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THE USE OF THE STATEMENT OF CASH FLOWS BY JAPANESE SMES

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Abstract

The purpose of the study is to analyze the usage of the statement of cash flows (SCF) by Japanese SMEs from the perspective of preparers. The paper analyzes how institutional mandates have shaped organizational behavior, and how these mandates reflect the country's social and cultural values. We analyze this premise in respect to the usage of the statement of cash flows by Japanese SMEs. The study relies on institutional theory and cultural values to help explain the results obtained from a survey questionnaire. We focus on financial reporting behavior when the SCF is a noncompulsory disclosure under SMEs general guidelines. We analyze different variables including intent to make a public offering and the number of professional accounting staff, and find firm size to be significantly associated with the recognition and production of the statement of cash flows. We believe that our findings will be useful to the Japanese government in designing SME economic guidance for capital growth to improve capabilities and ensure sustainability.

Keywords: Japanese SMEs, Statement of Cash Flows, Institutional Theory, Cultural Values, Voluntary Disclosure

1. Introduction

Throughout the years, accounting standard setting bodies in the U.S. and abroad have recognized that small and medium size enterprises (SMEs) have different accounting and reporting needs that differ from that of large organizations. In 2009, the International Accounting Standard Board (IASB) issued guidance for SMEs (IFRS for SMEs) and a revised version was subsequently issued in 2015. However, the guidance has not been universally adopted. In Asia, thirteen countries have adopted IFRS for SMEs, including three countries that have adopted a modified version of these standards (Malaysia, Pakistan, and South Arabia) (Bonito and Pais, 2018). There are still ten other countries that have not yet adopted these standards including Japan (Bonito and Pais, 2018). In its place, Japan has created its own guidance for SMEs beginning in 2005. The guidance was a collaboration between the Japanese Institute of Certified Public Accountants

(JICPA); the Japan Federation of Certified Public Tax Accountants' Associations (JFCPTAA), the Japan Chamber of Commerce and Industry (JCCI), and the Accounting Standards Board of Japan (ASBJ) (Kawasaki and Sakamoto, 2014). This guideline is known as the ASBJ guidelines for SMEs. A simplified version of these guidelines was issued in 2012, and these are known as General Accounting Standards for SMEs (General Standards for SMEs).

The focus of our paper is on Japan’s financial reporting guidance for SMEs and the exclusion of the statement of cash flows. Japanese SMEs are not required to prepare and/or disclose the statement of cash flows as part of their financial statement presentation under either the ASBJ or General Standards for SMEs. In comparison, the 2009 IFRS for SMEs guidelines (Section 3) outline the complete set of financial statements including the statement of cash flows. Further guidance for SCF presentation and disclosure is provided in section 7. In general, the statement of cash flows is used for assessing liquidity and solvency, forecasting and monitoring, and decision-making and performance evaluation (Jones and Ratnatunga, 1997). The SCF is also useful for planning, assessing performance, examining the relationship between profitability and net cash flows, and the impact of price changes (Farcane *et al.* 2012). These studies show that even in unregulated environments where most SMEs operate, financial statements including the statement of cash flows are necessary for internal and external use. Financial statements are exceedingly relevant when seeking outside investment capital. However, Japanese SMEs have historically relied less on financial statement presentation as a requirement for obtaining financing because of their reliance on government subsidies such as the credit guarantee system. Although the credit guarantee system provides financing and incentives to SMEs, these measures have limitations and restrictions that prevent these companies from investing in high-risk projects including intangible investment such as research and development hindering SMEs’ productivity growth (Colacelli and Hong, 2019). Government protection discourage SMEs from seeking alternative sources of financing such as asset-based lending and venture capital. To encourage the latter, SMEs must have reliable financial statements including the statement of cash flow to facilitate the analysis of potential venture capital investors. Furthermore, the need for companies to fully understand their financial situations is crucial in developing sound management strategies that address the changes experienced globally by the recent COVID-19 pandemic (Small and Medium Enterprise Agency, 2021).

This paper has three fundamental objectives. First, we relied on institutional theory and cultural values frameworks to analyze our findings. Second, we investigate the rationale for voluntarily issuing the SCF and examine producers and users’ perceived usefulness of this statement. Third, we contribute to the scant literature of Japanese small and medium size entities and provide an explanation for their accounting practices. Prior research focused on accounting information quality and lending (Kim and Yasuda, 2019), adoption of IFRS for SMEs (Amano, 2020; Tsuruta, 2020), and the influence of cultural values on financial reporting (Tsakumis, 2007; Fearnley and Gray, 2015; Zahid *et al.* 2018). None of these studies addressed the usage and preparation of the statement of cash flows. We attempt to fill this gap. We believe that our findings will be useful to the Japanese government in catering SME guidance to improve capabilities and ensure sustainability. Our findings show that SMEs behavior is compliant with government regulations and deep-seated practices that reflect Japan’s cultural values. These regulations target larger corporations making these entities the principal users and issuers of the statement of cash flows.

