

# Japanese Small and Medium-Sized Firms' International Operations in East Asia

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## Abstract

This paper aims to highlight small and medium-sized firms' (SMEs') international operations in East Asia in the context of "shared value." Although the concept of shared value emerged from the activities of multinational enterprises, the connection between SMEs and local communities in foreign markets also works well, especially for those in the high-tech sector, as they can accommodate new international business environments in this context and seek sustainable benefits in this sector.

This paper provides more detail on the current situation of Japanese SMEs' international business and support systems with some case studies and data from East Asia. The cases are focused on the Chugoku region of Western Japan. I found that the problematic low rate of Japanese SME internationalization stems from the strategies and support systems they have in place. The findings contribute to the emerging literature focusing on international operations by SMEs.

## Introduction

Former United Nations (UN) Secretary General Kofi Annan proposed the Global Compact in 1999 to promote responsible corporate citizenship, ensuring that business is one of the solutions to addressing the challenges of globalization (UNGC, 2007). A code of conduct to control the global activities of multinational enterprises (MNEs), mainly in developing countries, was a topic of discussion at the UN from the 1970s to the 1990s. Currently, more than 10,000 business participants and other stakeholders from 145 countries have joined the Global Compact, which has become the largest corporate social responsibility (CSR) initiative in the world. Many MNEs now cooperate to solve world problems like environmental damage and poverty, working with non-governmental organizations (NGOs) and the UN through the Global Compact.

Not all firms are interested in CSR. In the late 1980s, the case of Nike employing child labor and the poor working conditions in independent contractor facilities triggered discussion of global CSR in MNEs. Since then, improving the conditions of factory and agricultural workers in developing countries has emerged as a major focus of contemporary CSR (van Tulder & van der Zwart, 2005; Vogel, 2005).

Vogel (2005) noted that the implementation of a global CSR program is often a large burden for MNEs; others have proposed the concept of "shared value," a new business model

in which economic efficiency and social value are compatible (Porter & Kramer, 2011). MNE business models seek the most efficient location worldwide. At the same time, MNEs find that business model adjustments are required to accommodate current social values. Additionally, it is obvious that global problems decrease opportunities to grow businesses. It is essential for firms to secure both markets and the means of production. Nestlé and Starbucks are often exemplified as models of better practices (Lee, 2010; Porter & Kramer, 2011).

This leads us to the question of whether there is room for small and medium-sized enterprises (SMEs) in this context, or if these business model adjustments pertain only to MNEs. As noted above, the shared value proposal emerged from the activities of MNEs. Few case studies focus on SMEs.

In fact, Japanese SMEs have a low rate of international business, but have begun to expand recently (Small and Medium Enterprises Agency, 2013). Further, the environment of international business has changed, as noted above. It is now common for MNEs to consider CSR in their international businesses, and there is no reason for SMEs not to do so as well.

Although the scale of the international operations differs between MNEs and SMEs, SMEs are able to contribute to local communities in foreign countries in their own way, because SMEs sometimes solve problems in their own communities. Many have technology that is no longer used in Japan anymore.

For example, Ube City in the Chugoku region of Japan suffered from environmental pollution. However, firms and the municipal administration cooperated to resolve this problem, and the United Nations Environment Programme (UNEP) elected the city to the Global 500 in 1997 because of its good environmental conservation practices (Ube City, 2014).

This knowhow is required by other countries. In particular, economic interdependence between East Asia and Japan has been growing rapidly with the progress in globalization and information and communications technology (ICT). However, naturally, SMEs do not have as many resources as MNEs. Thus, their international businesses based on “shared value,” linking their technology to needs in the East Asian market, require the appropriate support systems. If the connection between SMEs and local communities in foreign market works well, especially for those in the high-tech sector, they can accommodate a new international business environment in the context of shared value and seek sustainable benefits in this sector.

Thus, this paper’s objective is to provide detail on the current situation of Japanese SMEs’ international businesses and support systems with some case studies and data from East Asia. First, it shows the changes in the number of SMEs operating international businesses. In the next step, it focuses on the Chugoku region in Western Japan to provide detail on firms’ features and targets. It explores whether the existing support systems are consistent with these firms’ operations. Then, this paper explores the relevant problems and provides possible solutions in the conclusion.

This paper is organized into four parts. The first part presents the objective and background of this study. The second part is a literature review of the existing work on shared value, born global companies (BGCs), and the international operations of Japanese SMEs. The review leads to two hypotheses. The third part of the paper uses a case study to examine the hypotheses. First, it shows the features and trends of Japanese SMEs' international operations. Afterwards, it explores the subject of this research's methodology and results, and provides a discussion. In the last part of the paper, the findings are summarized and directions for further research noted.

