

# Emergence of Regional Entrepreneurship through Hometown Tax Donation

— Unique Regional Development System:  
Implications from Development of New Products and  
Improvement in Business Capabilities by Gift Providers—

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## Abstract

Hometown Tax Donation is designed to bolster regional economies through the provision of reciprocal gifts by local businesses, and can be regarded as a unique SME policy which is not reliant on subsidies, but instead, offers businesses the incentive to develop attractive products and yields better results when businesses and municipalities collaborate closely. To assess its effectiveness, we surveyed certain gift providers on their efforts in new product development and advancement in business capabilities.

Results showed that the gift market is sowing the seeds for development of new products and businesses in rural areas, and is also boosting business capabilities in many cases. Meanwhile, certain companies have earned large revenues from gifts or are overdependent on gifts. It is therefore necessary to make Hometown Tax Donation function as a viable SME policy which incorporates an exit strategy.

Key words : Regional Entrepreneurship, Hometown Tax Donation, Regional Development, New Business Development, New Product Development

## 1. Introduction

### 1.1 Unicorn or Regional Entrepreneurship?

This study explores the possibility of revitalizing the Japanese economy through regional entrepreneurship. Discussions on entrepreneurship policies tend to emphasize fostering startups represented by “unicorns” which possess the potential for global expansion and a corporate value of over 1 billion dollars. However, nurturing such unicorns is challenging. A report by the Development Bank of Japan (2017) outlines issues in fostering startups in Japan, arguing that hardly any unicorns exist in Japan against a backdrop of Japan lagging far behind the U.S. in areas including startup rate of companies that VCs can invest in, the amount/number of VC investments, the number of IPOs, and the number of M&As targeting startup companies. The report also notes such issues as absence of technoparks like Silicon Valley, lack of entrepreneurship education, and insufficient social recognition of entrepreneurs, and suggests that it is necessary to create an ecosystem that resolves each of these issues.<sup>3</sup> Such issues have been acknowledged by and shared among the government and various other institutions. However, a valid solution is yet to be identified.

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<sup>3</sup> Even with an ecosystem in place, producing unicorns in Japan would still be difficult due to disadvantage in English skills. In the U.S., FAANG (i.e., Facebook, Apple, Amazon, Netflix and Google)—often regarded as the original unicorns—receive a lot of attention. These companies provide services in which language (English) plays a critical role; i.e., search engines, media (e.g., SNS) and online shopping. Moreover, the world's top 10 universities include six in the U.S., three in the U.K., and one in Swiss (according to *Times Higher Education*, a British magazine specialized in higher education). Japanese companies which mainly only use Japanese have a disadvantage in recruiting talents from such globally renowned universities.

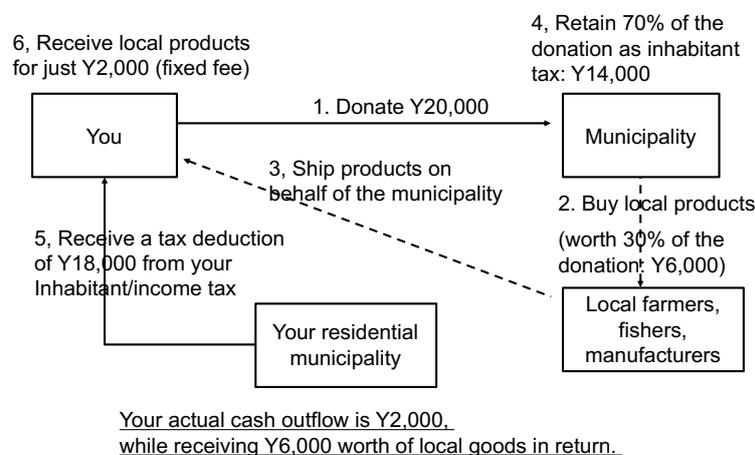
So instead, this study focuses on the development of entrepreneurship by local businesses. We explore the possibility of raising Japan's GDP through improving productivity, profitability and growth potential, albeit by small margins, in large numbers of companies not planning to go public (particularly in rural areas). Just as an ecosystem is required to nurture startups aiming to go public, an ecosystem is also necessary to support business expansion/growth or entrepreneurship by rural SMEs and startups. Equally important is entrepreneurship within existing companies—e.g., in-company new product and business development—since the hurdle is high for starting up companies from scratch in rural areas facing population decline. In short, when discussing entrepreneurship in rural areas, one should not only focus on new startup companies, but also on new initiatives within existing companies.

Previous SME policies mostly revolved around subsidies, and have not gone as far as to generate an ecosystem. Meanwhile, Hometown Tax Donation, initiated in 2008, has produced cases where inter-regional competition has intensified, or rural companies were urged to improve their business through providing reciprocal gifts. If similar cases can unfold on a nation scale, Hometown Tax Donation may serve as the much-needed ecosystem for facilitating regional entrepreneurship in Japan. To validate this prospect, we surveyed businesses providing gifts in return for Hometown Tax Donations.

### 1.2 Can Hometown Tax Donation Become an Ecosystem for Fostering Regional Entrepreneurship?

Hometown Tax Donation allows individuals to make donations to a municipality or municipalities of their choice rather than paying that amount as tax to where they reside. The amount donated, aside from 2,000 yen, is subject to deduction of inhabitant tax and refund of income tax, effectively costing the donor only 2,000 yen. Furthermore, municipalities that receive donations generally give reciprocal gifts to donors. While expensive gifts attracted attention at one point, the Minister for the Ministry of Internal Affairs and Communications (MIC) released a notice in April 2017 stating that the value of gifts should be kept below 30% of the amount donated. Thus, more recently, gifts are mostly worth 30%, more or less. To be more specific, if an individual donates 20,000 yen to a municipality, he or she receives a cash back of 18,000 yen through tax deductions or refunds, while also receiving 6,000 yen (i.e., 30% of 20,000 yen) worth of gifts, effectively benefiting from 4,000 yen worth of goods. Meanwhile, the municipality where the individual resides will suffer a loss from a decrease in inhabitant tax revenue.<sup>4</sup>

Figure 1 Overview of Hometown Tax Donation

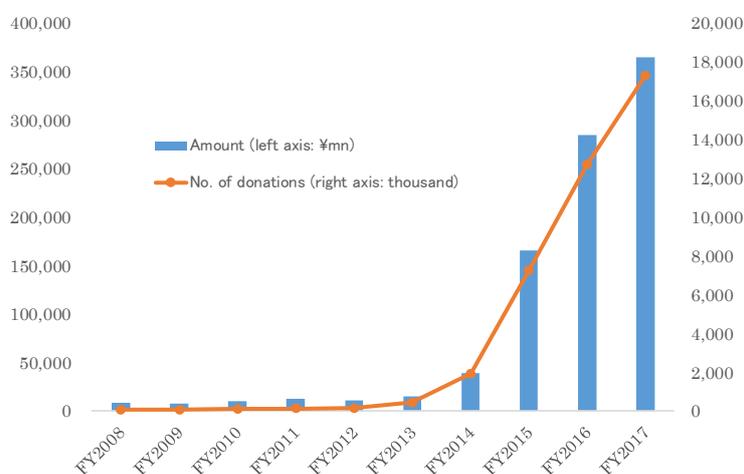


<sup>4</sup> An overview of Hometown Tax Donation is presented on MIC's website.

As such, although Hometown Tax Donation is defined as a donation, it can be interpreted as transfer of individuals' inhabitant tax to another municipality. Moreover, individuals' decisions of where to donate to is impacted by the attractiveness of gifts offered. Admittedly, the attractiveness of gifts is not the sole criteria—government cloud funding has also been gaining ground, where municipalities seek to win empathy from donors by allowing them to specify the usage of donations—nonetheless, gifts significantly impact donors' selections.

MIC announced that the total amount of inhabitant tax deducted through Hometown Tax Donation (for tax paid in 2018) was 244.7 billion yen. Accordingly, the same amount of inhabitant tax was transferred to other municipalities. Likewise, in the fiscal year ended March 2018, the number of donations accepted by municipalities was 17.3 million, and the amount accepted was 365.3 billion yen. Of this amount, expenses for procuring gifts totalled 140.6 billion yen.<sup>5</sup> This can be interpreted as the total revenues from reciprocal gifts earned by all gift providers in Japan.

