

STRATEGIC INSIGHTS INTO THE CHALLENGES FACING JAPAN'S SMALL AND MEDIUM-SIZED ENTERPRISES

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Abstract

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Small and medium-sized enterprises (SMEs) play a vital role in driving economic growth, fostering innovation, and generating employment opportunities. The study aimed to introduce a strategic insight into the challenges that face SMEs in Japan. This study employs a holistic approach by using a systematic literature review to explore the multifaceted challenges facing SMEs. SMEs serve as the backbone of the Japanese economy, contributing to over 50 percent of the nation's gross domestic product (GDP). Representing approximately 99 percent of all businesses in Japan, SMEs employ around 70 percent of the country's total workforce, underscoring their critical role in sustaining economic stability and employment. Despite their significant contributions, SMEs in Japan face a range of challenges that hinder their growth and sustainability. Key issues include limited access to financing, labor shortages exacerbated by an aging workforce, stagnant labor productivity, and a lack of successors for business continuity. Additionally, the increasingly competitive global marketplace poses further pressure, as Japanese SMEs struggle to match the cost efficiency and service quality of foreign competitors. Emerging economies such as China and South Korea, with their lower production costs, intensify this competition, making it more difficult for Japanese SMEs to maintain their market share. This article has thoroughly discussed and analyzed the challenges confronting the Japanese SMEs, along with the possible policy routes for supporting and promoting the SMEs in Japan.

Keywords: SMEs, Challenges, Japan, Workforce Shortage, Technological Adaptation, Competition, Regulatory Burdens

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1. INTRODUCTION

Small and medium-sized enterprises (SMEs) are playing a crucial role in the Japanese economy, and they are acting as a major pillar of employment, innovation, and industrialization. It can be confirmed that SMEs generate 70% of the total employment in Japan (Oliveira et al., 2022). In addition to their contribution to the local economy, SMEs contribute to sustaining competitive capabilities in international markets. However, SMEs in Japan also encounter several challenges that hinder their growth and long-term sustainability. These challenges are compounded by constraints on resource availability, organizational design, and exogenous factors such as industrial evolution and demographic changes (Kuteesa et al., 2024). The focus of this study is to identify the most significant challenges affecting Japanese SMEs and propose recommendations for solving these challenges so that SMEs can better survive and thrive in an increasingly challenging environment.

The SMEs-based economy of Japan is structured on a diversified set of SMEs across various industry sectors, such as manufacturing, retail, construction, and services. Generally, a small business is a firm employing fewer than 50 workers, whereas a medium-sized business has an employee population of up to 300. These are businesses that are integral parts of Japan's industrial system: providing necessary goods and services, as well as encouraging innovation, since they are entrepreneurial in dynamism (Sidek et al., 2020). As with most industries in the past, SMEs in Japan have been responsive to market structure and dynamics, with the majority providing focused product and service solutions for targeted market niches. Due to their diversification with the local sources of supply and logistics, they have been able to remain consistent in the economy (Eweje, 2020). However, the operating environment of SMEs in Japan has progressively worsened. There are challenges such as an ageing population, a decreasing employee pool, and the general scarcity of employees that affect these enterprises. Besides, the growing competition, technological advancement, and the shifting environment of regulations require SMEs to hold their own on the worldwide market (Idota et al., 2020). All these challenges were compounded by the COVID-19 pandemic, which impaired the life stream of small businesses and forced them to reset their strategies and go digital.

The study presents a historical overview of SMEs in Japan. In addition, it discusses the government support measures for SMEs in Japan and the role of SMEs in Japan's economy, and discusses the main challenges that face SMEs in this country. Furthermore, it proposes some practical strategies and interventions that can enable SMEs to overcome the challenges they face. The recommendations provided in this study benefit companies, government bodies, and private organizations by improving the business environment for SMEs. Recognizing the growing importance of technology, the study explores how digital tools and innovation can provide SMEs with a competitive advantage. It also examines how these businesses can effectively adapt to the evolving business landscape, ensuring their continued growth and

sustainability in a rapidly changing market. In addition, it attempts to provide a holistic view of the challenges that SMEs face in Japan, mainly focusing on five areas. The causes were financial constraints, labor shortages, technological adaptation, global competition, and regulatory burdens. The study tries to highlight the most difficult problems to SMEs' growth in Japan according to current academic research and industry reports. It also talks about how these challenges make the SMEs in Japan venture into operational efficiency, competitiveness, and viability for long periods.

The remainder of the paper is organized as follows. Section 2 discusses the existing literature review. Section 3 refers to the methodology. Section 4 shares the results and discussion. Finally, Section 5 concludes the article along with the recommendations.