The definition of an SME in this article is based on that of the Small and Medium Enterprises Agency in Japan (2013): any entity or company whose capital or total amount of investment does not exceed three hundred million yen, or a company or individual whose regular workforce does not exceed three hundred persons.

## Literature Review

The concept of shared value can be defined as policies and operating practices that enhance the competitiveness of a company while simultaneously advancing the economic and social conditions in the communities in which it operates. Shared value creation focuses on identifying and expanding the connections between societal and economic progress (Porter & Kramer, 2011).

The compatibility of economic efficiency with social value has been discussed from various perspectives. As Porter and Kramer (2011) noted, redefining productivity in the value chain is one way to achieve this compatibility. Starbucks' Coffee and Farmer Equity (C.A.F.E.) practice is a typical successful example. (Lee, 2010; Oxfam, 2002; Starbucks, 2014).

There is another way to achieve shared value: Reconceiving products and markets. The bottom of the pyramid (BOP) is a typical example (Praharad, 2005). Simanis (2012) noted that the key points for this market are low price, low profit ratio, and mass sales model. This market may make sense for MNEs with enough resources.

However, is the BOP an appropriate market for MNEs, when these communities have many social problems? It is thought that not only the BOP market but also international businesses based on "shared value" also relate to SMEs. As noted in the first section, many SMEs solve problems in their own communities. Thus, some SMEs have relevant experience and technology. If we can connect SMEs and social problems in foreign countries, the SMEs' international businesses can find new routes of expansion and create good relationships.

Some researchers have examined Japanese SMEs from the viewpoint of foreign direct investment (FDI) in Asia (Urata and Kawai, 2000), the relationship between firm age and extent of the trade network (Yasuda, 2005), and the relationship between internationalization and firm performance in the context of BGCs in China (Zhou et al., 2007). Fujisawa's (1987) empirical study is deeply related to export by local SMEs in Japan (Fujisawa, 1987). Japanese SMEs require product and service differentiation as they enter international operations with the goal of creating mutually beneficial relationships (Takai,

1989). Takai (1989) focused on the 1980s. How has the relationship changed in Asia since then? The “shared value” perspective has not been explored in the context of Japanese SMEs’ international operations.

Recently, in the literature published by the Ministry of Economy, Trade and Industry, the Kinki Bureau of Economy, Trade and Industry noted the importance of business models related to the BOP market to support SMEs’ international businesses (Kinki Bureau of Economy, 2011). International expansion is important for Japanese SMEs and the Japanese economy as one path to growth in the context of saturated domestic markets and chronic depression. About 99.7% of workers worked at SMEs in 2012 (Small and Medium Enterprises Agency, 2013) and SMEs maintain local employment and culture. Decline in SMEs that are deeply rooted in a local region leads to decline in sustainable local economic activity (Yoshida, 2013).

There is a gap between the existing literature and the facts. Because of saturated domestic markets in Japan, the discussion of Japanese SMEs’ international businesses has often been presented from a negative perspective because of the social and economic systems’ focus on large firms in Japan. When a firm makes a large order to go abroad, the SME has to fulfill it. However, because the Japanese economy is floundering, the firm may be unwilling to fulfill orders to go abroad (Tanaka, 2013). Tanaka suggests the choices for SMEs are to fulfill orders to go abroad, to find a new market to make up the loss in the domestic market, or to explore new businesses. He noted all of these choices are a heavy burden for them.

However, a large number of Japanese SMEs have noticed the difficulty of securing orders in the foreign market (Japan Financial Corporation, 2013). At the same time, many of them acknowledge that continual orders from a parent firm are very important as a first step in pursuing international business. Going abroad with the parent firm making a large order does not have negative effects for all SMEs.

As noted above, SMEs naturally do not have as many resources as MNEs. However, not all SMEs are poor at international operations. ICT allows them to promote their operations in foreign market. In particular, some MNEs from developing countries are overly hasty to move into international operations. In general, firms in advanced countries select the strategy of constructing a powerful organization and a strong market position in the home country (Guillén & Garcia-Canal, 2012). MNEs also lack the resources to pursue international operations right away. Although the ICT effect on international operations does not only apply to MNEs from developing countries, ICT promotes these firms’ entry into international markets.

After the 1990s, many BGCs have emerged in advanced regions such as Northern Europe (Knight, 2001). A BGC is an SME that operates abroad within the first three years after it is founded. This occurs in a context of political and organizational support for them (Nakamura, 2011). It is thought that the BGC phenomenon provides clear suggestions for Japanese SMEs’ international operations.

The existing literature provides an important perspective for the current and future internationalization strategies of SMEs.