Figure 2 Trend in Market Size of Hometown Tax Donation



Source: Ministry of Internal Affairs and Communication

There are various arguments for and against the current state of Hometown Tax Donation. Some are critical, asserting that it distorts the fundamentals of inhabitant tax, or that gifts can be regarded as purchase by municipalities using public money, or that contrary to the system's objective, the municipalities violating the Minister for MIC's notice are the ones collecting large amounts of donations.<sup>6</sup> Meanwhile, those in support of the system state that the gift market is buoying rural economies, inspiring local businesses to be creative, and nurturing companies through raising their business capabilities.

This study sets aside discussions about the system's pros and cons or proposals for improvement, but rather, through surveys to gift providers, intends to clarify whether the system contributes to improving

<sup>5</sup> The average ratio of value of gifts to amount donated (gift-to-donation ratio) is 38.5%. The reason why the current level exceeds 30%—the upper limit stated in the notice by the Minister for MIC—is because some municipalities are taking time to make adjustments or intentionally ignoring the notice and maintaining high gift-to-donation ratios. In a document released on July 6, 2018, MIC listed 12 municipalities that were expected to continue violating the notice beyond September 2018.

<sup>6</sup> Though the Minister for MIC called for municipalities to refrain from setting high gift-to-donation ratios and providing expensive gifts, this notice is unenforceable. Certain municipalities therefore violate the rule, and some believe that this distorts fair competition.

rural companies' business capabilities or is effective in nurturing them. If the effects suggested by proponents are not identified, Hometown Tax Donation may simply be considered purchase of goods using tax—i.e., short-term “pork barrelling”—and not much different from conventional subsidy-dependent policies. On the contrary, the system would have profound significance if it serves as a *dojo* (i.e., training/learning platform, originally for martial arts) for rural businesses and may be appraised as an ecosystem for developing regional entrepreneurship. Section 2 summarizes the current state of SME policies and Hometown Tax Donation; Section 3, explains the method of the survey to businesses in major municipalities around Japan; Section 4 describes analysis results; and Section 5 outlines conclusions and implications.

## **2. SME Policies and Hometown Tax Donation**

### **2.1 Landscape and Prior Studies of Regional SME Policies**

The basic vector of Japan's SME policy was determined in the “Small and Medium-sized Enterprise Basic Act” enacted in 1963. Initially, the act assumed a dual structure—large enterprises vs. SMEs—and its basic philosophy was to reduce the disparity between the two. The act was revised in 1999, and its basic philosophy shifted drastically from protecting SMEs to supporting them, re-interpreting SMEs as sources of economic vitality. In addition, the “Basic Act for the Activation of Small-sized Businesses” was enacted in 2014, acknowledging the need for protective measures targeting small-sized businesses. More recently, the government set a goal to raise the number of profitable SMEs and small-sized businesses from 0.7 to 1.4 million by 2020 as part of the “Japan is Back - 2016” strategy.

Against this backdrop, Eshima (2006) points out that Japan's public support policies for SMEs can be characterized as largely subsidy-oriented and lack support in such areas as strategic management expertise. Similarly, Natori (2017) states that most supportive policies for new business development by SMEs established by municipalities simply offer subsidies for technology development, and that it is more important to provide SMEs with knowledge that they lack, including on market information and quality management.

Meanwhile, Kurose (2006) notes the prospects of locally driven SME policies directed by municipalities through shifting ownership from the central government to each region. Honda (2016) mentions that the goals of SME policies established by municipalities incorporate aspects of both regional economy and regional society, and argues that while prior studies have focused largely on the former, the latter is also important, revealing that SMEs are also highly motivated to contribute to regional society. This aspect is probably not considered in fostering “unicorns.”

On another front, a study by Inoue (2016) which researched the excavation of customer and sales channels at the time of and after starting up a company, argues that capital support is necessary to acquire new customer bases, and that new customer bases cannot be excavated through existing networks. With regards to acquiring customers, business matchmaking events used to be important (e.g., Ito *et al.* 2002); however, with the wide-spread use of the Internet and smartphones, it has become critical to acquire customers directly on the Internet, particularly for B2C companies.

### **2.2 Prospect of Hometown Tax Donation as an SME Policy**

Various policies supporting SMEs and startups have been adopted and implemented thus far. The major difference between such policies and Hometown Tax Donation, is that the latter provides a market in advance where products can be sold. Many conventional SME and startup policies support business launches or fund procurement, yet, companies need to secure their own customers. Contrarily, Hometown Tax Donation is completely different from such policies in that it provides a market and

potential customers. Furthermore, municipalities support order processing, customer service, PR and advertising among other operations. Admittedly, gifts were not initially intended to be the pillar of Hometown Tax Donation, so it may be misleading to regard gifts as a given and call the system a supportive policy for SMEs and startups, but in reality, that is what it has become.

In our interviews with gift providers, not a few companies responded that the reason they were motivated to enter the gift market was “because a market was provided in advance.” Their approach is to sell their products as a trial, and for those without anything to sell, to develop new products as a trial. For example, Nahari Town, Kochi Prefecture collected 3.9 billion yen and came in ninth place nationwide in donations procured in the fiscal year ended March 2018. The town’s population is less than 3,500. Naturally, the town had close to no local industries or specialties, and for the few specialties that they did produce, they only produced enough to cover intra-regional consumption. Municipal officials encouraged various local businesses to develop new products, and started providing those products as reciprocal gifts. Businesses such as local *izakaya* with no experience in online sales suddenly began providing gifts, and initially received many complaints on packaging and product qualities from those receiving the gifts. They responded with numerous improvements in product packaging and shipping. The town also built a processing facility for farm food and another for seafood, as well as a shipping scheme. Such processing facilities created new jobs. If revenues of such processing facilities rely excessively on gifts, they will be deemed system-dependent and not self-sustainable, making Hometown Tax Donation no different from conventional subsidy-centered policies. However, the farm food processing facility is also posting robust in-store revenues from the shop and dining area on the same property, and receiving visitors from afar.

In another case, a local-born *patissier* working in Kochi City returned to Nahari Town and started a confectionery shop. This is also claimed to have been driven by the gift market. While approximately half of the company’s revenues derives from reciprocal gifts, the other half derives from in-store sales. Customers visit from dozens of kilometers away. While no one believed there was demand for a stylish confectionery shop in a town of only 3,500 residents, that was not true. Such demands were merely hidden since no supply existed, and once the shop opened, it attracted customers even from afar. Rural areas facing population decline will continue to contract as long as their businesses are bound to existing markets. However, if they extend their market to the entire country using the Internet, their business footprint will broaden exponentially, and businesses that cannot thrive solely through intra-regional sales will also be able to survive.

As such, Hometown Tax Donation is unique and differs significantly from other policies in that it created the gift market for rural businesses, and that this is promoting creativity in rural areas. Moreover, the barrier to enter this market is relatively low, with no overwhelming competitors. Businesses entering the market are mostly those in rural areas that are not so large. Normally, barriers are high for entering any kind of market, and even if a rural SME is able to make an entry, there is not much room for them to succeed as they would have to compete against large private companies backed by massive capital. The aforementioned studies (Kurose 2006, Honda 2016, and Inoue 2016) acknowledged support from municipalities and excavation of new customers as prospective areas that require further commitment. These challenges were met, albeit unintentionally, through Hometown Tax Donation and its gift market.