2. LITERATURE REVIEW

2.1. Historical overview of SMEs in Japan

After the Second World War, SMEs were acting as subcontractors to larger firms, especially in the manufacturing and automotive industries. The Small Business Basic Law of 1963, passed through the government, proved to be a vital support mechanism, providing a framework for financial, technical, and managerial assistance. This policy aims to bridge the gap between large corporations and SMEs through tax incentives, credit facilities, and access to technology (Wisuttisak, 2021). According to Andrade-Rojas et al. (2024), these measures lay down a platform for cooperative relationships between SMEs and larger firms, developing a unique ecosystem of relational subcontracting. SMEs operate as reliable partners within production networks dominated by larger corporations such as Toyota and Sony. These relationships are built on trust, quality, and mutual dependency (Laari et al., 2022). Among the SMEs of the high-growth period in the 1970s and the 1980s, roles expanded beyond subcontracting. This caused Japan to begin innovating, specialize in elusive niche markets, and become an integral component of the country's export-driven model. For example, Atieh et al. (2023) suggest that SMEs gained expertise in precision manufacturing and electronics, which synthesized the global strategies of large firms. This was also an era of keiretsu networks in which SMEs were tightly bound to vertical and horizontal business groups. Nevertheless, the "dual structure" problem remained; they lagged when it came to accessing advanced technology, global markets, and economies of scale. Consistent with the environment of global competition due to market liberalization, SMEs had to become innovative as this disparity exacerbated competition (Brancati et al., 2022).

The 1980s were characterized by speculative growth, which culminated in the collapse of Japan's bubble economy in the early 1990s. This period brought significant challenges for SMEs, including reduced domestic demand, rising competition, and the erosion of traditional subcontracting systems (Carroll, 2023). As the economy contracted, many SMEs struggled to maintain their profitability. This decline in relational subcontracting made these firms rethink their strategies. Fitzgerald et al. (2023)

argue that this was the critical moment when SMEs looked to achieve greater independence by expanding their customer base and venturing into new markets. The concept of flexible specialization began to gain importance as SMEs sought to adapt to changing market conditions. Advances in technology in the late 20th and early 21st centuries offered opportunities and challenges for SMEs. As globalization progresses, SMEs are subject to greater competition and receive new tools and markets at the same time. Many SMEs have adopted computerized tools and automated systems to improve their production efficiency and quality. However, as seen by Chowdhury et al. (2024), over-reliance on technology does not always lead to strategic success. However, the use of technology for integration is not accompanied by systemic changes in skills, processes, and resource management. Successful SMEs in this period combined technological upgrades with organizational restructuring as case studies. As a case study, SMEs from the precision engineering and electronics sectors could gain sustainable growth by combining their technological investment with market needs and internal capability.

Globalization has played a defining role in the development of SMEs in Japan in the 21st century. Businesses, especially SMEs, need digital management accounting to manage finances, make decisions, control time-saving, and control operations (Begum & Begum, 2025). Digital technologies and trade liberalization have opened new opportunities that

have exposed SMEs to unprecedented competition. Kobayashi (2014) states that Japanese SMEs are now becoming an emerging trend for Japanese SMEs to expand their market by globalizing. This has helped them capitalize on new customer bases and, in the process, expand revenue channels. According to Elbanna et al. (2024), behind Japan's ageing population and declining birthrate, labor shortages and business succession problems persist. These demographic trends represent a significant risk to survival, particularly for family ownership. The Japanese government has taken the necessary measures to react; for example, the SME revitalization support act provides support to promote innovation, support entrepreneurship, and help SMEs make digital transformations (Fitzgerald et al., 2023). Over the past ten years, many academic studies have focused on trying to account for the trajectory of the development of Japanese SMEs, mainly with respect to their ability to adapt and survive in turbulent environments. Internal transitions have focused significantly on improving an understanding of how these types of organizations react to disruptions of this type, as per Blomsma et al. (2023). The capabilities, assets, and technologies of SMEs must be systematically integrated and augmented to be able to sustain differentiation. In addition, according to Ketchen and Craighead (2020), history analysis is critical in trying to understand how strategic management practices change over time. Table 1 summarizes the key developments in SMEs history in Japan.