This leads to two hypotheses:

Hypothesis 1. The high-income segment of the foreign market is the main target of SMEs' international operations.

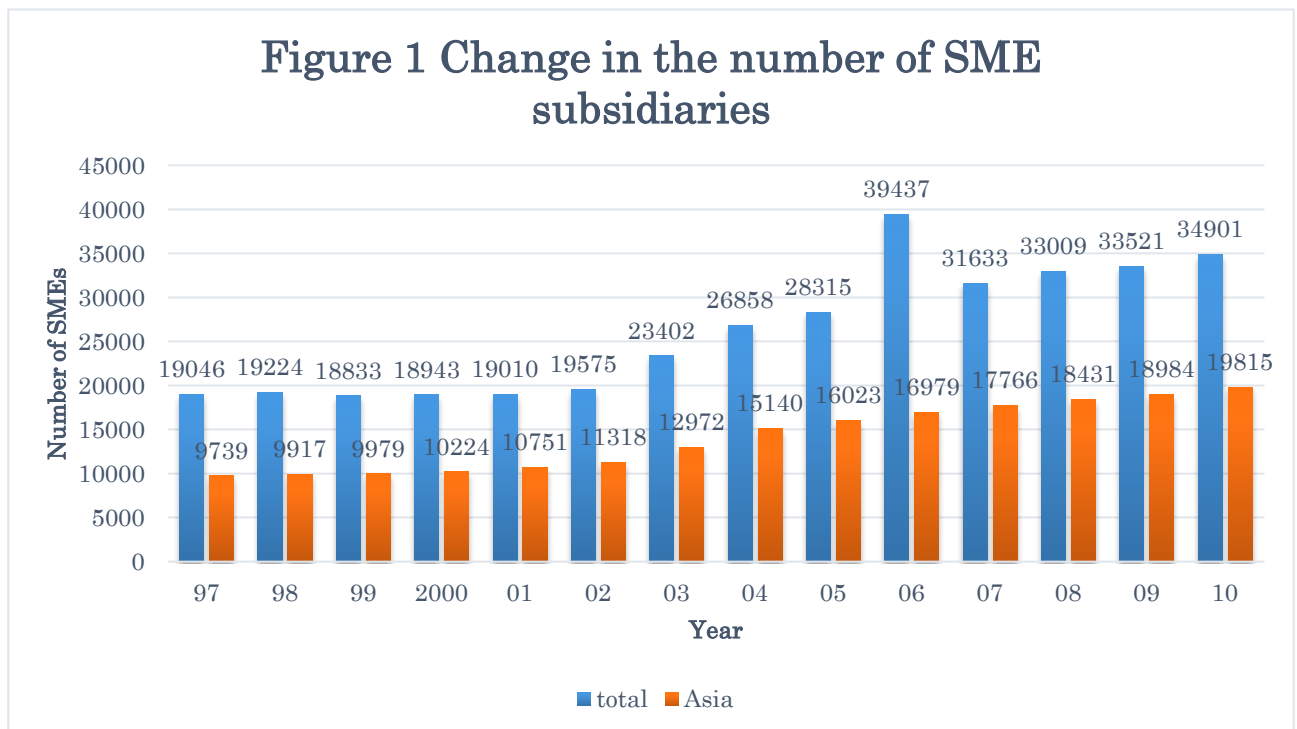
Because SMEs' objective for international operations is mainly to target one segment, the market does not expand and they cannot make full use of their own experience related to solving social problems.

Hypothesis 2. The support systems, information, and consulting services provided by various organizations overlap and are complex.

Support organizations play an important role in helping SMEs achieve smooth international operations. Support organizations in Japan provide many support and information services for SMEs. The ratio of international operations is low among SMEs. It is thought this is a result of systemic problems.

