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Small and medium-sized enterprises and their use of organizational forms in Japan after World War II

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ABSTRACT

This study investigates how people recognize and use organizational forms in the process of economic development. In order to do this, I will focus on the recognition and use of the corporate form as well as the private limited liability company (PLLC) form in Japan after World War II (WWII).

Before WWII, the corporate form was considered as an instrument for big businesses, while the PLLC was for small and medium-sized enterprises (SMEs). After WWII, however, many SMEs started to use the corporate form, even though they could not fulfill all the legal obligations. Even though this situation was criticized as 'abusive' use of the corporate form, SMEs continued to use it, but the extent to which they preferred it to the PLLC form has changed over time.

By referring to discussions of legal scholars as well as statistical data, I found that several different factors affected this phenomenon: the trustworthiness of corporations, the cost of using the corporate form, and its usefulness for the modernization of management.

KEYWORDS:

Corporations

private limited liability companies

organizational forms

economic development

small and medium-sized enterprises

Disclosure statement

No potential conflict of interest was reported by the author.

Data availability statement

The data that support the findings of this study are available from the corresponding author, Takashi Shimizu, upon reasonable request.

Notes

1. The corporate form here means a legal form of business which has the following characteristics: (1) separate legal personality, (2) limited liability of investors, (3) delegation of the management to the directors (or the board of directors as a collegiate body), and (4) transferability of stocks. The corporate form has its own name in each jurisdiction, such as 'corporation' in the United States, 'company limited by shares' in the United Kingdom, 'Aktiengesellschaft' in Germany, or 'société anonyme' in France.
2. Until 2006, corporate law in Japan was a part of the Commercial Code.
3. When we use the corporate price index, the current price is about 1,000 times larger than that in 1931. A previous study suggested the scale factor might be about 2, 000

(Iwase [\(2006\)](#)). It means that 10 million yen then is almost equal to 10-20 billion yen in present-day terms, or approximately US\$ 80-160 million.

4. In Japanese, 'yugen' means 'limited,' and 'kaisha' means incorporated business entities, including partnership (under the Commercial Law), limited partnership (under the Commercial Law), corporations, and yugen kaisha. When we consider the pronunciation, it should be written as 'yugen-gaisha.' However, because Japanese people often use YK as an abbreviation of 'yugen kaisha' to express this form, in this paper I will use 'yugen kaisha' as the name of this form. See Hannah and Kasuya ([\(2016\)](#) for details of the use of these words.

5. Nicholas ([\(2015\)](#) presented similar figures from 1896 to 1939 based on a different data set, which was based on Tables of Company Statistics. Compared with Tax Statistics used in this study, Tables of Company Statistics reported more detailed data on companies, but Tax Statistics covered more companies. For the details of the data, see Shimizu ([\(2012\)](#)).

6. Nicholas ([\(2015\)](#) pointed out that the increase in the number of PLLCs after 1940 did not cause a decrease in the number of corporations, and suggested this was because the PLLC appealed mostly to Japanese business owners who had previously chosen to organize as a limited or a general partnership. Though [Figure 4](#) supports his argument and thus the explanation is plausible for the situation before WWII, the situation after WWII cannot be explained by this. I will discuss this in the following sections.

7. According to this survey, the percentage of companies that disclosed their balance sheets was higher for larger corporations. Among corporations with capital of 2 to 20 million yen, it was about 20-30%. The percentage was more than 50% for those corporations with capital of more than 20 million yen. See Izawa ([\(1956\)](#) for the details.

8. This number might be smaller than the actual number, because the response rate in this category was only 28%. Many companies that did not hold annual shareholders' meetings did not answer this particular question, and it was also suspected that most corporations that did not hold annual shareholders' meetings did not even participate in the survey.

9. The current Companies Act abolished the duty of issuing stock certificates and at present corporations basically do not issue stock certificates. If a corporation wants to

issue stock certificates, it should indicate that it issues stock certificates in the Articles of Incorporation (Art. 214).

10. Even in recent days we can see some attempts to prevent this ‘abusive use’ of the corporate form. For example, in 1990 the Commercial Code was amended and the regulation on the minimum capital amount (10 million yen for a corporation and 3 million yen for a PLLC) was introduced. The difference in the minimum capital amount between a corporation and a PLLC suggests that one of the purposes of the Amendment was to provide an incentive for SMEs to use the PLLC form. However, in the Amendment of Commercial Code in 1974 and the enactment of the Special Law on Audit Practices under Commercial Law, small corporations were exempt from some regulations and this might have encouraged the establishment of such small corporations. In this sense, the Japanese legislature’s attitude toward small corporations was not consistent.

11. Moreover, it was customary for the owner-president of a small company to become a guarantor of the company’s debt (see Ishii et al. [1961](#), for example). In such a case, the limited liability is almost useless – the owner has an obligation to repay the debt of the company anyway.

12. This ban was lifted by the amendment of the Commercial Code in 1966.

13. Hannah and Kasuya ([2016](#)) indicate the importance of the liberal flexibility for using organizational forms, and mention the fact that corporations could restrict the transfer of shares as one of the examples of that flexibility.

14. In 1949, the Small and Medium-Sized Enterprise Cooperatives Act was enacted to support such efforts.

15. Moreover, Ryosan Co., Ltd., a company selling semiconductors and electronic parts, established as a PLLC in 1953 and became a corporation in 1957 (Ryosan Company Ltd [2004](#)). The company history indicates that its biggest partner, Nippon Electric Company, Ltd., recommended reorganization as a corporation, but the reason for this recommendation was not detailed. However, at least the reorganization cannot be explained by the trustworthiness or the cost considerations, because it is based on the recommendation from a business partner and is not a voluntary action of the company itself.

16. In 2006, the enactment of the new Company Act as an independent law abolished the PLLC form; however, it facilitated greater flexibility of the corporate form so that SMEs can use the corporate form with an internal structure which is suitable for them.

Additional information

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