### **2.3 Sustainability of Hometown Tax Donation**

An issue posed by Hometown Tax Donation is whether or not the gift market is sustainable. Although the gift market increases business opportunities for rural companies, gifts are essentially purchased by

local municipalities. The money is sourced from Hometown Tax Donations: in other words, inhabitant tax that was supposed to be paid to some other municipality (mostly in urban areas). Regarding this aspect, a separate analysis is necessary to compare the effectiveness of tax between when it is used by urban municipalities and by municipalities receiving donations. It should be noted that although Hometown Tax Donation is often regarded as transfer of inhabitant tax from urban municipalities to rural ones, in theory, urban municipalities can also receive Hometown Tax Donations. Also, considering that the maximum amount one can donate is 20% of one's inhabitant tax, a municipality's tax revenue will only be reduced by 20% even if all residents were to donate the maximum amount. Put another way, tax revenues will not decrease by over 20%. As discussed in Hoda and Yasui (2017), the model envisioned by Hometown Tax Donation is one where each municipality is ensured 80% of their current inhabitant tax, while they chip in the remaining 20% to a collective tax pool, and compete to win a slice of that pie. If all tax payers donate the maximum amount, 20% of the total inhabitant tax will be pooled. This means that the maximum market size of Hometown Tax Donation is some 2.4 trillion yen, and that municipalities will compete against each other to obtain their share within that amount. In other words, up to 2.4 trillion yen in tax revenue will become liquid. This is consistent with one of Hometown Tax Donation's vision to promote competition among municipalities. Thus, from the time it was introduced, the system was expected to cause a certain amount of shift in tax revenue from urban to rural areas. Yet, the gift market was presumably not expected to gain so much momentum at that time. Therefore, a revision of some kind may be required if the gift market is accelerating the shift of capital from urban to rural areas beyond necessity.<sup>7</sup> Nonetheless, the gift market will most likely be maintained in some form or another as long as the system itself or the provision of gifts is not banned.<sup>8</sup>

Provision of gifts may also be regarded as similar to subsidies since products are purchased from certain companies with tax. However, it differs from typical subsidies in that the money is only directed toward companies producing products that meet consumers' demands. In other words, the market (i.e., consumers) is essentially making assessments in place of subsidy screening, providing companies the incentive to develop and provide products that meet market needs. Traditionally, companies that excelled in creating convincing applications may have obtained subsidies; whereas, gift providers must win the competition against similar gift providers from around Japan for their products to be selected, and thereby need to raise their product competitiveness. In short, Hometown Tax Donation differs from subsidies as it naturally prompts creativity and competitiveness among businesses.

## 2.4 Improvement in Business Capabilities through the Gift Market

Hoda (2017) states that local companies may improve their business capabilities through the gift business, and classifies such improvements into three: the first is changes in packaging or unit of sales; the second is shifts in distribution channels or business categories; and the third is development of new products and businesses or launch of a startup. Hoda also introduces cases where local businesses increased employment or improved business capabilities.<sup>9</sup> The study also reports that many of the gift providers had no experience in online sales. Hoda and Kubo (2018) surveyed regional financial

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<sup>7</sup> In April 2017, the Minister for MIC released a notice calling for municipalities to keep the value of gifts to 30% or less of the amount donated and refrain from providing expensive or highly cashable products. In April 2018, the Minister also called for sensible judgement in sending non-local gifts.

<sup>8</sup> A revision of the law will be necessary to ban Hometown Tax Donation. Yet, considering that most lawmakers are elected from rural areas, there probably will not be much incentive to abolish the system on their part.

<sup>9</sup> The study introduces cases including product design improvement in Hirado City, Nagasaki Prefecture, a shift from B2B to B2C in Kitakami City, Iwate Prefecture, a shift from the primary sector to the secondary and tertiary industries in Shibushi City, Kagoshima Prefecture, and new product development in Osaki Town, Kagoshima Prefecture.

institutions on their thoughts on Hometown Tax Donation, and reported that respondents acknowledged that the system raises gift providers' motivation for new product development as well as their product design capabilities. However, no study directly targeting gift providers has been conducted to validate the effects of Hometown Tax Donation. Hometown Tax Donation can be appraised as an effective SME policy only if local businesses benefiting from the system improve their business capabilities and fortify their foundation. Thus, the next section reveals whether such improvements are actually taking place.

### 3. Analytical Research Method

#### 3.1 Purpose and Background of Survey

We conducted a survey targeting businesses in selected municipalities to verify the extent to which business capabilities of gift providers improved through Hometown Tax Donation. The survey is intended to validate whether such cases reported by Hoda (2017) can be generalized, thereby exploring the system's significance.

#### 3.2 Research Method

Of the top 20 municipalities accepting the largest donations in the fiscal year ended March 2017, we excluded Kumamoto City which received large donations for earthquake disaster relief efforts, and asked the remaining 19 municipalities for their cooperation with our survey. Among the 19 municipalities, 15 cooperated (hereinafter referred to as "top regions"). In addition, to grasp the situation of other municipalities, we randomly selected 10 other municipalities (hereinafter referred to as "randomly selected regions") and conducted a similar survey.<sup>10</sup> We sent a set of surveys to each municipality by postal mail, and asked the municipalities to forward the surveys to all gift providers in their region. We requested that each company directly send their responses to us by postal mail.<sup>11</sup> The surveys were sent to a total of 1,073 companies (in 25 municipalities). Among those, we received responses from a total of 310 companies, consisting of 163 from 15 top regions, and 147 from 10 randomly selected regions. Questions included those on basic corporate information such as revenues and number of employees, the current state of gift provision, changes in business management or improvement in business capabilities driven by Hometown Tax Donation, alliances with municipalities, and thoughts on the Hometown Tax Donation system. Results were analyzed using simple tabulation, cross tabulation and t-test. We classified the municipalities into top regions and randomly selected

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<sup>10</sup> The top regions include the following 15 municipalities: Miyakonojo City, Miyazaki Prefecture (1), Tsuno Town, Miyazaki Prefecture (4), Kamimine Town, Saga Prefecture (5), Yonezawa City, Yamagata Prefecture (7), Izumisano City, Osaka Prefecture (8), Tendo City, Yamagata Prefecture (9), Nemuro City, Hokkaido Prefecture (10), Katsuura City, Chiba Prefecture (11), Kotani Village, Nagano Prefecture (12), Bizen City, Okayama Prefecture (13), Sasebo City, Nagasaki Prefecture (15), Sagae City, Yamagata Prefecture (17), Shibushi City, Kagoshima Prefecture (18), Kamishiro Town, Hokkaido Prefecture (19), and Nahari Town, Kochi Prefecture (20). The randomly selected regions include the following 10 municipalities: Osaki Town, Kagoshima Prefecture (27), Hirado City, Nagasaki Prefecture (29), Suzaki City, Kochi Prefecture (55), Shiranuka Town, Hokkaido Prefecture (62), Fujiyoshida City, Yamanashi Prefecture (67), Hekinan City, Aichi Prefecture (102), Fukaya City, Saitama Prefecture (214), Sumida-ku, Tokyo (264), Tamaki Town, Mie Prefecture (495), and Sakai City, Fukui Prefecture (1,367). The number in parentheses indicates the national rank for amount of donations procured through Hometown Tax Donation in the fiscal year ended March 2016. Nakanajo Town, Gunma Prefecture also cooperated; however, their gifts consisted mainly of gift cards/coupons and should be treated differently from typical gifts. The town was therefore excluded from this analysis to be reserved for future analysis.

<sup>11</sup> Each municipality has a list of contacts for each business, but cannot publicize this information in some cases. Hence, we could not obtain the contacts of all gift providers. We therefore asked the municipalities to forward the surveys to the local businesses. As such, response rates for each municipality may be affected by the intimacy between each municipality and local businesses.

regions, and compared the impact and changes caused by Hometown Tax Donation.<sup>12</sup>

## 4. Analytical Research Results

### 4.1 Basic Attributes of Respondents

First, we explain the basic attributes of the businesses that responded to our survey (Table 1). The median annual revenue of gift providers was 0.1 billion yen in top regions and 58 million yen in randomly selected regions. The number of employees was 6 to 8, and online sales ratio was less than 10% in both groups. In other words, respondents were mostly typical rural small-sized businesses. It should be noted that no significant difference was detected in annual revenues between the top and randomly selected regions.

Table 1 Basic Attributes of Gift Providers

	Average		Median		SD	
	Top regions	Randomly selected regions	Top regions	Randomly selected regions	Top regions	Randomly selected regions
Revenues (¥mn)	503.3	832.8	100.0	58.0	1135.8	3,146.8
Extra-regional sales ratio (%)	44.5%	39.8%	50.0%	30.0%	34.5%	33.9%
Online sales ratio (%)	14.8%	12.0%	9.0%	5.0% *	22.3%	21.3%
B2B sales ratio (%)	44.4%	49.1%	40.0%	50.0%	36.3%	38.8%
No. of employees (ppl)	18.5	27.3 *	8.0	6.5	25.2	64.6
Female employment ratio (%)	50.65%	46.4%	50.0%	50.0%	27.0%	31.2%

Note: Categories marked with “\*” are those with a significance level of 5% between the top and randomly selected regions. The number of respondents was n=163 for top regions and n=147 for randomly selected regions.