## Case Examination

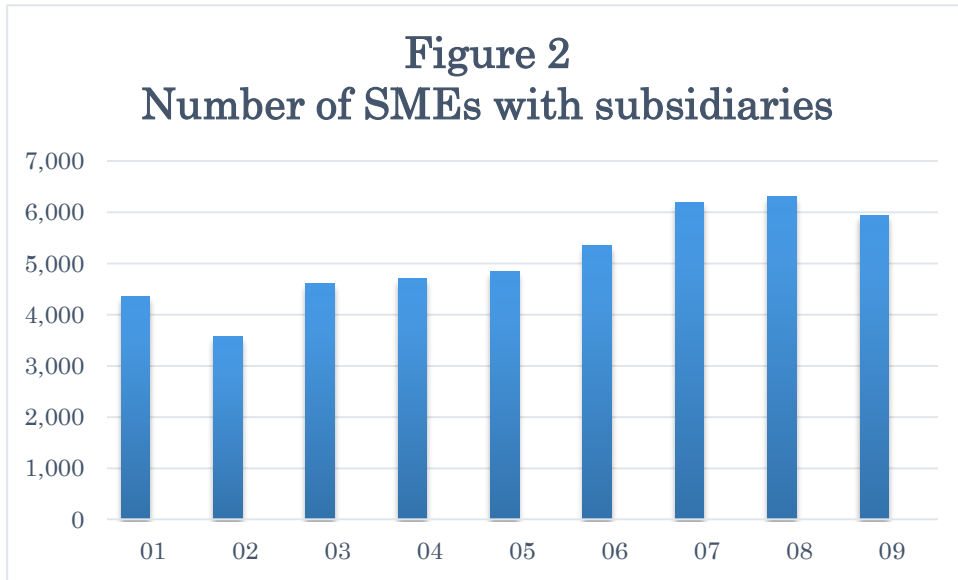
Many Japanese firms have exported to Asia. The percentage of exporting firms expanded from 38.1% in 1999 to 55.3% in 2011. Not only exporting firms but also the number of subsidiaries in foreign countries has increased in Asia, as shown in Figure 1.



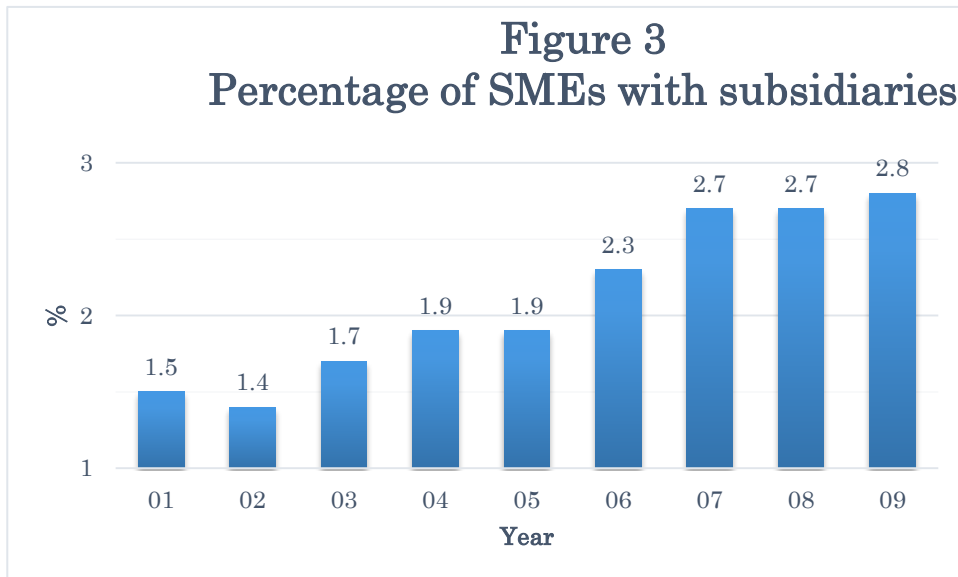
Source: Japan Finance Corporation (2013)

East Asia represents 30.4% of the share of world trade for Japanese SMEs (Japan Finance Corporation, 2013). The region's importance for Japanese firms has also increased recently.

However, the area is important not only for Japanese MNEs but also for SMEs. Although the speed and scale of SME internationalization is naturally slower and smaller than that of MNEs, the number of the SMEs going abroad has increased in terms of both exports and FDI.



Source: Japan Finance Corporation (2013)

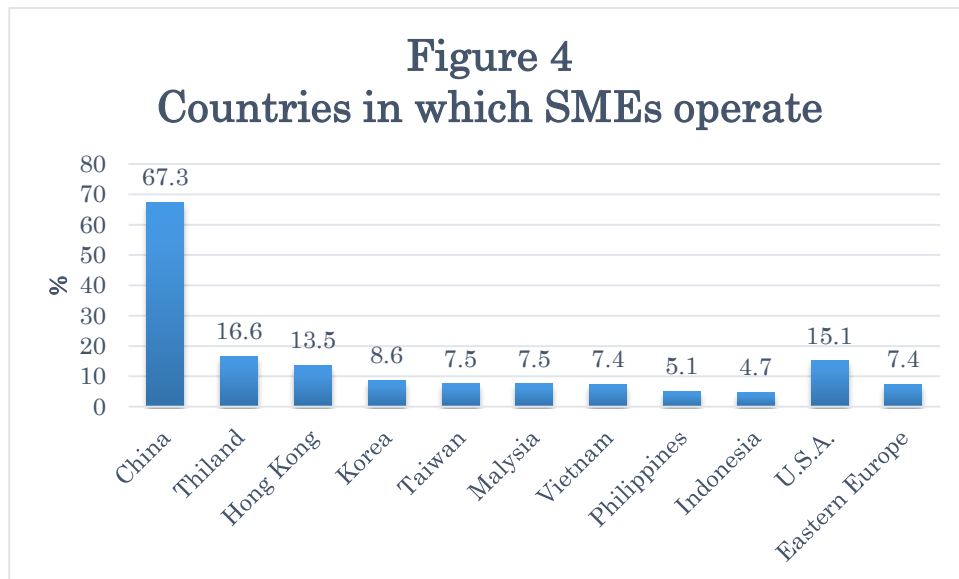


Source: Japan Finance Corporation (2013)