Table 1. Key developments in SME history

<i>Period</i>	<i>Key developments in SME history</i>
Pre-WWII (before 1945)	SMEs mainly operated as family-owned businesses, local crafts, and merchants. Limited industrialization.
Post-war reconstruction (1945–1955)	The government encouraged SMEs to revive local economies and absorb returning soldiers. Focus on rebuilding the industry.
High growth period (1955–1973)	SMEs supported Japan's rapid industrialization by supplying parts and services to large firms (keiretsu system).
Oil crises and economic stabilization (1973–1985)	SMEs struggled with inflation and energy costs. The government launched support policies (e.g., credit guarantees).
Bubble economy (1985–1991)	Economic boom encouraged SME diversification, but speculative investment led to vulnerabilities.
Post-bubble recession (1991–2000)	Many SMEs faced bankruptcy. The government introduced restructuring aid, financing schemes, and the SME Basic Act 1999.
21st century reforms (2000–2010)	Emphasis on innovation, globalization, and information technology (IT) adoption. Creation of regional SME support centers.
Recent decade (2010–2020)	Policies shifted toward promoting female and senior entrepreneurship, business succession, and local revitalization.
Pandemic and recovery (2020–present)	COVID-19 severely impacted SMEs. The government launched subsidies, digital transformation support, and revitalization grants.

Source: Shiohara (2023).

2.2. Government support measures for SMEs in Japan

Governments around the globe provide support and subsidies to support the domestic industries (Nawaz et al., 2025). SMEs have long been recognized for their potential to contribute to supporting countries' economies and introduce initiatives to reduce poverty.

The Japanese government has also implemented numerous policies to support SMEs, a critical segment of the economy responsible for innovation, employment, and regional development. Various studies have provided insights into these initiatives, their impacts, and areas for improvement (Durst & Gerstlberger, 2020; Kuteesa et al., 2024).

This literature review synthesizes the findings from key research on government programs that support SMEs. Under the business sustainable subsidy (BSS) program, SMEs have found opportunities to enhance productivity and promote sustainable development, introduced by the Ministry of Economy, Trade and Industry (METI) in 2013. The program forces firms to submit an in-depth business plan designed to strengthen their operations and sales. Even without receiving subsidies, the application process itself would benefit, according to Takahashi and Hashimoto (2023). The program was most effective for firms in their early growth phase (typically 6–10 years) and in service sectors, where we noted productivity improvements and entrepreneurial growth (Ohno & Uesu, 2022). While the BSS program

offers valuable support, research shows that merely receiving the subsidy does not significantly boost firm performance. Instead, active participation in planning and advisory processes is key to achieving tangible results. The BSS program proves to be an effective tool for promoting entrepreneurship, enabling firms to leverage new market opportunities and drive sustainable productivity growth (Takahashi & Hashimoto, 2023).

The Monodzukuri subsidy program focuses on promoting technological advancements in the manufacturing and high-value-added sectors. By subsidizing equipment upgrades and process automation, the program addresses the inefficiencies in production systems and fosters innovation. Nagao and Edgington (2023) found that such targeted subsidies significantly improved firms' research and development (R&D) capabilities, leading to long-term competitiveness. However, they caution that subsidies need to be paired with capacity-building initiatives to maximize their effectiveness. According to Dzienis and McCaleb (2024), this program underscores the importance of integrating government support with technological adoption, enabling SMEs to modernize while maintaining operational continuity. The third factor focuses on local initiatives that are meant to address regional disparities in Japan. Tiwasing and Sawang (2022) depicted that rural SMEs can benefit from support and funding offered by local chambers of commerce and associations, which helps them grow and develop. In addition, the study showed that effective activities have been implemented by targeted programs that offer sector-specific services, such as artisanal crafts and agribusiness. These moves have helped to promote regional economic development by strengthening the growth and sustainability of these industries. However, it is difficult to scale these campaigns while avoiding the impression that they are localized efforts (Downs et al., 2023).

The small business innovation research (SBIR) program emphasizes innovation-driven growth among SMEs, particularly in cutting-edge fields, such as robotics, green energy, and biotechnology. Kato and Coad (2024) report that R&D subsidies under SBIR have significantly contributed to technological advancements, facilitating the commercialization of innovative products. These subsidies also encourage collaboration between SMEs and academic

institutions, fostering a culture of knowledge-sharing and co-innovation. However, a consistent challenge noted in the literature is the underrepresentation of nontechnical SMEs in these programs (Suriyankietkaew et al., 2022). Expanding the eligibility to include firms in the creative and service sectors could further enhance the program's inclusivity and impact. Japan External Trade Organization (JETRO) assists in the globalization of SMEs with market research, export assistance, and participation subsidies for international trade fairs. Yao (2021) describes the important contribution of JETRO to SMEs' competitiveness abroad, particularly for SMEs in the manufacturing and technology sectors. Such initiatives help to remove the barriers that SMEs face, including high initial costs and a lack of knowledge.