Looking at the distribution of revenues, companies with annual revenues of 30 million yen or less accounted for nearly 30% in top regions and nearly 40% in randomly selected regions. Meanwhile, companies with revenues exceeding 0.5 billion yen accounted for some 20% in both regions. The impact that gifts have on total revenues may be larger for small-sized businesses; however larger companies should have the advantage in product and business competitiveness or production capacity in providing gifts.

Ratio of sales from outside the prefecture (extra-regional sales ratio) was 50.0% in top regions and 30% in randomly selected regions. However, looking more closely, both top and randomly selected regions could be divided into a group of companies with high extra-regional sales ratios and a group with low ratios. This suggests that the gift market reinforced extra-regional sales for companies that

<sup>12</sup> To accurately compare the top regions with other regions, it would be ideal to extract municipalities with attributes similar to the top regions as matching samples, and to group and analyze them as “random regions.” However, since it is difficult to elicit cooperation for this kind of survey, we regarded the group of municipalities that cooperated with our survey and were not among the top regions, as randomly selected regions. As such, the comparison between the top regions and the randomly selected regions should be treated as reference information. Nonetheless, donations procured by the top 20 regions account for one fourth of the total amount donated, suggesting that the top regions may be unique. We therefore believe it is important to verify the situation of other regions and compare them with the top regions, even if it is not a proper comparison based on sample matching. A significant difference was detected between the average number of employees between the top and randomly selected regions (21.4 for top regions vs. 47.4 for randomly selected regions), so we excluded four businesses with 500 or more employees from the randomly selected regions, and conducted an analysis without the significant difference. However, results were not much different, so we included all samples in this report.

were originally strong in this area, while offering companies that originally had low extra-regional sales ratios an opportunity to enter extra-regional markets.

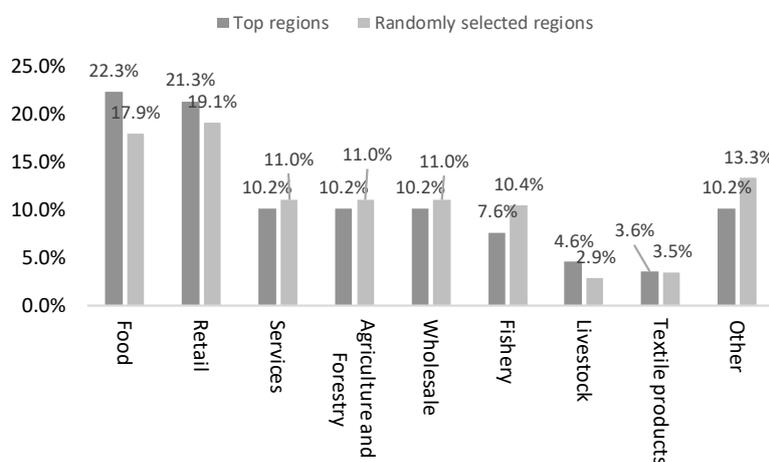
Online sales ratio was less than 20% for about 80% of the companies in both top and randomly selected regions, meaning that many companies without much experience in online sales entered the gift market. In other words, the gift market seems to be encouraging rural SMEs to try out/start online sales. It should be noted that the median for top regions was significantly higher than that for randomly selected regions. There is a possibility that top regions are either attracting donations because many companies are familiar with online sales, or that their online sales ratio increased owing to Hometown Tax Donation.

Next, looking at the ratio of B2B sales to total revenues (B2B sales ratio), the samples can again be divided into a group of companies with high ratios (chiefly B2B) and low ratios (chiefly B2C). Companies with a B2B sales ratio of over 80% accounted for over 30% in top regions and nearly 40% in randomly selected regions. These companies are mostly likely leveraging the gift market to enter into the B2C realm. Rural businesses tend to rely on low-margin wholesale since it is difficult for them to directly approach urban customers, but they may be utilizing the gift market as a solution to this issue.

Small-sized businesses with five or less employees accounted for some 40% in both top and randomly selected regions. Most of these companies are presumably family-run businesses. Considering this together with aforementioned revenue levels, Hometown Tax Donation can be considered a policy addressing rural micro enterprises. Such small-sized businesses may not sufficiently be able to handle the gift business even if they wanted to. For such businesses to be competitive in the gift market, they need to collaborate with other local businesses for order processing and back office operations, with the back up of municipalities or local trading companies. In reverse, businesses in municipalities that offer such intra-regional support may already have a strong competitive edge in the gift market. It is worth noting that companies with over 50 employees accounted for merely 10%. Since MIC suggests that gifts should be local specialties, one can assume that relatively large companies that produce and sell national brand products are excluded from the gift market.

The female employment ratio was 50.0% (median) for both top and randomly selected regions. However, this ratio rises when excluding industries/companies that are unfit for female employment, where the ratio is 0%. This suggests that gift providers are providing job opportunities for women in the region. The industry classification of gift providers is shown in Table 3, and is relatively balanced.

Figure 3 Industry Classification of Gift Providers



Note: Some companies operate in more than one industry.

## 4.2 Shipment Quantity and Revenues of Gifts

Gift revenues were 1.9 million yen in top regions and 1.2 million yen in randomly selected regions (median of 2017 for each company). Businesses with gift revenue of less than 5 million yen accounted for 64.0% in top regions and 76.6% in randomly selected regions (Table 2). So, as a whole, gift revenue is not so large within each company. However, gift revenue exceeded 0.1 billion yen in 6.6% of the companies in top regions and 1.6% in randomly selected regions.

Table 2 Shipment Value of Gifts (per business/annual)

(¥mn)	2016				2017			
	Top regions		Randomly selected regions		Top regions		Randomly selected regions	
	No.	%	No.	%	No.	%	No.	%
0-1	33	29.2%	39	39.8%	45	33.1%	59	47.6%
1-5	32	28.3%	32	32.7%	42	30.9%	36	29.0%
5-10	7	6.2%	5	5.1%	11	8.1%	6	4.8%
10-30	19	16.8%	15	15.3%	15	11.0%	13	10.5%
30-50	7	6.2%	2	2.0%	8	5.9%	4	3.2%
50-100	4	3.5%	3	3.1%	6	4.4%	4	3.2%
100-	11	9.7%	2	2.0%	9	6.6%	2	1.6%
Total	113	100.0%	98	100.0%	136	100.0%	124	100.0%
Not answered	50		49		27		23	
Average shipment value		¥43.6mn		¥10.7mn		¥26.1mn		¥12.8mn
Median shipment value		¥3.6mn		¥1.6mn		¥1.9mn		¥1.2mn
SD of shipment value		¥137.0mn		¥29.8mn		¥79.8mn		¥65.8mn

There may be several ways to interpret this situation where only a handful of businesses are earning massive gift revenue. One might argue that the larger the size of a company, the more apt they are at handling gifts; hence the more they would benefit from the system, spreading the disparity between local businesses further. This would cause a dilemma where the system intended to support local SMEs is, in reality, benefiting relatively larger local companies. On the other hand, the presence of an established local company may lead to better recognition of the region and in turn, also benefit smaller businesses. Since Hometown Tax Donation is a system where individuals donate to municipalities, it is particularly important for regions to have high profiles and strong PR capabilities. The presence of a renowned business in the region is important in procuring donations, and wider recognition of the municipality should benefit other businesses as well. Therefore, it would be naive to simply criticize the fact that certain businesses are making large profits.