The number of exporting SMEs declined because of the world recession in 2009, but the percentage of exporting firms exceeded 2.8% in that year (Japan Finance Corporation, 2013),

as shown in Figure 3. As noted the second section, international business is also important for Japanese SMEs in a saturated domestic market.

According to the Research, the main target of Japanese SMEs' FDI and exports is the Association of Southeast Asian Nations (ASEAN) region and China (The Medium and Small Business Research Institute, 2011). While the percentage of Japanese SMEs' FDI and exports going to ASEAN countries have not changed substantially (from 24.7% in 2001 to 24.0% in 2007), the percentage going to China have increased substantially: from 18.7% to 28.1%.



Source: The Medium and Small Business Research Institute (2011)

Figure 4 shows the details. SMEs mainly target Asia, especially China, Thailand, and Hong Kong. This is related to their industry and motivation for going abroad. The United States and Eastern Europe are among the largest markets, with relatively high percentages. Products with artistic character tend to go to these areas.

Half of the SMEs undertaking international business are in the manufacturing industry. The second-largest industry is wholesale. Much of the research focuses on the manufacturing industry, but the number of non-manufacturing-industry SMEs has increased from 2002 to 2006 (The Medium and Small Business Research Institute, 2011). Some non-manufacturing SMEs target Japanese manufacturing firms in foreign countries. As will be explained later, many SMEs undertake international business to supply their parent firms in foreign countries. This is a basic pattern and much of the literature has focused on it. On the other hand, some SMEs in non-manufacturing industries follow other Japanese firms to provide services. For example, a firm supplies Japanese vegetables to Japanese expatriates in Asia (Chugoku Bureau of Economy, Trade and Industry, 2013a). The international business of

parent firms in the manufacturing industry affects the related SMEs. Additionally, there are cases that indirectly affect SMEs.

According to the research, motivation for the operation is divided into three categories: cost reduction, market expansion, and procurement of orders by the parent firm (Japan Finance Corporation, 2013). However, at the same time, the motivations are diverse. Focusing on market expansion, there are three patterns: targeting high-, middle-, or low-income segments. As shown in later cases, Japanese SMEs often focus on the high-income segment, offering Japanese-oriented products or products with high technology to the Asian market. However, public institutions like the Kinki Bureau of Economy promote Japanese SMEs entrance into the middle- or low-income segment in the context of the BOP and/or “shared value.” This is a clear gap.

According to the same research, shortage of funds is the top reason why some SMEs do not go abroad. Many SMEs face problems related to human resources for FDI. The top reason for withdrawal is the difficulty of getting orders in a new market.

Motivations are diverse, and many SMEs do not have enough resources to start and operate international businesses. At the same time, their environment requires SMEs to operate in foreign markets to create opportunities for growth. Therefore, they need various supports in this context.

## Chugoku Region in Western Japan

There is little literature related to international business practices focusing on SMEs in the Chugoku region, even though the region is the one of the nearest areas to Korea and China.

The value of exports from this region is about 4.5 trillion yen. About 53.8% goes to Asia: Of this, 32.8% goes to China and 30.3% to Korea (Kobe Custom, 2014). This shows the dependence on East Asia. The Chugoku region covers 8.4% of Japanese land. The area’s gross production accounts for 5.7% of the Japanese total and 8.2% of Japanese all exports. Demographically, the region has a decreasing birthrate and an increasing aging population. People over 60 years old represented 22.1% of the population in 2012, which is above the Japanese average. The region features a developing marine transportation industry, which has been important historically. There are also many SMEs relying on high technical expertise (Chugoku District Transport Bureau, 2014). Therefore, this region is a representative local area for Japan.

Mazda (automobile industry) and Ube Industries Ltd. (chemical industry) have their head offices in this region. Ube City can be seen as the headquarters of Ube Industries. The firm and its associated SMEs support Ube City financially.



Figure 5 The Chugoku region in Japan



Source: Chugoku District Transport Bureau (2014).

