that facilitate exporting Japanese food products and give support and subsidize SMEs in the food manufacturing industry.

For example, the Ministry of Economy, Trade, and Industry (METI) provides SMEs with support for developing regional brands by introducing external advisors who have enough experience and knowledge of the overseas business. The Ministry of Agriculture, Forestry, and Fisheries (MAFF) subsidizes SMEs to develop new products using Japanese domestic agricultural, forestry, and fishery products, and design those product packages for the international market.

Furthermore, the Japan External Trade Organization (JETRO) supports SMEs in exporting their products by providing seminars on international trade administration and exhibiting their products at overseas trade shows.

Even though the Japanese central and local governments actively provide these export promotion programs, there are problems with accelerating the internationalization of the Japanese food manufacturing industry. Most companies engaged in the industry are SMEs, and they are unlikely to possess enough resources to promote and sell their products to international markets. SMEs need to gain experience in export processes and negotiations to expand their business overseas. Therefore, the Japanese government policy is expected to address this challenge. Regarding this, the following questions need to be examined: how do SMEs use the Japanese government export promotion program? How does the program stimulate the export of Japanese food products? Lastly, what other factors will facilitate the processes of SMEs' internationalization besides support from the government.

In the following section, I begin by taking a case study of a Japanese Sake brewery, an SME, in the Tokai area which I had collaborated with. This experience is related to how SMEs use and apply

for the export promotion program provided by a regional government. Secondly, I illustrate my experience of accompanying the CEO of the Japanese Sake brewery to the Hong Kong Trade Development Council (HKTDC) Food Expo, one of the famous international food trade shows in Asia. Based on the observation of SMEs' behavior at the HKTDC Food Expo, I explore the inter-relationships between SMEs, their regional government, bank, and the interactions among SMEs from the same region. This will describe how governmental support stimulates SMEs' internationalization and what other factors can influence the internationalization processes. Following this, I summarize the challenges Japanese SMEs face when entering international markets. Finally, I explain the future perspectives for the internationalization of Japanese SMEs in the food manufacturing industry.

The Motivation and Experience of Collaboration with a Japanese SME

For four years, my undergraduate seminar group had collaborated with a Japanese Sake brewery in the Tokai area. At first, one of the undergraduate students had connected me to the CEO of the Japanese Sake brewery who was eager to collaborate with a seminar group at Aichi University. The CEO wanted to get some ideas from undergraduate students about ways to promote Japanese Sake in domestic or/and international markets.

In the beginning, we tried to promote Japanese Sake for the younger Japanese generation by designing a label for Sake bottles and providing cocktail recipes that use Japanese Sake. However, the survey conducted by the seminar group revealed that the younger Japanese generation preferred the taste of other alcohols over Japanese Sake. Hence, the CEO decided to export Sake to international markets.

In the second year of collaboration, the CEO decided to promote his products in Asia. Since the brewery is a family run business and needed more resources to expand its business overseas, the CEO applied for subsidies from a regional governmental

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The Japanese central and local governments actively provide various export promotion programs. Still, there are problems with accelerating the internationalization of the Japanese food manufacturing industry, as most SMEs need more resources to promote and sell their products to international markets.”

institution to exhibit his products at the HKTDC Food Expo, held for five days in August every year. Subsequently, the CEO asked the seminar group to design a label for the Sake bottles for the Hong Kong market, help him to exhibit his products at the HKTDC Food Expo, and research local supermarkets and buyers in Hong Kong.

The Activities of Exhibiting at the HKTDC Food Expo

During the HKTDC Food Expo, the Japanese Sake brewery exhibited at a joint booth with other Japanese SMEs from the same region. Throughout the HKTDC Food Expo, the regional support bodies (i.e., regional government and regional bank) provided the financial support, including the translators' fees. In addition, they introduced the CEO to networks and connections in Hong Kong, such as staff of the JETRO Hong Kong branch and local business coordinators, who have expertise in the Hong Kong market for a long time.

Along with support from regional support bodies, Japanese SMEs in the same booth helped each other and shared information about international markets, including the Hong Kong market, to deal with foreign buyers. There were more than ten SMEs in the same booth, and each had different background and

experience in international markets.

As typical exchange activities among these SMEs, they visited local supermarkets in Hong Kong and had dinner with the regional support bodies. And if one of the SMEs detected a suspicious buyer who might not be trusted, the SME visited the buyer's office with the staff of their regional support bodies. I realized that SMEs built interpersonal relationships with their regional support bodies and other SMEs through interactions at the HKTDC Food Expo.

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To what extent can governmental support stimulate SMEs' internationalization, and other factors influence the internationalization processes of Japanese SMEs?"

Some SMEs had been exhibiting at the HKTDC Food Expo for several years since they wanted to communicate with local buyers and find new distributors in Hong Kong. Furthermore, they acquired market knowledge and learned about foreign buyers' behaviors as the years passed. I discovered that those SMEs have kept good relationships with customers in Hong Kong and continuously obtained more beneficial information from their regional support bodies. Along with their regional support bodies, the SMEs had accumulated common knowledge of international markets by sharing the same experience and building interpersonal trust through several years.

The Struggles and Challenges of Japanese SMEs

As mentioned above, the SMEs collected international market information and built-up networks through foreign activities, including the HKTDC Food Expo. From my experience, however, I realized each Japanese SME in the food manufacturing industry had faced similar struggles and challenges. Since the Japanese domestic market is shrinking due to a declining birthrate and aging

population, their best strategy to survive is to expand their business overseas.

However, SMEs face some barriers to internationalization known as “the liability of smallness” (e.g., Child et al., 2022). The liability of smallness means that SMEs have restricted resources and capabilities, such as detailed foreign market information, finances, and managerial resources since the company size is small (e.g., Child et al., 2022; Guercini & Milanese, 2016).