JETRO's programs are highly impactful for export-oriented firms, but less accessible to SMEs in the non-export industry. Given that recent research also suggests that internet globalization strategies, such as e-commerce and cross-border internet platforms, can similarly provide a wide range of SMEs with a source of competitive competence, researchers suggest that JETRO should broaden its scope to include digital globalization strategies. The COVID-19 pandemic presented SMEs with challenges that were heretofore unknown; the Japanese government responded with numerous emergency relief measures that comprised interest-free loans, rent support, and wage support for affected SMEs. Such measures helped to prevent large-scale closures, especially among tenants in industries such as retail and hospitality (Yamori & Aizawa, 2021). Additionally, digital transformation initiatives accelerated during the pandemic, with subsidies supporting SMEs in adopting remote work technologies and e-commerce solutions. These measures equipped SMEs with tools to thrive in the post-pandemic digital economy (Honda et al., 2023). Despite extensive support, several challenges remain to be overcome; Ding et al. (2022) argue that excessive dependence on subsidies may discourage innovation and risk-taking among SMEs. Furthermore, Sakamoto (2024) notes the uneven distribution of resources, with urban SMEs benefiting disproportionately compared to rural SMEs. Table 2 shows a summary of Japanese government support to SMEs.

Table 2. Japanese government support for SMEs

Type of support	Program/Agency	Description	Target beneficiaries
Financial support	Japan Finance Corporation (JFC)	Provides low-interest loans and credit guarantees.	Startups, small manufacturers, service providers
Subsidies and grants	METI	Offers subsidies for innovation, digital transformation, and energy saving.	SMEs investing in technology or green innovation
Tax incentives	National Tax Agency	Tax breaks for capital investment, R&D, and hiring.	SMEs expanding operations or conducting R&D
Business consultation	SME Support Japan (SMRJ)	Offers expert advice, seminars, and consultation for business improvement.	All SMEs
Market expansion support	JETRO	Assists SMEs in entering international markets through exhibitions and consulting.	Export-oriented SMEs
Digital transformation	METI/Digital Agency	Support for IT adoption and digital transformation (DX) initiatives.	SMEs digitizing operations or services
Disaster recovery aid	Various Prefectural Governments and METI	Grants and low-interest loans post-disaster for recovery and continuity.	SMEs affected by natural disasters
Startup support	J-Startup Program (by METI)	Provides mentoring, visibility, and funding access for promising startups.	Innovative early-stage SMEs

Source: METI and Small and Medium Enterprise Agency (SMEA) (2024).

2.3. The role of SMEs in Japan's economy

Small and medium-sized enterprises play a very crucial role in driving economic growth, innovation, and job creation. Similarly, SMEs are the backbone of Japan's economy, accounting for labor force generation, their interface with industrial supply chains, technology innovation, regional economic development, and economic dynamism. In this section, findings from several studies are synthesized to develop a detailed understanding of the fundamental economic role that SMEs play in Japan's economic structure and to analyze challenges and opportunities for SMEs to further strengthen their contribution. SMEs employ 70% of the Japanese workforce and are therefore the largest employers in the country (Eweje, 2020). In fact, they are particularly important in rural areas because large corporations may be less prevalent. By employing in otherwise distressed regions with high levels of unemployment, smaller firms help neutralize urban-rural disparities (Kuteesa et al., 2024). Gamage et al. (2020) indicated, SMEs generally act as stabilizers in times of economic crisis, while during recessions, big corporations tend to reduce employment, SMEs tend to maintain their employment levels by employing the excess labor.

Lim et al. (2020) argue that SMEs have been very resilient in maintaining the number of employees despite global shocks, e.g., during the 2008 financial crisis and its subsequent economic recessions. In rural Japan, SMEs are vital for ensuring the functionality and stability of the local economy. As a result of being major employers in the country, they create sustainable job opportunities in these areas. According to Owalla et al. (2021), these areas depend heavily on SMEs because they help grow local industries and are highly community-oriented. Furthermore, new evidence suggests that SMEs are good employers who offer employment to minorities and those who are oppressed. According to a study by Pilz and Sakano (2023), SMEs are major employers of old age workers, contributing to solving demographic issues in Japan's society. Concerning SMEs, Pulka and Gawuna (2022) stated that these institutions are becoming increasingly important in reducing unemployment and income inequality because they offer employment to local talent.

SMEs are heavily involved in the industrial cluster in Japan, and they are the major suppliers of large firms, especially in manufacturing, the automobile industry, and the electronics industry. Through producing specialized elements and services, SMEs in Japan are enabling the large firms to sustain their competitiveness in the international marketplace. Among all companies' cooperation strategies in Japan, the keiretsu model, which is a complex of interconnected companies, plays one of the key roles for supply chain integration. Pinto et al. (2018) analyzed how SMEs fit into this system by supplying materials to large firms and maintaining strict adherence to just-in-time manufacturing principles as well as managing supply chain logistics. The participation of SMEs also describes industrial change in Japan. Jones et al. (2022) studied how many of these organizations developed from subcontractors for other firms to independent companies within a certain

specialization. However, it has been advantageous for most of the SMEs to engage in subcontracting from other large companies. This has opened employment opportunities to SMEs to release specialized products as well as services since they directly sell these products to various supply chains.