### Sampled SMEs

The sample for this article is made up of 37 SMEs in the Chugoku region chosen from 2009 and 2013 casebooks published by the Chugoku Bureau of Economy, Trade and Industry (2009, 2013a). These are presented in Table 1.

Table 1 Sampled small and medium-sized firms

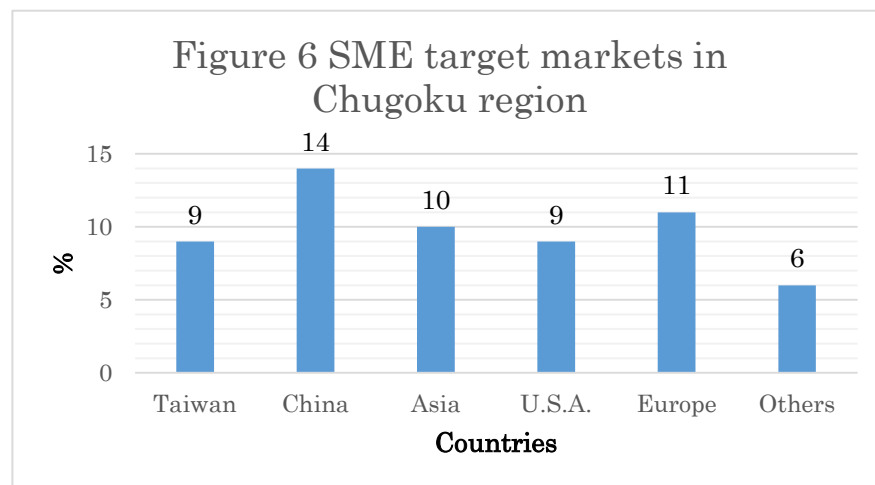
No.	Firm name	Industry
1	Shimizu	Food
2	Fujii	Textiles
3	Sanki	Manufacturing (machine)
4	Taiko	Manufacturing (machine)
5	Semco	Manufacturing (machine)
6	Nakashima	Manufacturing (machine)
7	Greenplus	Manufacturing (other)
8	Shimane-jidoki	Manufacturing (other)
9	Meikodo	Manufacturing (other)
10	Nagashimaseika	Wholesale
11	Oho Trading	Trading

12	Max-power	Wholesale and retail
13	M-tex	Food
14	Chiyomusubi	Food
15	Marukyo	Food
16	Sawaicoffee	Food
17	Taniguchiwashi	Manufacturing (other)
18	Barcos	Wholesale and retail
19	Koge	Construction
20	Ama-cas	Processing and retail
18	Barcos	Wholesale and retail
19	Koge	Construction
20	Ama-cas	Processing and retail
21	Tajimaya	Manufacturing (other)
22	Nakamura	Manufacturing and retail
23	Nihon Kominka	Construction
24	Nakaura	Food
25	Teori	Manufacturing (other)
26	Namba	Retail
27	Nihonmenpu	Textiles
28	Kanemitsu	Food
29	Umedasyuzou	Food
30	Takeda	Manufacturing (other)
31	Sasaki-mokko	Manufacturing (other)
32	Kaihara-denim	Textiles
33	Masuyamiso	Food
34	Take Create Hagi	Manufacturing
35	Asahisyuzo	Food and retail
36	Life	Manufacturing (other)
37	Yanagiya	Manufacturing (machine)

Source: Chugoku Bureau of Economy, Trade and Industry (2009, 2013a)

These SMEs have head offices in this region and have international operations. The manufacturing industry accounts for the largest number of firms, followed by food and textiles. Some of them have patents and specific technology.

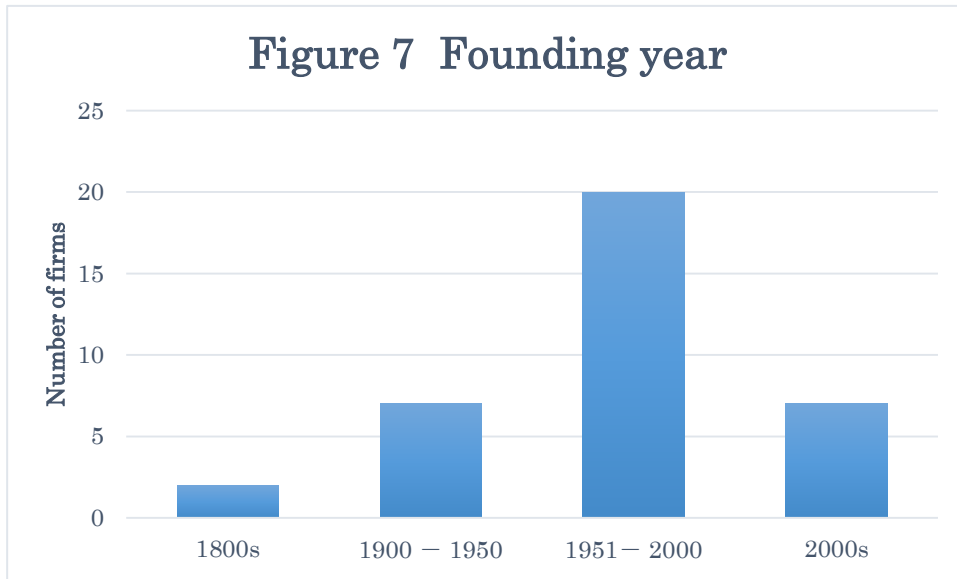
Figure 6 shows the SMEs' target markets. Their main target is Asia. The result corresponds with Figure 3. In many cases in this region, however, the firms go to Taiwan first. Then they go to China. They tend to go to the larger market after learning the international business in Taiwan. This is one of the region's features. "Other" markets in Figure 6 include Oceania and Africa.