There are various types of information that SMEs need to obtain for internationalization: 1) a detailed targeted market, 2) the internationalization processes, and 3) network building.

Japanese SMEs in the food manufacturing industry started searching for information using the closed network linkage to overcome the lack of detailed foreign market information. They used their connections from existing social ties and networks to enter a new market (e.g., Agndal et al., 2008; Coviello & Munro, 1997; Ellis, 2000; Ellis & Pecotich, 2001; Evers & Knight, 2008; Harris & Wheeler, 2005; Loane & Bell, 2006). At the first stage of internationalization, SMEs intended to collect information and opportunities about detailed foreign markets from regional networks. For example, the information on how and where to exhibit in international trade shows was sometimes collected from neighboring companies or official organizations in the same region.

At the next stage of internationalization, some SMEs exhibited at the HKDTC Food Expo to collect primary data and information about the target markets to decide whether they should export products to Asia. A trade show is generally regarded as a place that provides opportunities to access foreign markets and acquire knowledge of customer needs from different geographical areas, which helps the companies that have little international business knowledge and experience (e.g., Bathelt et al., 2014).

By exhibiting at a trade show, SMEs were

able to gain relevant knowledge from multiple associations and diverse international businesses (Bathelt et al., 2014; Measson & Campbell-hunt, 2015). I observed that the regional support bodies, mainly regional public organizations, introduced advisors and local coordinators to SMEs using their networks in a targeted foreign market. Also, some SMEs from the same region shared information about networks, including overseas distribution networks and exporters in Japan, during the HKTDC Food Expo (Furukawa, 2018).

Regarding financial restrictions, SMEs received subsidies to exhibit at a joint booth at the Food Expo from their regional support organization in their institutional network (Oparaocha, 2015). In my study, I found, such subsidies brought down the cost of the standard fees to almost half. In addition, to reduce the shipping fees of their products, SMEs from the same region used the same container organized by one of the SMEs.

The other financial challenge for SMEs was hiring translators in Hong Kong. Since support region bodies also provided translators for the joint booth, SMEs did not need to hire translators by themselves. This enabled them to promote and sell products at the HKTDC Food Expo, even though SMEs' sales and marketing staff did not speak the local language.

Given the limited managerial resources, some SMEs from the same region helped each other to deal with foreign buyers if others had faced a staff shortage. In addition, SMEs shared their experience of the Food Expo and foreign trade as they spent a lot of time together. This shows that SMEs from the same region might create strong ties and such social network relationships connect to the concept of social capital (Brass, 2012). These relationships also lead to building group social capital (Oh et al., 2006) and community social capital (Kwon et al., 2013) to protect against the liability of smallness by using networks, inter-firm relationships, and informal connections (Paul et al., 2017). After the HKTDC Food Expo, some SMEs kept their connections with the regional support bodies to expand the business, even though other connections

among SMEs may have become weak.

Future Perspectives

Through my experience accompanying SMEs for the HKTDC Food Expo for three years, it was clear that Japanese SMEs in the food manufacturing industry tried to expand business overseas using their regional networks. Although SMEs seemed to overcome some barriers to exhibiting at international trade shows, such as the HKTDC Food Expo, several challenges still need to be addressed for large scale internationalization. These challenges are related to their resources, time constraints, and networks.

Firstly, SMEs, despite successfully promoting their products at an international trade show, might not be able to accept large orders from foreign buyers and distributors due to their limited production capabilities. One SME explained that buyers and distributors from Mainland China requested large amounts of products that Japanese domestic buyers and distributors have never ordered.

In addition to this, they face language challenges due to their lack of foreign language skills and face financial limitations in hiring translators. Therefore, they must use free AI translators to communicate with local buyers and distributors. For example, they use the WeChat application, which has a translation function. Such problems restrict ex-post dealing with foreign buyers and interfere with expanding the international business networks.

In the movement of the world food market, some regions that produce local specialty foods try to build a regional brand. For example, French wines and Italian hams are distinguished and promoted by regional brands. Such regional brands also contribute to adding value to the food products. However, the Japanese food manufacturing industry is behind with making such movement towards creating regional brands.

This may be because Japanese SMEs have time constraints that do not allow them to establish their regional brand. Some SMEs at the HKTDC Food Expo

recognized the importance of building their regional brand for internationalization and the necessity to collaborate with other SMEs. Establishing a regional brand takes time and requires keeping relationships among SMEs in the region. That creates the next challenge in terms of maintaining networks.

There are several challenges in maintaining and developing regional networks to create a group social capital (Oh et al., 2006) and community social capital (Kwon et al., 2013) to overcome the liability of smallness. As mentioned before institutional networks of regional support bodies and the relationships they make during trade shows with SMEs from the same region are beneficial at the early stage of internationalization (Oparaocha, 2015). However, it is hard for those SMEs to maintain and develop networks after the trade show even in the same region because they have different levels of awareness about internationalization.

We already acknowledge that Japanese SMEs search for ties and opportunities in their region to overcome their limited capabilities for internationalization due to the liability of smallness. In the next step of Japanese SMEs' internationalization, it would be ideal to figure out how to facilitate the interaction among Japanese SMEs by sharing the experience and knowledge of international markets and how to make them more interdependent in expanding their business overseas with developing social and business networks. I believe it would be possible to encourage Japanese SMEs to build group social capital (Oh et al., 2006) and community social capital (Kwon et al., 2013) among the SMEs from the same region by sharing awareness of the importance of internationalization and trying to establish their regional brand. Building a group and community social capital would also contribute to accelerating Japanese SMEs' internationalization in several regions and facilitate the internationalization of the entire Japanese food manufacturing industry.

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