In the section 2, we provide background information about Japanese SMEs accounting practices. In section 3, we link institutional theory with social and cultural values. We provide a rationale for our hypotheses in section 4 based on our analysis and findings from similar studies. Then, in section 5, we detail our research method, and in section 6, we present results of this examination. We offer a discussion on the significance of these findings in section 7. Concluding remarks, opportunities for future research, and limitations complete our analysis in section 8.

2. Background

In Japan, SMEs comprise approximately 99.7 percent of all businesses, employing 70 percent of the working population (METI, 2019). SMEs depend largely on the domestic economy, and for this reason, they are increasingly vulnerable to economic downturns (EIU, 2010). The highest number of SMEs is in retail, restaurant and lodging services, construction, and manufacturing (EIU, 2010). The latter is the most productive industry as subcontractors of larger corporations such as Toyota, Sony, and others (METI, 2013). Unlike the U.S. and most European countries, Japanese SMEs are legally defined as shown in Table 1 based on the SME Basic Act of 1963, as revised in 1999.

Table 1. SME definition under the Small and Medium-sized Enterprise Basic Act

INDUSTRY TYPE	CAPITAL (IN YEN)	No. OF EMPLOYEES
Manufacturing	300 million or less	300 or less
Wholesale	100 million or less	100 or less
Service	50 million or less	100 or less
Retail	50 million or less	50 or less

Source: Adapted from the Ministry of Economy, Trade, and Industry (METI, 2019)

Japanese SME's accounting has its origins in the bookkeeping guidelines of 1949 (Kawasaki and Sakamoto, 2014). However, formal guidance was not published until August 2005. These guidelines were known as the ASBJ guidelines (Accounting Standards Board of Japan). Nevertheless, these guidelines were still considered complex by many users and a simplified version was subsequently published in February 2012 under General Accounting Standards for SMEs (known as the General Standards). Currently, SMEs have the option of using the ASBJ guidelines or the General Standards (GS). The conceptual framework for the General Standards is characterized by the premise that accounting should be simplified for management use (Kawasaki and Sakamoto, 2014). This statement infers that management, mostly owner-managers, may lack the accounting knowledge and sophistication to understand the complex financial reporting needs of larger organizations. The general perception of scholars and researchers is that SME managers do not have an appreciation for accounting and its use in planning and decision making, often regarding it as costly and time consuming (Kawasaki and Sakamoto, 2014; McMahon, 1998). From an Austrian economic perspective, the function of financial reporting is confirmatory and retrospective validating the business present position and the result of decisions made in the past (McMahon, 1998). In this context, financial information that satisfies taxation filings and/or minimal corporate financial standards is considered sufficient.

The basic premise of the General Standards is to provide relevant information to third party users such as banks, customers, and suppliers, similarly to IFRS for SMEs. It presents a more pragmatic approach by following widely accepted business practices and taxation requirements. This coincides with the belief that the costs of implementation should not outweigh its benefits (Kawasaki and Sakamoto, 2014). Consequently, the General Standards have three main purposes: to reduce the complexity of accounting standards under the ASBJ guidelines, to facilitate digital disclosure of financial statements, and to decrease litigation and simplify the burden of proof (Mizunoura, 2017). Although ASBJ guidelines are considered complex, their purpose is to properly report the economic substance of transactions adopting a 'top down' approach. On the other hand, the General Standards have adopted a 'bottom up' approach with the purpose of harmonizing accounting systems with the tax system (Kawasaki and Sakamoto, 2014). Hence, the General Standards follow a mechanical method rather than functional because it focuses strictly on bookkeeping while the functional method focuses on the utility of financial statements and its usefulness for decision making (Mizunoura, 2017).

In Japan, SMEs face various challenges: decreasing domestic demand due to a shrinking and aging population, inadequate funding, limited capital, and human resources, and increasing competition from other Asian countries. As a result, the Japanese government has focused on providing financial assistance and advisory services to SMEs. In the Enterprise Power report, the government recommends that managers of SMEs become knowledgeable about growth, raising capital, financial management, and technological capabilities (Kawasaki and Sakamoto, 2014). More recently, the focus has been on digitalization, business succession, and disaster prevention (METI, 2019). The purpose of these measures is to facilitate globalization of SMEs activities. To achieve this objective, SME's financial reporting must reflect the needs and requirements of international markets and investors. This means that their accounting systems must become more complex, transparent, and reliable if they are to make that leap.

3. Theoretical framework and literature review

3.1. Institutional theory

In this paper, a neo-institutional perspective is adopted to evaluate exogenous factors (e.g., regulatory, economic, and socio-cultural) that shape the accounting practices of Japanese SMEs. Institutionalization is a process where accepted social practices are developed and learned (Dillard *et al.* 2004). They are taken for granted assumptions that are supported legally and socially (Meyer and Rowan, 1977). An institution is a system of beliefs, values, and social norms (Judge *et al.* 2010). These systems are ingrained in society and are the platforms for shared cognitive constructs in politics, education, regulation, and other establishments.