Fitzgerald et al. (2023) examined the mechanization of work in Japan and large companies as well as the SME industry. SMEs are important for maintaining the efficiency of industrial supply chains because of their flexibility and agility in adapting to changes in market demand and technology. SMEs are key to cutting bottlenecks and getting components out in time in high-tech sectors. They also help in maintaining Japan's global competitiveness, especially in high-tech manufacturing, as argued by Osano (2023). However, as stated by Hosono (2023), Japan's export-oriented industries remain resilient and competitive globally due to the ability of SMEs to promptly adjust to changing market conditions. Bag et al. (2022) highlighted the innovative role of SMEs within supply chains, particularly in the automotive and electronics sectors. SMEs often develop cutting-edge technologies and process improvements that provide them with a competitive edge even in industries characterized by intense competition. SMEs can create strong partnerships with larger firms and gain access to international markets by developing unique products and services. The technological adaptation in the world is indeed a critical factor for firm innovation, growth, and competitiveness, and plays a strategic role for both SMEs and large firms (Ricciardi, 2024).

SMEs in Japan are taking an active part in technological innovation efforts, though their role may not be as significant compared to the larger IT firms. The SMEs play a critical role in Japan's R&D efforts, particularly in areas like robotics, clean technologies, and precision engineering. Owen et al. (2020) demonstrated that SMEs are significant patent creators in the fields of robotics and green technologies, which seem to be highly prominent in the generation of patents. These features show why Japan continues to stay at the top as a hub for global technology. Encouragement from the government is also important in increasing innovation among SMEs. Kato and Coad (2024) highlighted the effectiveness of the SBIR program, which provides funding and resources to SMEs engaged in cutting-edge research. This program has significantly contributed to the development of SME-led R&D projects and facilitated technological breakthroughs in fields such as robotics and environmental sustainability.

Public-private partnerships are also contributing to SME innovation. Osano et al. (2023) studied how technological advancements in the Japanese manufacturing sector have arisen from collaboration between the government and private SMEs. Muenjohn et al. (2021) compared innovation results from the SMEs of Japan to other countries and established the point that, although Japanese SMEs are innovators in comparison to their European counterparts, this is due to targeted governmental support to R&D activities. For their part, improved cooperation between universities and industries enhanced Japanese innovations by SMEs as well. Pereira and Franco (2022) analyzed the knowledge

transfer process from an academic institution to SMEs with a focus on how such cooperation can contribute to innovation commercialization. This kind of knowledge transfer is very important since it stimulates technological activities aligned with national economy priorities in such spheres as top-priority technologies, advanced manufacturing innovations, and sustainable technologies.

The role of SMEs is quite vital in the regional economic development, especially in rural areas, where they ensure stability and drive growth. In regions with traditional industries, such as the Tohoku area, renowned for sake brewing and ceramics, SMEs play an essential role in sustaining and revitalizing these sectors. By fostering innovation, they not only preserve cultural heritage but also contribute significantly to the advancement of local economies. Kouam and Asongu (2022) insisted that SMEs in regions with traditional industries are important for generating employment and for promoting the building of infrastructures, which are critical in sustainable economic growth. Overall, previous studies have shown that SMEs are uniquely resilient in responding to natural disasters. Despite various calamities, the SME sector has continued to play a leading role in regional rebuilding and revitalization efforts, demonstrating its adaptability and commitment to recovery.

According to Vermeulen (2022), the surviving SMEs in Japan's Tohoku region, post-March 2011 earthquake and tsunami, depicted that the surviving SMEs played a critical role in the recovery and revitalization of the region. Their survival and activities were crucial for the reconstruction efforts of the affected sites. They preserve cultural heritage and are crucial to local economies by promoting innovation. Guerrero et al. (2021) demonstrated in their study how regionally focused SMEs promote

entrepreneurship as a tool to bridge the economic gap between urban and rural regions. SME-supporting initiatives can thus reduce economic inequalities and contribute to the fair distribution of wealth in Japan. Ortega-Argilés (2022) examined the various ways in which SMEs reduce regional inequality by combining policies that foster local industries and entrepreneurial activity. Flexibility and sustainability define what SMEs are, especially in very turbulent periods such as during the bursting of the economic bubble of the 1990s or during the COVID-19 pandemic. A major strength of these kinds of enterprises is their surprising power to adapt, which, ultimately, has allowed several organizations not only to survive the tragedy but also to thrive.