Source: Chugoku Bureau of Economy, Trade and Industry (2009, 2013a)

## Analysis

How quickly do SMEs internationalize? Are these SMEs BGCs? Figures 7, 8, and 9 suggest the speed of internationalization. Figure 7 shows when these SMEs were founded.



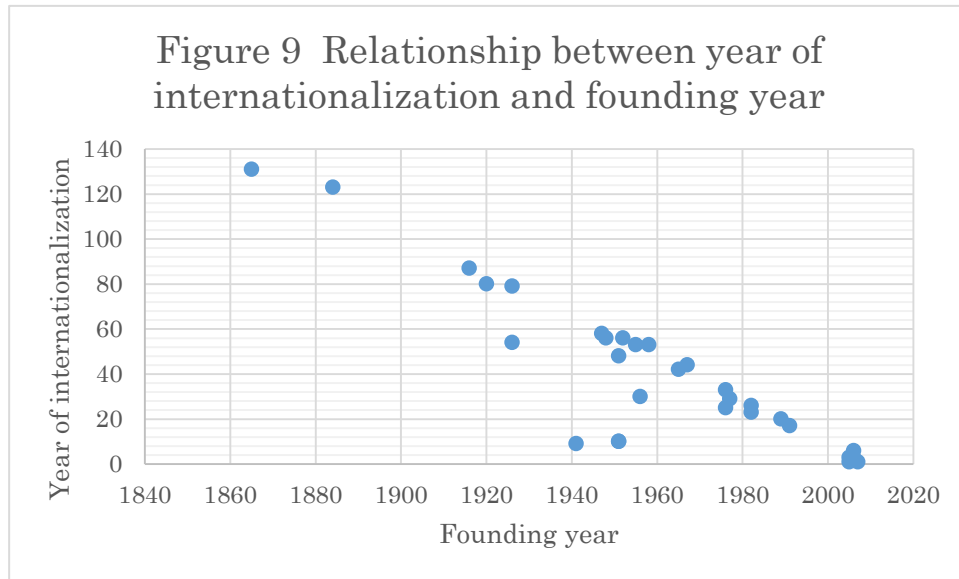
Source: Chugoku Bureau of Economy, Trade and Industry (2009, 2013a)

Almost 20 firms were founded from 1951 to 2000. Next, Figure 8 shows how long it takes SMEs to internationalize after they are founded.



Source: Chugoku Bureau of Economy, Trade and Industry (2009, 2013a)

Figure 9 combines information from Figures 6 and 7, showing how these two factors are correlated.



Source: Chugoku Bureau of Economy, Trade and Industry (2009, 2013a)

Not many of the sample SMEs are BGCs. However, the more recent the year of foundation, the faster the internationalization. In fact, many of the SMEs examined in this article started international operations in the 2000s. This would have been easier because of the evolution of information technology. Although traditional firms take many years to internationalize, it seems that SMEs' strategies changed in the 2000s. However, they tend to have a later starting point for internationalization than do Japanese MNEs.

In the next step, I examined the objective of each SME's international operations, targeting the keywords "brand" and "high value added." This search yielded 18 of 34 firms, while only three firms stated that their international operations addressed social problems. Many SMEs target high-income segments in the foreign market with their high technical expertise. Although this is a natural strategy, it is the same strategy Japanese MNEs use and has been a common strategy for expanding internationally in previous years. Moreover, as noted above, many Japanese MNEs started international operations before the 2000s, targeting high-income segments. It is thought that not all firms need to target this segment. I do not deny the effectiveness of targeting this segment with high technology, but there are other sustainable ways for Japanese SMEs to go abroad. Thus, appropriate support is needed because of resource shortage.