Early studies theorized on factors that affect organizational homogeneity, or isomorphism, in adapting to the environment (Meyer and Rowan, 1977; DiMaggio and Powell, 1983). These scholars identified societal parameters and prescribed requirements that organizations ought to follow to become legitimate structures. DiMaggio and Powell (1983) define isomorphism as a process of homogenization where an organization is forced to be like others to face common environmental conditions. DiMaggio and Powell (1983) identify three institutional pressures: coercive, mimetic, and normative. Coercive pressure is exemplified in interorganizational relations, the socio-economic and regulatory environment, and cultural expectations. Mimetic pressure refers to the tendency for some organizations to follow the practices of more successful and well-established firms. Normative pressure originates from professionalism in an organizational field. An underlying benefit of institutionalization is legitimacy and stability (Meyer and Rowan, 1977).

Later studies acknowledged the value of politics and individual actors in the structuralization process. Dillard *et al.* (2004) emphasize the influence of politics and power in the adoption of norms. Their model illustrates an iterative process between economic and political powers permeating to the organizational field and organizations. In turn, companies are tasked with integrating these institutional practices into their cultures, structures, processes, and daily tasks (Irvine, 2008). Similarly, Scott (2001) acknowledges different levels of institutions. At the highest level are global institutions which governance affects organizational fields and organizations. At the lower level are actors made up of individuals or groups. These may embrace or reject these institutionalized norms. The main assumption is that all social actors seek legitimacy. Accordingly, accounting practices are rationalizations of legitimization (Dillard, *et al.* 2004). Accounting information is perceived as legitimate and trustworthy by users (Judge *et al.* 2010).

Institutional approaches have been applied in accounting research especially in relation to the adoption or rejection of International Financial Reporting Standards (IFRS). For example, Judge *et al.* (2010) find that foreign aid (such as IMF), import penetration, and level of education of accounting professionals are predictive factors of the degree of IFRS adoption as explained by institutional theory. Hassan *et al.* (2014) examine the influence of coercive, mimetic, and normative factors on the initial decision to adopt IFRS in Iraq. Mantzari *et al.* (2017) conclude that the adoption of IFRS in Greece was influenced by coercive and hegemonic pressures from parent companies, legal environment, and those providing source of finding such as financial institutions. In the same vein, Tahat *et al.* (2018) and Osinubi (2020) support previous findings with respect to Jordan and Nigeria, respectively. In relation to financial disclosure regulation and institutional theory, Cooke and Wallace (1990) observed that external factors usually shape financial disclosure regulation in developing countries while developed countries are influenced by internal factors.

A handful of studies have relied on institutional theory to help explain organizational behavior in Japan in the field of accounting and finance. A salient characteristic of Japanese organizations is the existence of strong intercorporate alliances (Gerlach, 1997). Unlike the United States, these alliances fuel the power of institutional investors and diminish the influence of individual shareholders (Urasaki, 2014). Organizations in Japan uphold the group's value maximization rather than competing individually. These *keiretsus* serves as principal monitoring systems in the business environment (Rahman *et al.* 2010). Hence, institutional theory is an appropriate approach to study these characteristics. Research focused on Japanese organizational practices include Lu's (2002) examination of new firms' entity choice. Findings support mimetic pressures based on the rate of success of established companies. In regards to corporate governance, Yoshikawa *et al.* (2007) report that mimetic and coercive pressures from organizations sparked institutional change. In accounting, Parboteeah *et al.* (2005) examine differences in national culture and ethical climates between Japanese and U.S. accountants. Findings support accounting rules and regulations (institutionalized normative factors) over national culture for egoism and benevolence. In assessing Japanese non-financial performance measurements, Hussain and Hoque (2002) identify economic constrains, regulations, accounting standards, management's strategic focus, size, and competition as coercive and mimetic forces. Rahman *et al*. (2010) examine earnings quality focusing on abnormal accruals. Their study compares accounting practices in five different countries including Japan. Results show that agency theory is pertinent to the U.S., but it does not explain differences from other countries including Japan based institutional practices and characteristics. To the best of our knowledge, no studies were found that employed an institutional theoretical framework to analyze Japan's accounting reporting practices for SMEs.

3.2. SMEs economic environment

SMEs like most Japanese organizations rely heavily on debt. In Japan, banking relationships are actively sought because debt is widely acceptable and these relationships can provide better rates and prestige (Bush, 1991). Historically, Japanese companies have relied more heavily on debt than equity for financing (Gordon, 1999). In large organizations, institutional shareholders are the majority shareholders. Therefore, unlike the U.S., there is no need for individual shareholders. However, banks have been increasingly reluctant to lend money to SMEs because they are riskier than larger organizations. Moreover, banks rely on fixed assets for collateral, but generally, SMEs do not invest on fixed assets because of cash flow constraints (EIU, 2010).

The Japanese government understands these financial restrictions and has endorsed numerous policies aimed at providing financing assistance to SMEs (Tsuruta, 2020). It is estimated that as much as 40 percent of Japanese SMEs depend largely on this type of government subsidies supported by the credit guarantee system (Tsuruta, 2020). In this lending process, financial institutions have taken the role of compiling relevant financial information from various sources (e.g., income tax forms and financial statements) given the asymmetry of the quality of this information. In turn, these applications are closely examined by the Credit Guarantee Corporations (CGCs) in determining the candidates' ability to repay the loan. In this context, Kim and Yasuda (2019) find that interest rates are higher for nonguaranteed than guaranteed loans because the former rely mainly on financial statements provided by these entities while the latter have established procedures for compiling reliable and relevant information in the prescreening process aided by financial institutions.