Next, looking at the unit price of gifts (Table 3), in both top and randomly selected regions, gifts worth less than 5,000 yen have the highest ratio, and gifts worth less than 10,000 yen accounted for 80% or more. This shows that the majority of businesses and municipalities do not provide expensive gifts, and are acting reasonably.<sup>13</sup>

<sup>13</sup> Some municipalities and businesses continue to provide expensive gifts even after the Minister for MIC released a notice in April 2017 warning municipalities to refrain from doing so. The data in Table 2 shows that such businesses are the minority; however, precisely because of this, they attract concentrated donations from consumers seeking expensive gifts, and thus, revenues of such businesses and donations to such municipalities tend to increase. Municipalities and businesses are both inclined to offer expensive gifts as a quick and easy solution to gain higher financial merits. In July 2018, MIC released a list of municipalities that have continued to ignore the Minister's notice. However, this instead served as effective advertising on the part of such municipalities, and even more donations were collected. To justly sustain the system, it will be necessary to impose some form of control on such violations.

Table 3 Unit Price of Gifts

(¥thousand)	2016				2017			
	Top regions		Randomly selected regions		Top regions		Randomly selected regions	
	No.	Accumulated%	No.	Accumulated%	No.	Accumulated%	No.	Accumulated%
1-5	55	52.4%	60	63.8%	61	48.4%	78	66.1%
6-10	32	82.9%	17	81.9%	44	83.3%	23	85.6%
11-50	14	96.2%	14	96.8%	16	96.0%	13	96.6%
51-100	2	98.1%	1	97.9%	3	98.4%	2	98.3%
101-	2	100.0%	2	100.0%	2	100.0%	2	100.0%
Total	105		94		126		118	
Not answered	58		53		37		29	
Average gift unit price	¥9.7 thousand		¥12.2 thousand		¥10.4 thousand		¥9.5 thousand	
Median gift unit price	¥5.0 thousand		¥4.0 thousand		¥5.0 thousand		¥4.0 thousand	
SD of gift unit price	¥19.3 thousand		¥39.3 thousand		¥21.6 thousand		¥25.4 thousand	

Table 4 Ratio of Gift Revenue to Total Revenues

Ratio	2016				2017			
	Top regions		Randomly selected regions		Top regions		Randomly selected regions	
	No.	%	No.	%	No.	%	No.	%
0-9%	42	43.8%	44	50.6%	55	45.5%	57	53.8%
10-19%	14	14.6%	20	23.0%	22	18.2%	22	20.8%
20-29%	9	9.4%	10	11.5%	13	10.7%	11	10.4%
30-39%	10	10.4%	6	6.9%	11	9.1%	4	3.8%
40-49%	5	5.2%	0	0.0%	3	2.5%	1	0.9%
50%-	16	16.7%	7	8.0%	17	14.0%	11	10.4%
Total	96	100.0%	87	100.0%	121	100.0%	106	100.0%
Not answered	67		60		42		41	
Average revenue ratio	13.4%		13.5%		19.2%		14.1%	
Median revenue ratio	8.0%		8.0%		10.0%		8.0%	
SD of revenue ratio	18.5%		18.4%		23.3%		19.8%	

The ratio of gift revenue to total revenues per gift provider (Table 4) was 10.0% in top regions and 8.0% in randomly selected regions (median for 2017), suggesting that, as a whole, dependency on gifts is not so high. However, companies whose gift revenue exceeded 50% of total revenues was 14.0% in top regions and 10.4% in randomly selected regions (for 2017). Such companies require attention since they are highly dependent on Hometown Tax Donation and their financial results are susceptible to the system.

The three tables above imply that it is essential to establish a flexible policy that offers more support to businesses with low shipment value of gifts or with low ratio of gift revenue to total revenues, while offering less support to those with opposite traits. The policy should be designed to redirect businesses that are inclined to rely on the system, while giving guidance to those that are not fully leveraging the system.

#### 4.3 Changes in Businesses Triggered by the Gift Market

Next, we look at the changes experienced by businesses through the provision of gifts (Table 5). We examine the system's significance by clarifying through surveys the extent to which such cases as introduced by Hoda (2017) can be generalized. Firstly, approximately one out of three companies in both top and randomly selected regions developed new products or businesses. This number is extraordinarily large considering that most respondents are rural businesses and mainly SMEs. This implies that the gift market is sowing the seeds for entrepreneurship among some rural SMEs. Such developments should have a large impact on rural economies and companies where stagnation is a

serious issue. In our interviews with businesses, some mentioned that they face a dilemma when engaging in intra-regional innovation, since they are not motivated to develop new products for the local market, and even if they did develop products, it would push down revenues of existing products. Interviewees also mentioned that even if they did possess the skills to produce high-quality products, there is no demand for such products locally, so products are not commoditized. However, with the emergence of the gift market which mainly consists of urban consumers, the momentum to develop new products has risen.<sup>14</sup> In addition, many businesses attempted to adapt to the national market by upgrading their products so as to endure long-distance shipping, for example, through extending shelf-life or enabling storage in ambient temperatures. This would set the foundation for further business expansion, since once such products are developed, businesses can open a shop in online shopping malls or start proprietary online sales.

Table 5 Changes Caused by Hometown Tax Donation

	Changes experienced	
	Top regions	Randomly selected regions
New products/businesses	37.4%	35.3%
Increase in employees	28.1%	13.8%
Increase in employees' income	25.5%	19.5%
Intra-regional sales expansion	25.3%	19.9%
Extra-regional sales expansion	22.3%	16.7%
Extra-regional bases (e.g., establish office)	2.7%	4.0%
Improved productivity	29.5%	24.8%
6th industrialization	32.5%	23.9%
Online shopping mall, proprietary online shopping site	27.8%	16.8% *
Form of sales	8.3%	6.7%
Product unit	14.2%	12.6%
New product manual	32.6%	27.9%
Capital investment	20.1%	12.1% *
Additional/new loans	11.8%	3.0% **
Consulting financial institutions	5.6%	4.5%
Media coverage	36.2%	35.0%

Note: Categories marked with “\*” and “\*\*” are those with significance levels of 5% and 1% between the top and randomly selected regions.

As for the number of employees, nearly 30.0% of the companies in top regions and nearly 15% in randomly selected regions responded that they hired more, implying that the gift market is creating new employment. Also, one out of four companies in top regions and one out of five in randomly selected regions responded that they raised their employees' salaries. An increase in employment and income in rural areas should boost regional consumption, which in turn could raise regional gross production.<sup>15</sup>

Next, regarding intra-regional sales, one out of four companies in top regions and one out of five in randomly selected regions responded that they experienced an expansion. These are cases where once

<sup>14</sup> For example, *catalana*—a popular gift offered by Osaki Town, Kagoshima Prefecture—is a fancy confectionery with a high cost rate, made from local eggs and milk. *Catalana* was not developed previously since there was no local demand, but it was developed for the gift market based on expectations that there would be demand from urban consumers.

<sup>15</sup> Some caution is required in arguing that the increase in employment and salary is an "effect" of Hometown Tax Donation. Although gift revenue is earned through the effort of each company, such revenues are tied tightly to Hometown Tax Donation. Hence, the sustainability and stability of such increases should be considered with a grain of salt.

local specialties became popular in the gift market and earned high reputations from outside the region, locals realized or re-acknowledged the value of such specialties and requested that they also be sold locally. There is also a move to strategically market gifts that gained popularity as local specialties and to sell them on a mass scale to non-local travelers and visitors. As such, sales are expanding mainly in shipments to local *michi no eki* (i.e., roadside stations) and wholesalers.

Similarly, 22.3% of the companies in top regions and 16.7% in randomly selected regions have experienced an increase in extra-regional sales. These are cases where products gained recognition through Hometown Tax Donation, prompting businesses to enter into online sales or new sales channels. We also asked respondents to write down the regions where they acquired new sales. While the Kanto area came in first, foreign countries were also listed in three cases. While, excavating extra-regional sales channels is especially challenging for rural SMEs, Hometown Tax Donation helps raise product recognition, serving as a supportive policy. Also, intra-regional sales expansion represses consumption outflows and promotes intra-regional circulation of money. Meanwhile, extra-regional sales expansion causes capital inflow, which in turn raises regional GDP.

It should be noted that there were only a handful of companies that expanded their businesses to the extent of establishing new bases (e.g., sales branches or offices) in other regions (only 2.7% in top regions and 4.0% in randomly selected regions).

Regarding productivity, 29.5% of the companies in top regions and 24.8% in randomly selected regions experienced a rise. According to our interviews, some businesses could not find new local personnel to hire, and were forced to maintain their capacity while raising their productivity in order to handle the increase in sales and production. Also, since the size of each business is small, there are cases where one person plays more than one role to handle gift-related operations.

