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Japan plots path to venture capital relevance

Country planning big revamp of its ecosystem for startups to boost struggling economy

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The Asahi Shimbun

Takuya Hirai's party will present a 'very ambitious' proposal to the prime minister.

Japan, an afterthought for most big venture capital players, is plotting a big revamp of its startup ecosystem to boost its economy.

Japan's status as a minor destination for global venture capital investors may be poised for an upgrade amid growing consensus in Tokyo that strengthening the country's startup ecosystem may be Japan's last, best chance to revitalize its economy.

In recent weeks, the ruling Liberal Democratic Party of Prime Minister Fumio Kishida and the Japan Business Federation, or Keidanren — both better known as advocates for the country's business incumbents — have called for far-reaching reforms that would pave the way for tens of billions of dollars to be funneled every year to disruptive new companies.

There's been "a shift in mindset," with policymakers — after years of effort that left Japan well off the pace being set by markets like the U.S. and China — concluding they have to raise their game if Japan's economy is going to garner the benefits of innovation, said Sho Kawashima, a Singapore-based associate vice president and lead performance researcher with Preqin focused on Japan's private equity and venture capital industries.

Takuya Hirai, a Liberal Democratic Party member of the lower house of Japan's parliament and head of an LDP working group on startups and digitalization, said his party will present a "very ambitious" proposal to the prime minister this week, spanning Japan's "tax system, regulatory reforms, procurement and so on."

Mr. Kishida is also scheduled to announce a package of policy measures in June focused on strengthening Japan's startup ecosystem.

The LDP proposal, targeting a more than tenfold surge in annual venture capital investments in Japanese startups to ¥10 trillion ($82 billion) by 2027, includes:

- Expanded tax breaks for angel investors.
- Creation of a secondary market to trade founders' shares.
- Establishing a ¥1 trillion government fund to invest in foreign venture capital general partners willing to open offices in Tokyo.
- Calling on public pension funds such as the ¥199.3 trillion Government Pension Investment Fund, Tokyo, to add VC allocations.
- Establishing an incubator startup campus in Tokyo in partnership with high powered universities overseas.

“We cannot build a competitive startup ecosystem” by tinkering with existing policies, Mr. Hirai said in an interview. “So mindset will have to change. Policy will have to change. We have to change everything.”

Mr. Hirai called the choices being made now difficult ones. On a cultural level, “we are not good at change,” he conceded. “But this time, we have made up our mind to change — this is the final opportunity for us.”

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Learn from history

Keidanren — in recommendations for Japan's startup ecosystem the business organization released March 15 that share many similarities with the LDP proposal — pointed to the global financial crisis of 2008 and 2009 as an illustration of what's at stake.

In the wake of that upheaval, Japan's lack of a startup-friendly environment left its economy and stock market stalled, while in the U.S., newcomers such as Airbnb Inc. and Uber Technologies Inc. blazed new paths, helping to levitate the economy and employment along the way, Keidanren's proposal noted.

The years following the financial crisis produced more than 120 U.S. "unicorns," or startups that achieved valuations of more than $1 billion, while Japan had only one — Tokyo-based e-commerce company Mercari Inc., Keidanren said.

Tomoko Namba, the founder and executive chairman of Tokyo-based online services firm DeNA Co. who became the first woman to assume one of Keidanren's 19 vice chairman posts in June, said in an interview that 70 years ago the Japanese government could identify automobiles and electronics as pillars of the country's economy for decades to come, but those days are over.

"The name of the game changes every three years now and technology is changing far more rapidly," so developing an ecosystem that allows private-sector people to keep innovating is the only way forward, said Ms. Namba, who authored Keidanren's startup ecosystem recommendations.

While the business organization is best known as home to Japan's corporate titans, Ms. Namba insisted it's not paradoxical that Keidanren backed her calls to target a tenfold jump in annual venture capital investments and the number of new startups in Japan by 2027.

It's tough to get all of Keidanren's more than 1,400 companies to agree on anything but "nobody disagrees about the importance of growth of the national economy" or national prosperity, she said.

Fixing Japan's startup problems has been a work in progress for years but steps taken have never been comprehensive, Ms. Namba said.

"I think we've reached an inflection" point now, with a recognition that "we have a massive amount of things to do in the private sector and the public sector" alike, she said.

While many of Keidanren's proposals overlap with those of the Liberal Democratic Party, including calls to reduce burdensome regulations, encourage startups to foster global ambitions, incentivize overseas venture capital heavyweights to set up shop in Japan and foster investment flows to Japanese startups from foreign and domestic asset owners alike, one recommendation that has garnered attention is the business organization's call to establish a dedicated startup agency, or "control tower" to consolidate the government's policy efforts.

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Wait-and-see attitude

Industry players, while anticipating more good than harm from the policy steps to be rolled out later this year, say they're taking a wait-and-see attitude regarding how effective they will be.

Yasushi Kusaka, Tokyo-based CEO of Mercer Japan, said he has mixed feelings about the government's latest initiatives. A strong push by the government in this direction can only be welcomed and the fact that the founder of a startup such as Ms. Namba, rather than a more typical corporate titan, has emerged as Keidanren's voice on this topic, promulgating new ideas such as establishing a dedicated startup agency, is strongly positive as well, he said.

On the other hand, this becomes just the latest in a long line of proposals, and with a June unveiling coming just a month before a scheduled upper house election, the results of which could effect the timing and scope of policy changes, it's a good time to wait and see what the details of the prime minister's package will be, Mr. Kusaka said.

The steps being discussed now have been under consideration for years and if they're finally being put in place, then better late than never, said Motoya Kitamura, a private equity and venture capital veteran who founded Tokyo-based private equity secondaries manager Northvillage Investment last year.

Japan's venture capital industry was already enjoying strong growth in recent years, albeit from a low base.

The past year saw dramatic growth in venture capital investments in Japan to $8 billion, up 50% from the year before, with a pickup in foreign flows as well, Mercer's Mr. Kusaka said.

Northvillage's Mr. Kitamura said he's bullish about the prospects for venture capital in Japan, but not because of the coming policy steps to promote that market. Instead, he cited the growing ranks of young Japanese willing and eager to begin their careers at startups as opposed to the time-honored route of joining corporate behemoths like the Mitsubishi group and Nippon Telegraph & Telephone.

Mr. Kusaka welcomed the same trend. "In the past, those who worked on startups were unconventional types," he said. "But now many smart graduates from Tokyo University or Keio University will work on starting up a business," which is leading to a more diversified universe of venture capital-backed firms in Japan, he said.

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