This adaptability has been a critical factor in their resilience and continued success in the face of adversity. Fitzgerald et al. (2023) note that manufacturing SMEs decreased their dependence upon large firms since the 1990s and restructured themselves for flexible specialization to be better prepared for fluctuations in the market. They, therefore, adapted to the disruption during the times of the COVID-19 pandemic by promptly adopting digital technology to survive this disruption. By becoming digital and adapting to online models, SMEs can continue being competitive despite a global crisis. According to Weaven et al. (2021), SMEs can continue operating following external shocks because they have decentralized decision-making structures that enable them to respond more quickly and efficiently to these shocks. SMEs can protect themselves from far larger market risks by focusing on specialized products and services to build a strong customer base. Table 3 indicates SMEs' contributions to the Japanese economy.

Table 3. SMEs' contributions to the Japanese economy

<i>Aspect</i>	<i>Contributions</i>
Economic contribution	SMEs account for over 50% of Japan's gross domestic product (GDP), playing a key role in value creation.
Employment	SMEs employ approximately 70% of Japan's total workforce.
Number of enterprises	Over 99% of all enterprises in Japan are SMEs.
Innovation	SMEs contribute significantly to innovation, especially in niche technologies and manufacturing.
Regional development	SMEs support local economies and help prevent urban overconcentration by sustaining regional industries.
Supply chain integration	SMEs play a critical role as suppliers and subcontractors in large industrial supply chains.
Export and international trade	While less dominant in exports, many SMEs are increasingly active in overseas markets with government support.
Flexibility and resilience	SMEs often show greater adaptability to economic changes and shifting consumer needs.

Source: METI and SMEA (2024).

3. RESEARCH METHODOLOGY

This study employed a holistic research approach by conducting a systematic literature review to comprehensively examine the diverse and interconnected challenges confronting SMEs in Japan. Unlike traditional methods that focus on isolated variables, a systematic review allows for the exploration of complex, overlapping issues that shape the operational environment for SMEs. This approach recognizes that the problems faced by these businesses do not exist in isolation but are influenced by a network of internal and external factors that interact in dynamic ways.

One of the key strengths of using a systematic literature review is its ability to uncover the wide-

ranging challenges that affect the performance and sustainability of SMEs. In the case of Japan, these include persistent financial constraints, an aging and shrinking labor force, rapid technological changes requiring constant adaptation, increasing global competition, and stringent regulatory frameworks. Each of these issues presents a unique obstacle, but they are also deeply intertwined. For instance, labor shortages can hinder the adoption of new technologies, while financial constraints can limit the ability to expand or compete internationally. The systematic review approach enables the identification of these linkages, thereby providing a more accurate representation of the SME landscape.

Ultimately, this method provides a robust foundation for developing informed, evidence-based strategies to support SMEs in Japan. By viewing the challenges holistically, policymakers, researchers, and business leaders can move toward integrated solutions that address root causes rather than symptoms. This is particularly crucial in the Japanese context, where SMEs make up the vast majority of businesses and play a vital role in economic growth, innovation, and employment. A systematic understanding of their struggles is therefore essential to ensuring their long-term resilience and competitiveness.

4. RESULTS AND DISCUSSION

4.1. Challenges facing SMEs in Japan

Despite their significant contributions to the economy, SMEs in Japan are facing different challenges that are hindering their growth and sustainability. These challenges are like a lack of access to financing, labor shortage and aging workers, stagnant labor productivity, lack of successors, and other related issues. Funding constraint is one of the biggest problems that SMEs are facing in Japan. Dubovec and Owada (2021) established that SMEs in Japan are bound to face several obstacles to accessing loans. This does not let them spend money on growth, new ideas, and better organization because they cannot find financial means for it. Japanese banking risk-averse approach has, over time, involved the extension of credit to large companies or companies with standard audited accounts. Therefore, there is credit rationing for SMEs, especially the small-scale businesses or start-ups that are most likely to be considered financially less secure. As mentioned by Chit and Rizov (2024), owing to the higher standards set for credits, there is little hope that SMEs can achieve better finances, and therefore, the use of internal financing or even informal loans has a bad effect on the further expansion and technological development of these enterprises.

Labor shortages are another significant challenge being faced by SMEs in Japan and are exacerbated by the country's aging population. Japan's labor force is aging rapidly, with a low birth rate and fewer young people entering the workforce. The Japan Statistics Bureau reports that the working-age population (15–64 years) has been steadily declining, creating a gap in the labor market, particularly for low-wage and manual labor jobs (Debroux, 2022). The aging population also affects the availability of labor in rural areas, where many SMEs are concentrated. Pedron (2022) discussed how SMEs in rural regions face even more severe labor shortages, as younger generations migrate to urban centers for better job opportunities. The lack of a sufficient workforce hampers the growth and operational capacity of SMEs, particularly in industries that rely on manual labor or specific skill sets that are difficult to replace.