32.5% of the companies in top regions and 23.9% in randomly selected regions engaged in “sixth industrialization” (i.e., provision of value-added products and services through a vertical integration of primary, secondary and tertiary industries).<sup>16</sup> This includes cases where livestock and fishery businesses built their own processing facilities to manufacture and sell processed goods, or where farmers started manufacturing juice. A common issue in sixth industrialization is that businesses tend to be product-oriented, not market-oriented. However, one can instantly identify the kinds of products that are popular by browsing online gift portals. Based on such information, primary industry businesses can easily decide to start a processing business. Moreover, since the gift market covers sales operations, the hurdle for managing sales is lower than in a normal sixth industrialization. In this way, the gift market also triggers engagement in sixth industrialization.

To make Hometown Tax Donation function as an SME policy, the system should ideally serve as a *dojo* for nurturing local businesses so that they would not continue relying on the system. Below, we summarize some of the questions asked from this perspective. Firstly, 27.8% of the companies in top regions and 16.8% in randomly selected regions opened a shop in online shopping malls or launched their own online sales site owing to Hometown Tax Donation. For businesses in rural areas facing a declining population, market expansion through online sales is an important challenge. Yet, many are hesitant since the barrier is high for attempting entry on one’s own. However, results suggest that businesses are able to launch online sales by gaining know-how through the gift market. Results for the top region were significantly higher than for the randomly selected regions. One can assume that the more gift orders a business receives, the more know-how they can accumulate for starting online sales, but this is also most likely the result of such businesses gaining confidence in their products. When

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<sup>16</sup> We asked this question only to agriculture, forestry, and fishery businesses.

grouping the companies in top regions by companies whose B2B revenue is 50% or more and those with less than 50%, the latter (i.e., those with higher B2C sales ratio) showed a higher number (significance level of 5%). This suggests that Hometown Tax Donation is promoting the launch of online sales especially by rural B2C companies.

Next, a common issue of rural businesses is their low profitability due to their wholesale business style. Once such businesses establish their own brand or secure their own customers, they can lower the weight of non-profitable wholesale and aim for higher corporate profitability. For example, Hoda (2017) introduces a case in which a clothing manufacturer whose main business was originally OEM, established its own brand triggered by Hometown Tax Donation, and is now in the process of shifting from B2B to B2C. However, this survey revealed that such cases are rare. Changes in form of sales represented by shifts from wholesale to retail were only seen in 8.3% of the companies in top regions and 6.7% in randomly selected regions.

In terms of thorough customer service, more than 10% of the companies in both top and randomly selected regions changed or added their stock keeping unit (reduced in most cases), and some 30% created new product manuals.<sup>17</sup> This shows that companies are raising awareness toward sales and customer service.

More than one out of three companies in both top and randomly selected regions received media coverage. This means Hometown Tax Donation is contributing to regional promotion—a key challenge for rural municipalities and companies. As mentioned above, many of the respondents are small-sized businesses. Such businesses with insufficient PR capabilities can benefit largely from Hometown Tax Donation as it enables their products to be advertised on a national scale. Media coverage also has positive side effects including a rise in employees' motivation. Moreover, media coverage can contribute to increasing the number of people connected to or involved in the region, as well as migrants—a major political challenge for many rural areas facing population.

#### **4.4 Impact on Regional Investment and Lending**

Forward-looking investments are essential in raising corporate value. However, making investments is difficult for companies with uncertain business outlooks. This is especially true in rural areas facing population decline. Under such circumstances, corporate values and regional economy tend to contract further. However, if companies foresee business opportunities in the Hometown Tax Donation gift market, they may be motivated to make long-term investments. Businesses that earned higher profits through the gift market would ideally invest such surplus capital in future growth and also gain competitiveness in areas other than gifts. The survey results revealed that 20.1% of the companies in top regions and 12.1% in randomly selected regions made additional or new capital investments. The amount of capital investment made by those that responded totalled some 150 million yen, covering 25 regions. Two out of three among such respondents did not use subsidies for their investments, but instead, were fully self-financed. The contents of investments range from purchase of large refrigerators/freezers to purchase of various processing equipment, construction of new shops, expansion of offices, and purchase of office automation equipment.

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<sup>17</sup> In the top regions, comparing the group of companies with B2B sales accounting for less than 50% with the group of other companies, the former (i.e., the group with higher B2C sales ratios) had a significantly higher ratio for creating new product manuals (significance level of 5%). This suggests that there was a larger impact on B2C companies in terms of customer service improvement.

Recently, regional financial institutions' lending amount and loan-to-deposit ratio have been declining. This is due to a slowdown in companies' demand for capital. Against this backdrop, it is remarkable that Hometown Tax Donation is encouraging capital investment, and that such investment is self-funded rather than subsidy-dependent in many cases.

Related to this, 11.8% of companies in top regions and 3.0% in randomly selected regions have received additional or new loans from financial institutions triggered by gift provision. Also, 5.6% in top regions and 4.5% in randomly selected regions have consulted financial institutions on business matters other than loans. When considering the various aforementioned changes undergone by and capital investments made by businesses, the extent of new/additional loans and involvement by financial institutions seems to be somewhat weak. This is consistent with the report by Hoda and Kubo (2018) which researched the current state of lending by regional financial institutions triggered by Hometown Tax Donation. Going forward, further involvement by regional financial institutions will be critical for the system to function more effectively as an SME policy. Of the businesses that received new or additional loans, 77.3% responded that they also made capital investments.

There was a significant difference in investment and lending between the top and randomly selected regions. Such results were expected, since top regions are earning larger profits from gifts, and in order to meet additional demands, are required to make investments or receive loans. This poses an issue where regions with active investments and lending will gain further competitiveness, widening the disparity between such regions and regions that are not yet active in Hometown Tax Donation. Similar to typical online sales, the gift market embraces an aspect of "winner takes all." Therefore, policy makers in regions not ranked in the top regions should acknowledge that the top regions are pressing harder on the accelerator, and that they need to catch up at an early stage.

#### **4.5 Improvement in Business Capabilities**

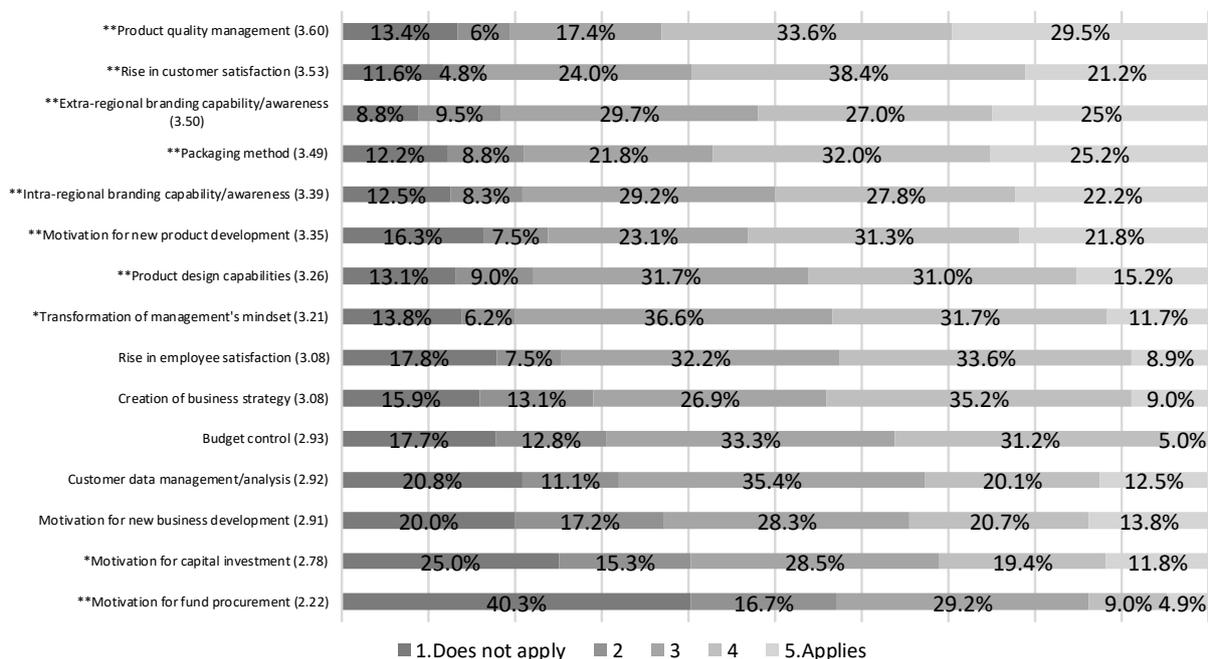
Figure 4 shows results of whether businesses experienced change in various categories in business capabilities/capacities as a result of providing gifts.