Some have argued that these government policies have discouraged capital growth among SMEs for fear of losing their status and the incentives granted including the credit guarantee and a lower corporate tax rate (Tsuruta, 2020). Because Japan's population is rapidly shrinking, SMEs that depend on the domestic market for survival are more susceptible to economic fluctuations unless they expand to global markets. However, a majority of SMEs have attributed their hesitancy to a lack of funding, information about these markets, and management resources (EIU, 2010). Many SMEs do not have proper bookkeeping and recording systems in place, and this jeopardizes their ability to remain sustainable under current economic pressures and constrictions (Kawasaki and Sakamoto, 2014). Because of abrupt changes in the business environment, the ability of SMEs to overcome crises depends largely on managers' understanding of financial information and the development of feasible strategies (Small and Medium Enterprise Agency (SMEA), 2021). However, in many instances, management remains focused on taxation ignoring external financial reporting (Urasaki, 2014). This attitude has been fomented by Japan's governmental policies that have perpetuated these mandates including the enactment of accounting standards (Urasaki, 2014).

3.3. Accounting regulation and financial reporting

From a regulatory and financial reporting perspective, there are three major laws in Japan, which form a triangular structure: the Companies Act, the Corporation Tax Act, and the Financial Information and Exchange Act. The Companies Act is required for all companies with capital of at least ¥500 million or total liabilities of ¥20 billion (Kawasaki and Sakamoto, 2014). The Corporation tax Act contains rules and regulations for computation, collection, and enforcement of tax. It is applicable to all entities regardless of size. The Financial Information and Exchange Act only regulates publicly traded companies (Kawasaki and Sakamoto, 2014).

Fujibayashi *et al.* (2015) observed that most SMEs prepare their financial statements on tax basis in accordance with the Corporation Tax Act. In many respects, the tax authorities function as surrogate financial reporting auditors because these entities are required to attach a copy of their financial statements (except for the statement of cash flows) to their tax returns. If the tax authorities do not question the financial reports enclosed, then they are perceived to be prepared accurately and fairly. Even financial institutions consider SMEs' financial statements unreliable, therefore, they require that in addition to their financial statements they also provide a copy of their tax returns. We could consider that because Japanese banks distrust SMEs' financial statements, the statement of cash flows would not be required and relied upon, as is in other countries with a stronger agency relationship like the U.S.

3.4. The influence of culture on accounting practices

Social and cultural values influence institutional structures (legal, political, etc.) legitimizing shared understandings and constructions. Likewise, these cultural values also influence the accounting practices of each country. Gray (1988) theorizes that there is a link between accounting practices (defined in four dimensions), and social and cultural values. The accounting dimensions identified and compared are as follows: professionalism and statutory control, uniformity and flexibility, conservatism and optimism, and secrecy and transparency. He based these classifications on Hofstede's (1980) cultural dimensions: uncertain avoidance, masculinity, individualism and power distance. Uncertainty avoidance relates to the perceived level of threat from ambiguous or uncertain situations. Masculinity refers to society's focus on competition and achievement of success. Individualism indicates the level of independence emphasizing the individual person over communities or groups. Last, the power distance dimension addresses the hierarchical structure of societies. Based on these dimensions, Japan is high in uncertainty avoidance and masculinity, low in individualism, and medium in power distance. Gray's (1988) framework attempts to predict and explain how financial reporting differences relate to these cultural idiosyncrasies.

Gray's (1988) findings show Japan as moderately influenced by statutory control and high in uniformity. Based on this premise, we would expect that Japanese SMEs would be less likely to produce the SCF because it is not required under the General Standards, and it is not widely used by other SME companies. Gray's (1988) other dimensions are conservatism/optimism and secrecy/transparency. Societies that are high on power distance are expected to be less transparent to protect the flow of information and disclosure from competitors allowing them to retain power. Institutional norms support the Japanese organizational system of groupings especially for large companies. This concept is rooted in the Japanese cultural values and belief system of collectivism (Rahman *et al.* 2010). Unlike the U.S., banks have ownership rights in these groupings making it unnecessary to issue financial statements for third party use because the users are the owners or members of these groupings. Therefore, information is only privy to shareholders preserving secrecy and conservative practices. Historically, relationships and commitments are highly valued in Japanese society. Thus, transparency in financial reporting is not as highly appreciated in Japan as is in the U.S. or Europe because it is not needed when information is widely shared among networks and business groups.