Despite the importance of technology for SMEs, which provides business owners opportunities to incorporate digital technologies and innovations into their operations, aiming for sustainable growth, where digital technologies and innovations bestow substantial advantages upon SMEs in their pursuit of

long-term development. The technological adoption remains problematic for SMEs in Japan to undertake. Many Japanese SMEs have not embraced the digital transformation and are still relying on several analogical business and technological structures, causing inefficiencies and a lack of competitiveness, as pointed out by Lechevalier and Shibata (2024). Most micro businesses and many small businesses still cannot justify the outlay to acquire new online software, applications, cloud services, e-commerce solutions, or automation solutions. Additionally, resistance to change within many SMEs is rooted in a traditional business culture that values face-to-face interactions and established workflows. Bhuiyan et al. (2024) argue that many SME owners view technological change as disruptive, and this reluctance to adopt new methods hampers their ability to remain competitive in the global marketplace. Without proper technological tools, SMEs find it difficult to streamline operations, improve customer experience, or expand into international markets.

The global marketplace has become increasingly competitive, and Japanese SMEs face significant pressure to compete with foreign firms that are offering newer products at lower prices and superior services to customers. Emerging economies such as China and South Korea have lower production costs, and SMEs in Japan are facing increasing pressure from these foreign competitors. Products are similar or better but can be offered at a fraction of the cost, complicating the Japanese SME's ability to be competitive (Naradda et al., 2020). In addition to price competition, internationalization continues to be a formidable obstacle for most SMEs. While Japan is famed for its manufacturing, the fact remains that SMEs are hesitant to expand overseas primarily because many are unfamiliar with foreign markets, are not fluent in foreign languages, and are not fully aware of the intricacies of global trade regulations. According to Elbanna et al. (2024), much of the literature on Japanese SMEs emphasizes their scarcity of resources and lack of knowledge to enable them to deal with the complexity of international trade, such as partner management overseas, customs regulations, and entry into foreign markets. This limited international presence renders Japanese SMEs vulnerable to domestic competition and stifles their potential for growth. Gamage et al. (2020) emphasize that while larger corporations have established global supply chains and distribution networks, many SMEs are still focused on the domestic market, thus limiting their opportunities for global expansion. The digitalization can expedite the completion of financial records for SMEs. The application of digital management accounting can enhance productivity, document financial transactions, and facilitate informed decision-making for SMEs. It can enhance the operational efficiency of SME (Begum & Begum, 2025).

Historical business culture is also a problem for SMEs as they experience difficulties when it comes to adapting to Japan. The Japanese business model is the result of a hierarchy, long-term cooperation, and group decision-making, so there is a lot of resistance to change in SMEs. This traditionalism, according to Elbanna et al. (2024), results in conformity, with a slow decision-making process, and reluctance to engage in risk-taking, especially in

the global business environment that changes at a very fast rate. Regarding organizational barriers to innovation, SMEs in Japan frequently observe family tradition as a means of operation, with very limited professional management. However, the lack of professional management expertise in key areas such as finance, marketing, and operations significantly restricts the ability to compete and scale. SMEs find it difficult to cope with governance issues and succession planning, and they largely become less viable and prospects for long-term growth suffer, as suggested by Sasaki et al. (2021).

Based on the previous discussion, the novelty of this study lies in its holistic approach to understanding challenges SMEs face in Japan. This study, however, diverges from much of the extant literature that focuses on specific problems—such as labor shortages or financial constraints—treats an even broader range of possible growth barriers. The findings of the current study update knowledge concerning the recent developments and influences arising from the COVID-19 pandemic; hence, the continued increasing importance of research for digitalization is accounted for. In addition, all the findings have significant practical implications since their insight can guide policymakers, other business leaders, and various related stakeholders in addressing some critical issues facing Japanese SME survival and growth. This study offers actionable recommendations for SME challenges from a public and private sector perspective, which differs from many theoretical studies. Aligned with Japan's context, the proposed solutions improving access to finance, promoting labor force growth, and encouraging technological innovation aim to address the challenges of fast, affordable, and locally sustainable SMEs. This study bridges the gap between academic research and practical application, offering insights to guide policy and business strategies that support SME growth.

4.2. Theoretical implications

This study has several important theoretical implications. The findings of the current study update knowledge concerning the recent developments and influences arising from the COVID-19 pandemic; hence, the continued increasing importance of research for digitalization is accounted for. In addition, it bridges the gap between academic research and practical application, offering insights to guide policy and business strategies that support SME growth. Moreover, the study has several important practical implications for SMEs in Japan, as the objective of this study is to offer a path to overcoming these obstacles and provide actionable capabilities to overcome them through organizational and policy road maps.