This shows that significant, positive effects were felt in product quality management, customer satisfaction, intra-regional and extra-regional brand awareness and recognition, packaging, motivation for new product development, product design capabilities, and transformation in management's mindsets. With regards to extra-regional brand awareness and recognition, companies were able to reach a customer base which they previously did not have access to through online gift portals, and as aforementioned, one out of three companies received media coverage. In addition, businesses can benefit from extensive PR and promotions that would not be possible otherwise, since municipalities take the initiative in advertising and PR as part of promoting the region. In effect, local businesses are making a concerted effort to raise their marketing power, and thereby engaging in advertising and PR.

Interestingly, positive effects were also seen in intra-regional brand awareness and recognition. According to our interviews with businesses, higher appraisal from outside the region has led to stronger trust in brands and a rise in recognition within the region. Improvements were also felt in quality control, customer satisfaction, packaging and design capabilities, all of which are business capabilities. This is the result of local businesses which mostly targeted local customers or were in the wholesale trade and did not have direct contact with customers, being rigorously assessed by consumers mainly living in urban areas. Online gift portals contain user reviews similar to typical online shopping sites, and produce word-of-mouth effects. Higher motivation to develop new products and transformation of managements' mindsets lead to the emergence of regional entrepreneurship. Meanwhile, there was a significant, negative effect in motivation for procuring funds and making capital investment, meaning

that there was no impact in such areas. This is consistent with aforementioned survey results on the current state of lending.

Figure 4 Changes in Business Capabilities and Capacities through Gift Provision



Note: Rating from 1 to 5 in 1-point increments. The highest score is 5 while the lowest is 1. A test was applied to the difference from 3—the median score. Categories marked with “\*” and “\*\*” are those with significance levels of 1% and 5%.

Table 6 Inter-regional Comparison of Changes in Business Capabilities and Capacities

	Top regions	Randomly selected regions
Product quality management	3.60	3.36
Improved customer satisfaction.	3.53	3.23 **
Rise in extra-regional brand awareness	3.50	3.38
Packaging method	3.49	3.22
Rise in intra-regional brand awareness	3.39	3.34
Motivation for new product development	3.35	3.37
Product design	3.26	3.15
Transformation of management's mindset	3.21	3.08
Improved employee satisfaction	3.08	2.95
New business strategies	3.08	3.05
Budget control	2.93	2.76
Customer data management and analysis	2.92	2.61 **
Motivation for capital investment	2.91	2.50
Motivation for new businesses development	2.78	2.78
Motivation for fund procurement	2.22	2.07

Note: Categories marked with “\*\*” are those with a significance level of 1%.

Table 6 compares the contents of Figure 4 between top and randomly selected regions. As discussed above, we did not conduct sample matching between the top and randomly selected regions, so this comparison is merely meant to be reference information. However, as a whole, values are higher in top regions, and a significant difference was detected in increase in customer satisfaction and customer data management/analysis. This may imply that the top regions are either winning loyal customers by improving customer satisfaction, which in turn leads to an increase in donations, or that they are consciously endeavoring to raise customer satisfaction in order to gain loyal customers.

Also, although not shown in the table, there was a tendency for business capabilities to improve more in companies with larger revenues from gifts and higher ratio of gift revenue to total revenues. This was confirmed by analyzing the correlation between each business capability category in the survey and the basic attributes of businesses in both top and randomly selected regions. This suggests that businesses achieving a larger rise in profitability from gifts tend to be more highly motivated, leading to fortification of their business capabilities.

#### 4.6 Effects from Matching Interests between Municipalities and Businesses

Hometown Tax Donation is a unique SME policy since the interests of municipalities and businesses match. In typical SME policies, an increase in business revenues does not directly benefit municipalities other than through a rise in corporate tax revenues. However, with Hometown Tax Donation, businesses need to provide appealing gifts in order for municipalities to procure more donations. From the perspective of businesses, it is difficult for them to handle all operations themselves in order to gain competitive advantage over the many other gift providers in Japan, so they need support from municipalities. As such, success depends on close collaboration by municipalities and businesses. For the question of whether businesses were satisfied with the support from municipalities, some 90% in both top and randomly selected regions responded in the affirmative. Table 7 presents the results of what businesses discussed with municipalities. Table 8 shows operations for which they received support from municipalities or local service providers and non-profit organizations.

Table 7 Matters Discussed with Municipality Officials

	Top regions		Randomly selected regions	
	No.	%	No.	%
Verifying contents and no. of orders	84	36.8%	59	27.8%
New product development	46	20.2%	51	24.1%
Product upgrades	39	17.1%	44	20.8%
Checking inventory	34	14.9%	21	9.9%
Securing personnel	2	0.9%	1	0.5%
Obtaining subsidy	3	1.3%	2	0.9%
Future capital investment	2	0.9%	1	0.5%
Other	18	7.9%	33	15.6%
<b>Total</b>	<b>228</b>	<b>100.0%</b>	<b>212</b>	<b>100.0%</b>
No. of multiple answers	65		65	
	163		147	

Table 7 shows that the most frequently discussed matters are verification of order processes, but product development and upgrades were also discussed frequently. As for support from municipalities and

service providers (Table 8), businesses received support in specific areas including website updates, customer service, and shipment. Traditional SME policies established by the national government or municipalities merely presented a list of initiatives, and businesses had to do all the work. Yet, businesses faced the issue of lacking resource, so it was difficult to yield results. However, in the case of Hometown Tax Donation, municipality officials are actually taking actions to support SMEs. The success or failure of such actions directly impacts the amount of donations a municipality receives, so officials also make extensive efforts. This aspect makes Hometown Tax Donation an extremely unique SME policy.<sup>18</sup>

Table 8 Support from Municipalities and Local Companies

	Top regions		Randomly selected regions	
	No.	%	No.	%
Gift portal update	58	32.4%	51	28.8%
After-sales customer service	46	25.7%	39	22.0%
Customer list management	27	15.1%	31	17.5%
Preparation of shipping slip	18	10.1%	23	13.0%
Shipment	8	4.5%	7	4.0%
Packaging	4	2.2%	2	1.1%
Other	18	10.1%	24	13.6%
<b>Total</b>	<b>179</b>	<b>100.0%</b>	<b>177</b>	<b>100.0%</b>
No. of multiple answers	16		30	
	163		147	

#### 4.7 Competitive Edge and Differentiation of Gift Providers

As mentioned above, since the size of each business is small, they need to compete in the gift market by effectively utilizing external resources. Aside from such support by municipalities as noted above, businesses can also use paid services provided by various local or non-local companies.

Table 9 To Whom Businesses Ask for Advice and Consulting

		Top regions				Randomly selected regions			
		Municipality	Local company	Non-local company	Total	Municipality	Local company	Non-local company	Total
Packaging and Shipment	Paid	2	4	5	11	1	3	4	8
	Free	11	4	2	17	12	3	2	17
Design	Paid	2	6	14	22	2	5	9	16
	Free	12	2	3	17	10	2	4	16
Online photos	Paid	5	6	13	24	9	5	7	21
	Free	29	3	5	37	25	3	4	32
Product slogan	Paid	2	1	4	7	0	3	4	7
	Free	19	4	4	27	23	2	5	30
Product manual	Paid	1	1	4	6	0	1	4	5
	Free	16	3	5	24	16	2	4	22
General business know-how	Paid	2	0	2	4	0	1	3	4
	Free	14	3	3	20	15	3	6	24
Case studies	Paid	2	0	1	3	0	0	1	1
	Free	18	4	2	24	24	2	5	31
PR/Advertising	Paid	2	0	4	6	0	2	2	4
	Free	42	6	2	50	46	5	6	57
Total	Paid	18	18	47	83	12	20	34	66
	Free	161	29	26	216	171	22	36	229

<sup>18</sup> Some municipalities outsource part of their operations to local service providers or private companies. However, even in such cases, the interests of municipalities and gift providers match.