Many researchers have relied on Gray's framework to evaluate the influence of culture on financial reporting specially related to the adoption of International Financial Reporting Standards (IFRS). For example, Bonito and Pais (2018) conclude that countries that lack national accounting standards but are knowledgeable in applying IFRS and have a common law system are more likely to adopt IFRS for SMEs. Other researchers focused on measurement more specifically fair value versus historical cost approach. Fearnley and Gray (2015) examined national institutional factors such as conservatism (related to Hofstede's uncertainty avoidance) in the context of IFRS implementation regarding investment property under IAS 40. They find that civil law countries like Germany where accounting standards are directed at protecting creditors are more likely to be high on conservatism and low in individualism and therefore support the cost approach to measure investment property more so than fair value. Even though these EU countries have uniformly adopted IFRS, there are still variations in financial reporting allowed by certain options provided in the standards. Zahid *et al.* (2018) also investigate the influence of cultural values of uncertainty avoidance, individualism, and masculinity in the uniformity of accounting practices in eastern European countries. The authors find discernible differences related to disclosure practices more so than measurement. Likewise, Tsakumis (2007) concludes that disclosure decisions are more strongly influenced by cultural values when evaluating accounting practices in Greece.

4. Hypotheses development

Based on our previous discussion, we would expect that most SMEs would not prepare a SCF for external or internal use. However, we hypothesize that under certain circumstances, these entities would be forced to imitate listed companies' financial reporting practices including issuing a SCF. One of the factors that would influence the issuance of the SCF would be firm size. As previously explained, the Japanese Companies Act has implemented stricter financial reporting requirements for large organizations. In this case, SMEs that meet the stated filing thresholds are forced to comply these regulations. Previous research support the premise that firm size is associated with availability of resources including sophisticated accounting systems and knowledgeable personnel facilitating the issuance of financial statements including the SCF (Jones and Ratnatunga, 1997; Allee and Yohn, 2009). Therefore, it is expected that larger firms would use financial statements more effectively to manage resources more so than smaller entities as they are held accountable by a larger base of stockholders. Consequently, our first hypothesis states:

H_1. There is a positive relationship between firm size, determined by number of employees and capital, with the recognition and production of the statement of cash flows.

Focusing on coercive and mimetic pressures, we would expect that Japanese SMEs that plan to make an initial public offering (IPO) would be more likely to follow publicly traded companies' financial reporting requirements pre-IPO in preparation for this crucial step. For example, Allee and Yohn (2009) concluded that SMEs that are preparing to make an IPO are more likely to have financial statements to meet the requirements of regulatory agencies. Similarly, Yström (2010) arrived at similar conclusions supported by managers' qualitative interviews. Suzuki and Suda (2004) found, based on the samples from 498 Japanese enterprises, that the production of the statement of cash flows is affected by the intention of an initial public offering.

Therefore, our second hypothesis is based on the intention to make a public offering. In this respect, we expect that companies that intent to make a public offering would mimic the same accounting practices of larger listed companies. Therefore, they will abide by not only the Companies Act and the tax regulations, but also by the Financial Information and Exchange Act, which regulates publicly traded companies and requires a statement of cash flows.

H_2. There is a positive relationship between intention to make a public offering with recognition and production of the statement of cash flows.

Parboteeah *et al.* (2005) found that professional accountants are positively influenced by the process of socialization of the accounting profession and that this predisposition outweighs, in some instances, the effects of national culture in relation to ethical climates. In light of these findings, we propose that SMEs employing professional accountants would be more inclined to prepare and disclose the SFC. Fujibayashi *et al.* (2015) reported that only 6.9 percent of SMEs have employed or contracted an accountant or advisor. This illustrates the lack of knowledgeable accounting personnel instrumental in the production and use of financial statements among SMEs. Many Japanese SMEs are owner operated and managed making unaudited financial statements less reliable (Mizunoura, 2017). Thus, Japanese accountants are influential in the production and use of the financial statements. Therefore, we hypothesize:

H_3. There is a positive relationship between professional accounting personnel with recognition and production of the statement of cash flows.

5. Research method

We relied on a survey questionnaire to assess these hypotheses. As done in previous studies (e.g., Suzuki and Suda, 2004), we evaluated the association between these variables. We also provide additional information on the production and use of the SCF for decision-making. The variable firm size is represented by the number of employees and capital consistent with the determining factors used in the classification of SME by the Ministry of Economy, Trade, and Industry (METI, 2019). The following dichotomous (yes=1/no=0) variables were assessed: intention of IPO, recognition of SCF, production of SCF, recognition of the schedule of cash receipts and disbursements (SCRD), production of SCRD, recognition of the importance of SCF for decision-making, recognition of General Accounting Standards (GAS) for SME, and recognition of ASBJ for SME.

The sample was composed of Japanese SMEs (excluding listed companies and their subsidiaries). The survey was mailed to these companies between January 2015 to May 2015. The total number of usable responses were 416. However, for some questions, the number of responses was slightly lower, and this is indicated when applicable.