One of the main recommendations of this study is to increase SMEs' financing accessibility. This study provides a guide for policymakers, business leaders, and various related stakeholders in addressing some critical issues facing Japanese SME survival and growth. It offers financial institutions and government agencies how they can make lending more appealing to SMEs by identifying barriers to credit access and suggesting ways in which lending practices can be improved, such as by providing lower interest rates or making loans more

flexible. Small businesses can channel their investments towards new technology, further improve their market reach, and become even more competitive (Jia et al., 2020). This paper also reviews the permanent labor shortage that has bedeviled Japan. In this regard, SMEs can tap a larger talent supply through a combination of policy approaches and business policies that will stimulate youth employment, push for more liberal working environments, and ensure training in skills. The paper provides policies of internationalization that can empower SMEs to seek export opportunities and obtain global partners, as they also seek to know the principles guiding international trade. SMEs may minimize risks associated with reliance on domestic markets by diversifying markets, exploring new sources of income. Furthermore, it offers actionable recommendations for SME challenges from a public and private sector perspective, which differs from many theoretical studies. Aligned with Japan's context, the proposed solutions improving access to finance, promoting labor force growth, and encouraging technological innovation aim to address the challenges of fast, affordable, and locally sustainable SMEs.

5. CONCLUSION

The study proposes some practical strategies and interventions that can enable SMEs to overcome the challenges they face. SMEs are playing a crucial role in the economic development of Japan as they are contributing to over 50% of the nation's GDP and employing around 70% of the country's total workforce. SMEs in Japan are facing a range of challenges that are hindering their growth and sustainability. The key issues include limited access to financing, labor shortages exacerbated by an aging workforce, stagnant labor productivity, and a lack of successors for business continuity. Furthermore, the increasingly competitive global marketplace poses further pressure, as Japanese SMEs struggle to match the cost efficiency and service quality of foreign competitors. Some of the recommendations to support and promote the SMEs in Japan are shared below.

Firstly, there is a need to provide financial support to SMEs in Japan. This can be done by strengthening government-backed loan programs through institutions like Japan Finance Corporation to provide tax concessions for SMEs, especially those who are investing in digital transformation, green technologies, and overseas expansion. Secondly, for talent development and labor support, there is a need to partner with universities and technical schools to reskill workers in data analysis, Artificial intelligence, and global business. To reform the regulations to allow more flexible work arrangements for startups and small firms, and to streamline the visa processes for foreign labor and entrepreneurs. Thirdly, SMEs can utilize the platform of JETRO to identify potential overseas markets and to attend the trade fairs. SMEs should be provided with training to sell globally via online channels. Fourthly, the SME innovation clusters need to be expanded in rural areas to decentralize the business activities from Tokyo. Fifthly, the bureaucratic procedures need to be simplified to

facilitate companies in registration, licensing, and reporting. One-stop support centers need to be promoted so that consulting, legal advice, and business matching can be offered to SMEs in one location.

The study proposes some practical strategies and interventions that can enable SMEs to overcome the challenges they face. The recommendations provided in this study benefit companies, government bodies, and private organizations by improving the business environment for SMEs. Recognizing the growing importance of technology, the study explores how digital tools and innovation can provide SMEs with a competitive advantage. It also examines how these businesses can effectively adapt to the evolving business landscape, ensuring their continued growth and sustainability in a rapidly changing market. In addition, it attempts to provide a holistic view of the challenges that SMEs face in Japan, mainly focusing on five areas. The causes were financial constraints, labor shortages, technological adaptation, global competition, and regulatory burdens. The study tries to highlight the most difficult problems to SMEs' growth in Japan according to current academic research and industry reports. It also talks about how these

challenges make the SMEs in Japan venture into operational efficiency, competitiveness, and viability for long periods.

Despite the valuable contribution and novelty of this study, there are some limitations where the study relied on a holistic approach, which provided a broad understanding of SME challenges; however, it limited the depth of analysis within individual domains, such as financial constraints or digital transformation. In addition, the reliance on secondary data and literature limited the ability to validate findings through direct fieldwork or empirical testing. Due to time and resource constraints, the scope of the study was restricted to select further regions to give a sufficient situation of SME contexts within other countries and conduct comparison studies that future studies can cover. The qualitative nature of the research may have introduced subjective interpretations, particularly in the thematic categorization of challenges; therefore quantitative approach, besides a qualitative by using secondary data, is essential for future research. Moreover, longitudinal studies are recommended to explore how SME challenges evolve over time, especially in response to policy changes or economic disruptions.

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