A few firms have started to undertake works related social problems in foreign countries. One SME in the construction industry is addressing social problems. This firm, with a workforce of 56, is not very large (Chugoku Bureau of Economy, 2013a). However, its high-value-added products are expected to stop desertification in Africa and other developing countries. It has laid the groundwork for crime prevention. To develop its products, this SME cooperates with a local university. Collaboration with universities is common in BGCs in

Northern Europe. This firm was founded in 2001 and internationalized in 2008. Although it does not meet the definition of a BGC, it was internationalized comparatively quickly.

An SME in the trading industry is also addressing social problems. The firm utilizes the Internet for trading agricultural implements. It stocks used implements from the domestic market and sells them to foreign markets online. Its market has expanded to about 70 countries, and it contributes to agricultural mechanization in developing countries.

Few SMEs cases are related to shared value. However, this suggests the possibility of another way to achieve a sustainable benefit. In addition to the firms noted above, some SMEs have high technology and experience related to solving problems. How can they connect to benefit each other? A support system is one of the key ways to do this.

The CEO of the firm in construction industry in the case stated that the firm requires government backup to expand its products to decrease poverty. SMEs' resources for selling or producing their products are limited, especially in foreign markets. Government and other support is essential for both BGCs and SMEs' international operations.

Therefore, I also examined support organizations. Many public and private sector entities provide support in the Chugoku region. There are three main types: public institutions, local self-governing bodies, and private support institutions.

1. Public (national) institutions: For example, the Chugoku Bureau of Economy, Industry and Trade; the Local Finance Bureau of Chugoku
2. Local self-governing bodies: For example, the prefecture of Yamaguchi
3. Support institutions: For example, the Japan International Corporate Agency (JICA) Chugoku, Yamaguchi Bank, the Chamber of Commerce

The central organizations in this region are the Japan External Trade Organization (JETRO); the Chugoku Bureau of Economy, Industry and Trade; and SME Support Japan (Chugoku Bureau of Economy, Trade and Industry, 2013a). They provide information, consulting and advice, support for business exhibitions, training, financial support, subsidies, and support in host and home countries.

For example, if SMEs in this region want to get financial support, they can access 16 support "systems" through the Chugoku Bureau of Economy, Industry and Trade; the prefecture of Tottori; the Chugoku and Shikoku agricultural administrations; and so on.

In terms of financial support for marketing, not all support systems cover product development, but some of them support business negotiation. No support system covers Internet applications. While some of these organizations offer support for operations worldwide, others focus on China, Asia, and ASEAN (Ibid.). All of these organizations are able to provide information about the regions. Not all organizations are able to provide advice about all regions to which the SMEs want to go; only Asia is covered by all. All organizations are able to provide subsidies under some conditions. Both public and private support organizations are very interested in the SMEs' international operations, especially in Asia.

However, there is a shortage of support in the next step. If SMEs want to raise funds, only three organizations have opportunities to provide them. Exhibitions and business communication are essential for them to get new orders in foreign market. However, the

opportunities in the Chugoku region are limited to Asia. Although many SMEs have faced various problems after FDI, there is little support in foreign countries.

At first glance, there appears to be enough support for SMEs in this region. However, these services are provided by many entities, resulting in overlap. There are many options, and not all are free. If SMEs want to find information or consult with an organization, they have to ask more than one organization. The support systems for SMEs are not very systematic. They need to be integrated into a whole. Furthermore, support of Internet applications, including operational support, is required to facilitate international business rapidly, easily, and smoothly.

## Conclusion

MNEs' international business model adjustments representing shared value can be seen clearly in recent years. SMEs' business models are also related to this concept, because both MNEs and SMEs are in the same international business environment. Some of the SMEs have high technology. To use it efficiently for both SMEs and society, it is not enough just to sell their products with the technology to the high-income segment. Although some SMEs noted problems in their businesses, they need to make major changes to adopt new business model adjustments. These adjustments have been seen since the 2000s. Thus, there is still the possibility that SMEs can access international markets and use their experience well.

SMEs can internationalize more easily than in previous years and need to expand their markets. However, the ratio of international operations among SMEs is still low in Japan. Through a case study, two problems are found. First is SME strategy. Most of them have the same target market and segment as MNEs. If they only follow the path MNEs took in previous years, they cannot get the required market share. Additionally, the segment is not as large as the market to address social problems.

The second problem involves support systems for SMEs. The Japanese administration provides various supports for SME operations in foreign countries. However, these services are provided by several types of entity, resulting in overlap. The creation of an information unification system covering all of these support organizations, and providing information to connect SMEs' skills with social problems in Asia, would help to solve these problems. These are the areas suggested for further research.

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