Table 2. Number of respondents and percentages

	Variable	No. of respondents	Percentage
Firm Size	No. of employees (n=416)		
	0 - 10	99	24%
	11 - 30	160	38%
	31 - 50	77	19%
	51 - 100	50	12%
	101 - 300	22	5%
	301 +	8	2%
	Capital (n=412)		
	¥0 - ¥10M	161	39%
	> ¥10M to ≤ ¥30M	136	33%
	> ¥30M to ≤ ¥50M	70	17%
	> ¥50M to ≤ ¥100M	32	8%
	> ¥100M	13	3%
	IPO Intention (n=410)		
	Yes	13	3%
	No	397	97%
	Person in Charge of Preparing Financial Statements (n= 211)		
	President or Accountant	121	57%
	Other Staff	90	43%

Source: Summarized Results of Survey Questionnaire

In Table 2, we have tabulated the number of respondents and corresponding percentage per variable. The major prefectures represented in the sample are Kanto (172 samples, 41.2%), Kansai (90 samples, 21.7%), and Chubu (47 samples, 11.3%). The distribution of samples per prefectures could be provided by authors upon request.

6. Results

6.1. Pearson correlation coefficients

A correlation coefficient analysis was performed for these variables in relation to firm size (number of employees and capital), intention of IPO, and number of accountants. These associations are shown in Table 3.

Table 3. Pearson correlation coefficients

	1	2	3	4	5	6	7	8	9	10	11
1.No. of employees	1	0.940**	0.105 *	0.153**	0.068	0.122 *	0.166**	0.226**	0.305**	0.149**	0.154**
2.Capital	0.940**	1	0.065	0.091	0.03	0.065	0.123 *	0.140**	0.268**	0.121 *	0.126 *
3.Recognition of SCFs	0.105 *	0.065	1	0.541**	0.336**	0.312**	0.345**	0.210**	0.028	0.363**	0.337**
4.Production of SFCs	0.153**	0.091	0.541**	1	0.292**	0.452**	0.576**	0.251**	0.008	0.432**	0.432**
5.Recognition of SCRD	0.068	0.03	0.336**	0.292**	1	0.480**	0.200**	0.151**	-0.032	0.183**	0.166**
6.Production of SCRD	0.122 *	0.065	0.312**	0.452**	0.480**	1	0.306**	0.256**	0.066	0.274**	0.292**
7.Recognition of the importance of the SCF for DM	0.166**	0.123 *	0.345**	0.576**	0.200**	0.306**	1	0.283**	0.096	0.377**	0.387**
8.No. of accountants	0.226**	0.140**	0.210**	0.251**	0.151**	0.256**	0.283**	1	0.024	0.203**	0.218**
9.Intention of IPO	0.305**	0.268**	0.028	0.008	-0.032	0.066	0.096	0.024	1	0.035	0.047
10. Recognition of GAS for SMEs	0.149**	0.121 *	0.363**	0.432**	0.183**	0.274**	0.377**	0.203**	0.035	1	0.938**
11. Recognition of ASBJ for SMEs	0.154**	0.126 *	0.337**	0.432**	0.166**	0.292**	0.387**	0.218**	0.047	0.938**	1

Note: Significance level – two-tail: ** 1%, * 5%.

The number of employees and capital variables define SMEs (Table 1). These variables represent firm size and are strongly positively correlated ($r = 0.940$; $p < 0.01$). This means that as the number of employees increase so does the amount of capital. We also find that the number of employees is positively significantly associated with recognition and production of the SCF (at 5% and 1% significant level, respectively) in partial support of H_1. However, we do not find a similar statistically significant relationship between capital and the recognition and production of SCF. Interestingly, both variables, no. of employees and capital, are positively significantly associated with the number of accountants and knowledge of accounting standards for SMEs. Capital was positively correlated with recognition of the importance of the SCF with decision-making, recognition of GAS and ASBJ for SMEs at 5% significant level. Capital was also positively associated with intention of IPO at 1% significant level.

The intention of IPO variable was only significantly associated with firm size variables, number of employees and capital, at 1% level. This indicates that larger SMEs may intent to go public. Nevertheless, we find no association between this intent and the recognition or production of SCF. Thus, we find no support for H_2. In support of H_3, we find that the number of accountants is positively correlated with recognition and production of SCF and SCRD, recognition of the importance of SCF for decision-making, and recognition of GAS and ASBJ for SMEs at 1% significant level. However, there was no significant correlation between number of accountants and intent of IPO.

6.2. Additional analysis

For those SMEs that produce the SCF, we investigated the main reason for preparing this statement. We relied on cross tabulations and Chi-square test to assess the statistical significance of these relationships (Table 4). We find that firm size (number of employees and capital) is significantly ($p < 0.01$) associated with the issuance of the SCF for shareholders' benefit. Likewise, those companies that intent to make an IPO are also significantly ($p < 0.05$) associated with reporting to shareholders. We also find a significant ($p < 0.05$) association between using the SCF for decision-making and a small number of employees.