Table 9 summarizes the use of external resources by businesses. This shows that free support from municipalities comes in first for companies in both top and randomly selected regions. At the same time, remarkably, not a few businesses also use paid services provided by non-local companies for packaging/shipping, design or photos to post online. Product attractiveness should increase relative to other products on online gift portals if businesses spend more money on designs or online photos. Thus, the gap may spread between businesses with superior and inferior designs or photos going forward. In our interview with municipal officials and local businesses, interviewees mentioned that when using paid services provided by private companies, they try to find local companies in order to support intra-regional money circulation. However, to differentiate oneself from other gift providers on national-scale online gift portals, they also need to consider using non-local services that excel at the national level.

#### 4.8 Intra-regional Collaboration

It is challenging for each business to acquire expertise on their own and enter the gift market. Some municipalities therefore organize workshops for local gift providers so that they can share their know-how. Table 10 outlines such initiatives.

Table 10 Sharing of Knowledge and Know-how among Gift Providers on Business Matters and Gift Provision

	Top regions		Randomly selected regions		Total	
	No.	%	No.	%	No.	%
Have shared	35	22.7%	37	26.4%	72	24.5%
Have plans to share	39	25.3%	35	25.0%	74	25.2%
Have not shared	80	51.9%	68	48.6%	148	50.3%
<b>Total</b>	<b>154</b>	<b>100.0%</b>	<b>140</b>	<b>100.0%</b>	<b>294</b>	<b>100.0%</b>
Not answered	9		7		16	
	163		147		310	

As long as all local businesses operate within the local market, they will need to compete against each other to win their share of limited demand. Such is the traditional business scheme in rural areas. However, if all businesses aim to win a share of demand outside the region, they can become partners, rather than rivals, who share know-how and help each other advance.

About half of the respondents are engaging in or are interested in sharing knowledge and know-how. This suggests that Hometown Tax Donation may be prompting closer collaboration among local businesses. Going forward, the gap in regional competitiveness may widen between regions with and without such collaboration schemes in place. In fact, there are cases where new products were developed through collaboration among local businesses, including in Fukaya City, Saitama Prefecture and Osaki City, Kagoshima Prefecture. If Hometown Tax Donation promotes collaboration among local businesses, it may also spur regional innovation and entrepreneurship.

Such intra-regional collaboration can be built voluntarily by businesses (e.g., through chambers of commerce and industry) or spearheaded by municipalities. Meanwhile, there are also cases where regional financial institutions play a central role as seen in Kitakami City, Iwate Prefecture and Kashiwazaki City, Niigata Prefecture (Hoda and Kubo, 2018). If Hometown Tax Donation promotes partnership between local businesses, municipalities and financial institutions, this may lead to the emergence of regional entrepreneurship.

#### 4.9 Gift Providers' Thoughts on Hometown Tax Donation

The Minister for MIC released a notice calling for municipalities to keep the gift-to donation ratio to 30% or less, and to refrain from providing expensive or highly cashable products. We asked businesses what they thought of this notice (Table 11). With regards to the gift-to-donation ratio, the top answer was the ratio “should be slightly higher” in top regions, and the ratio “is adequate” in randomly selected regions. One can assume that some municipalities in top regions procured large amounts of donation by providing products with high gift-to-donation ratio, and are dwelling on their past success. On the other hand, randomly selected regions seem to have an understanding toward government regulations. Although not yet shown in the table, about half of the companies in both top and randomly selected regions responded that more flexibility in regulation of expensive gifts is desired taking into account regional characteristics.

Table 11 What Businesses Think about the 30% Gift-to-Donation Ratio

	Top regions		Randomly selected regions	
Is adequate	62	40.0%	84	60.4%
Should be slightly higher	69	44.5%	30	21.6%
Should be slightly lower	2	1.3%	1	0.7%
Not sure	22	14.2%	24	17.3%
<b>Total</b>	<b>155</b>	<b>100.0%</b>	<b>139</b>	<b>100.0%</b>
Not answered	8		8	

### 5. Summary and Discussion

This study focused on the function and effect of Hometown Tax Donation as an SME policy, and explored the mechanism required to develop regional entrepreneurship. We applied the research method of asking gift providers around Japan about their engagements in Hometown Tax Donation and improvements in business capabilities triggered by such engagements. The results also offered insight into the idealistic scheme of Hometown Tax Donation going forward.

There are three aspects that make Hometown Tax Donation unique compared to typical SME policies. Firstly, while the source of gift revenues is tax, profits can only be earned by providing products that appeal to consumers. Thus, businesses gain the incentive to develop products that meet market needs. Secondly, Hometown Tax Donation produced the gift market. As a general rule, this market mainly consists of local specialties, and most of its players are rural SMEs, so large private companies cannot compete in the market with their national brand products. This creates an environment of moderate competition among local SMEs. Finally, the interests of local businesses and municipalities match. The attractiveness of gifts provided by local businesses directly links to the amount of donations a municipality receives. Therefore, municipalities and businesses need to work in tandem for improvement in business capabilities and products. In some cases, regional financial institutions are also cooperating, so the entire community is acting in unison to run the gift business. There have also been cases where the system is facilitating regional entrepreneurship, stemming from a common interest of gaining access to extra-regional markets. For example, local businesses are fortifying collaboration through workshops, or jointly developing products.

Such cases provide two insights into effective local startup/SME policies. One is the existence of a market with adequate competition. If there is a platform that serves as a *dojo*, local SMEs can prepare

and train to enter large-scale markets (e.g., online sales). Importantly, general consumers should be the ones providing guidance in this *dojo*. Local businesses will then attempt to be creative in order to be selected by consumers. This is different from the scheme in which businesses simply improve their paperwork skills in order to successfully obtain subsidies. The second is matching interests among municipalities and businesses, and the promotion of collaboration among local businesses.

On the other hand, there is an issue that needs to be addressed; namely, the exit strategy of the Hometown Tax Donation system. If Hometown Tax Donation merely creates a special government-produced gift market and continues to simply support SMEs' revenues using taxes, then the system's value will not be exercised sufficiently. It will only hold value as a SME policy if it helps companies "graduate" from the *dojo* and thereafter strive competently in regular markets. For example, Vegiko based in Miyazaki Prefecture provided vegetables for smoothies as gifts for Hometown Tax Donation. After leaving the gift market, they are achieving ample financial results from normal business. They are now expanding their business through delivery service of fresh foods. In this way, businesses are required to effectively use the gift market, rather than depending on it, to boost brand awareness or conduct test marketing, and thereby achieve growth. Our survey revealed that some businesses are posting large revenues from gifts, and that certain companies among those are overdependent on gifts with their ratio of gift revenue to total revenues exceeding 50%. Such businesses need to make an effort to try to exit the gift market instead of overly relying on it, and municipalities also need to shift from supporting entry into the gift market, to supporting exit from the gift market.

Matching interests between municipalities and businesses also incorporate a potential pitfall. Once businesses exit the gift market, as in the case of Vegiko, donations to municipalities will decline. Since donations to municipalities are tightly tied to gift revenues, it is necessary to have strong businesses continue providing attractive gifts. This is the exact opposite of not allowing businesses to depend on the gift market as mentioned above, so steering the system in the right direction will be tricky. Ideally, businesses should increase their revenues in both gift and general markets. However, they then face the question of whether general consumers would pay the full price to buy products that were offered for no cost in the gift market.

Such issues remain in Hometown Tax Donation in terms of exit strategy; however, this study revealed that the system embraces unique functions as an SME policy. The biggest challenge going forward is to increase the ratio of companies whose business capabilities strengthen through gift provisions, and to produce as many companies as possible that can also strive in general markets. Furthermore, it is important that municipalities themselves not rely on gifts, but instead, make such efforts as winning the empathy of donors through presenting effective usage of donations.

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