Table 4. Purpose of the SCF – Cross Tabulation

Variables	Total	Management Decision-Making	Lending Institutions	Business Partners	Employees	Shareholders
No. of employees	**214**					
0 - 10	28	23 82% ***0.017 ****	16 57% *0.714*	2 7% *0.287*	2 7% *0.154*	1 4% *0.54*
11 - 30	72	40 56% *0.621*	43 60% *0.878*	12 17% *0.654*	2 3% *0.834*	1 1% *0.09*
31 - 50	51	27 53% *0.44*	27 53% *0.308*	4 8% *0.208*	- - -	3 6% *0.863*
51 - 100	37	20 54% *0.583*	27 73% *0.156*	6 16% *0.748*	1 3% *0.893*	2 5% *0.794*
101 - 300	18	11 61% *0.853*	14 78% *0.153*	4 22% *0.378*	- - -	3 17% *0.113*
301 +	8	5 63% *0.838*	3 38% *0.188*	3 38% *0.076*	- - -	4 50% ***0.000 *****
Capital	**211**					
¥0 - ¥10M	50	35 70% *0.147*	26 52% *0.257*	4 8% *0.223*	2 4% *0.510*	- - -
> ¥10M to ≤ ¥30M	81	40 49% *0.142*	54 67% *0.349*	15 19% *0.394*	2 2% *0.947*	4 5% *0.608*
> ¥30M to ≤ ¥50M	51	31 61% *0.803*	28 55% *0.445*	6 12% *0.614*	- - -	2 4% *0.48*
> ¥50M to ≤ ¥100M	20	10 50% *0.442*	15 75% *0.209*	3 15% *0.950*	1 5% *0.471*	3 15% *0.163*
> ¥100M	9	7 78% *0.258*	6 67% *0.721*	2 22% *0.522*	- - -	5 56% ***0.000 *****
Intention of IPO	**212**					
Yes	7	5 71% *0.506*	4 57% *0.848*	2 29% *0.304*	1 14% *0.056*	2 29% ***0.027 ****
No	205	121 59% *0.976*	125 61% *0.962*	28 14% *0.808*	4 2% *0.786*	11 5% *0.611*

Note: Multiple answers were allowed. Significance level – two-tail: ** 1%, * 5%

7. Discussion

In general, institutional theory states that societal structures or institutions pressure organizations to become homogenous, this is achieved through coercive, mimetic, and/or normative practices (DiMaggio and Powell, 1983). In Japan, a code law country, legal and regulatory systems dominate the institutional environment. We find that coercive pressures imposed by the regulatory system and debtholders have the greatest impact on Japanese SMEs financial reporting. Previous research has shown that institutions are shaped by cultural values (Hofstede, 1980; Gray, 1988). This is also relevant in accounting standard setting. Several studies have found a relationship between national cultural values and financial reporting standards. Some of these make a distinction between code law countries like Japan and Germany, and common law countries such as the United States and the United Kingdom. Unlike common law countries where the focus is on investors, in code law countries, other stakeholders have greater influence on the issuance of accounting standards (Fearnley and Gray, 2015). These cultural differences are found even after the implementation of International Financial Reporting Standards, which were instituted to add uniformity to financial statement reporting among adopters. However, many researchers have found differences mainly attributed to disclosure practices (Tsakumis, 2007; Zahid *et al.* 2018) and measurement options provided in the standards (Fearnley and Gray, 2015).

Our first hypothesis (H_1) examined the association between firm size and the recognition and production of the statement of cash flows. We found partial support for this hypothesis. Firm size was measured by two variables: number of employees and capital. We only found a statistically significant association between number of employees and recognition and production of the SCF, and recognition of its importance in decision-making (Table 3). Previously, it was stated that SMEs may lack the funding and resources to hire qualified personnel, and that frequently, accounting functions are performed by owner-managers of the business (Urasaki, 2014). Therefore, it is plausible that as the firm size increases, resources would increase as well allowing for the acquisition of qualified personnel and that these individuals may be responsible for producing and using the SCF. Although this study found no support for the accounting personnel hypothesis (H_3), the number of accounting personnel was positively significantly associated with the recognition and production of the SCF, and recognition of its importance for decision-making (Table 3). An explanation for the lack of significance for H_3 may be that the qualified personnel may not be accountants per se but may have the knowledge, training, and work experience to perform these duties accordingly. Employees' education and training was not factored in the survey questionnaire; thus, we are unable to confirm this premise. We also found no support for the likelihood of producing and using the statement of cash flows when the company intends to make an initial public offering (H_2). Only thirteen companies surveyed indicated their intention to make an IPO out of total usable responses of 410 (Table 2). The small sample may be the reason for the lack of statistical significance. This variable was only found to be positively significantly associated with firm size (number of employees and capital, Table 3) suggesting that larger companies would be more likely to make an IPO.

As stated earlier, Japan's cultural dimensions scored high in uncertainty avoidance and masculinity, low in individualism, and medium in power distance. According to Gray (1988), countries that are high in uncertainty avoidance are expected to favor financial reporting practices that are uniform, conservative, and tend to uphold secrecy as opposed to transparency. Other studies have come to similar conclusions when analyzing the relationship between Hofstede's and Gray's cultural and accounting values. For example, Fearnley and Gray (2015) find that EU countries high in uncertainty avoidance favor more conservative accounting practices. Han *et al.* (2010) examine North American and non-North American countries with comparable results. Countries that are high in the Masculinity dimension tend to be more cautious in support of secrecy and less disclosures (Zahid *et al.* 2018). Likewise, our findings demonstrate that most Japanese SMEs do not prepare the statement of cash flows because it is not required by statute. Furthermore, lending practices fomented by government policies have created a system of checks and balances that does not require extensive financial disclosures. The accounting standards have been formalized to effectively provide and meet the minimum requirements needed in order to satisfy debtholders' needs (Urasaki, 2014). Thus, SMEs have no incentive to issue the statement of cash flows or additional disclosures to obtain credit and other benefits provided by these subsidies. Additionally, a possible explanation for the lack of statistical significant association between the capital variable and the recognition and production of the SCF may be due to the restrictions imposed under the SME definition in respect to this variable that may have a negative effect on capital growth (Tsuruta, 2020). In order for these SMEs to achieve financial growth, they should consider adopting IFRS to obtain external financing and facilitate expansion overseas (Amano, 2020).

For those SMEs that currently prepare a SCF, we also investigated its purpose and use (Table 4). We only found statistical significance for larger companies (number of employees and capital) when they are required to issue financial statements to shareholders. We found no statistical significance for other uses such as lending institutions, business partners, and employees. We found a moderate significance for management decision-making when the number of employees is ten or less. As stated earlier, owner-managers tend to prepare their companies' financial statements, and this may be the reason for this statistical significance. Similarly, Amano (2020) investigated the impact of intangible assets for those Japanese firms that had voluntarily adopted IFRS. Findings show that larger firms with operations overseas and intangible assets were more likely to voluntarily adopt IFRS because of the number of foreign subsidies, a larger shareholder base, and the opportunity to capitalize their intangibles. This assists in our understanding of the incentives for larger SMEs to issue a complete set of financial statements for the benefit of their shareholders.

8. Conclusion

We examined the production and use of the statement of cash flows by Japanese SMEs. Overall, we conclude that in accordance with institutional theory and Gray's (1988) cultural accounting practices, SMEs are more likely to produce and use the statement of cash flows only when required by statute, lenders, or shareholders. Our study explains these findings in relation to institutional theory (mimetic, coercive, and normative pressures) and Japanese cultural dimensions that are linked to accounting standards and practices. Firm size was found to be positively related to the recognition and issuance of the SCF, especially in relation to number of employees. Capital may not have been a factor because most SMEs surveyed indicated an amount of capital that was less than the required filing threshold. Japan is a code-law country, and its commercial code is modeled after Germany's commercial code. It focuses on tax collection and creditors. Consequently, the General Standards for SMEs emphasize the harmonization of financial reporting with the Corporate Income Tax Law (Urasaki, 2014). Many unlisted (not traded publicly) organizations select accounting practices that reduce taxable income rather than properly reflecting the economic substance of transactions (Gordon, 1999). Therefore, it can be inferred that organizations abide by laws and regulations and rarely deviate from prescriptive practices. In general, East Asians value collectivism, hierarchy and context while Westerners are more 'egalitarian' and work in a less restricted and more individualistic environment (Martinsons and Davison, 2007). Collectively, the actions of group members, including society and cultural expectations, weigh heavily on management's decision-making and behavior. Furthermore, the Japanese are more likely to imitate strategies and decisions that reduce or avoid risk (Martinsons and Davison, 2007). Hence, we agree with Gray's (1988) premise and conclude that Japanese SMEs value statutory control and uniformity more so than professionalism and flexibility. Moreover, they abide by minimum financial reporting requirements because they appreciate secrecy rather than transparency in line with a strong uncertainty avoidance restricting information to prevent conflict (Gray, 1988) and probing, or to minimize reputational risk.

Future research could investigate the production and use of other financial statements such as the income statement and balance sheet and their relationship to access and cost of credit. An investigation into owner-managers, and other personnel's education, training, and prior experience in accounting would also provide additional insights into SMEs' attitudes in producing and using financial statements in general. We also recognize that this study has a few limitations. We have assumed that respondents have provided honest answers and that they have access to reliable and up-to-date financial records. The lack of these may have an impact on the empirical results reported. Moreover, the information provided is only for a certain period, January through May 2015 and does not provide the effects of a longitudinal analysis. We also did not investigate the reason(s) or motivation for SMEs' initial financial reporting and continuation, or factors that impede it.

An evaluation of Japanese SME's sustainability is necessary, and this study contributed by providing valuable information on the financial reporting behavior of these entities in relation to the statement of cash flows. In light of current economic conditions sparked by the COVID-19 pandemic, we expect that SMEs would be at a great disadvantage given that they rely heavily on debt for funding and that banks are increasingly risk-adverse (EIU, 2010). Because of market volatilities, SMEs are reluctant to spend on fixed assets and intangibles (Amano, 2020) depriving them of much needed cash. Since most SMEs depend on the domestic market for their survival, an aging and shrinking population leaves them economically challenged. Many may have to expand overseas to look for new opportunities (EIU, 2010; Amano, 2020). Those SMEs that enjoy access to funds they do so through international investors. Many require financing for research and development activities and technological innovations for growth (EIU, 2010). Although the central government has instituted many policies to assist SMEs such as loan guarantees and state-affiliated financial institutions, many perceive these policies as hindering capital growth and expansion (Tsuruta, 2020). Therefore, we hope that our study will serve to enlighten future policymaking for SMEs in Japan.

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