

AN OVERVIEW OF JAPANESE VENTURE FIRMS WITH AN EMPHASIS  
UPON THE ECONOMIC ANALYSIS OF POLICY  
AND INFORMATION ACTIVITIES

Toshihiro HORIUCHI <sup>1</sup>

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An Overview of Japanese Venture Firms with an emphasis upon  
the economic analysis of policy and information activities

Toshihiro HORIUCHI <sup>1</sup>

School of Political Science and Economics

Waseda University

1. Introduction

In 1990s Japanese economy has been struggling with the financial instability and it is now going into the worst recession since the end of second world war. Japan will have to increase more unemployed people rapidly in the near future unless it will have more new venture firms (hereafter VFs).

Nevertheless VFs or small and medium-sized firms have been influenced much more heavily than large corporations by their limited fund raising capability, aggravated seriously by the ongoing economic recession and financial market instability. VFs policy has become one of the most important and urgent policy issues which Japan has to solve soon in order to get the normal growth path and to stabilize its economy, thereby to contribute to the world economic stability. We can expect that VFs can accelerate the transformation of Japanese economy from the regulated to the more liberalized and flexible one. This policy issue, however, is not only important in Japan but also in Europe or the world as a whole. The paper discussing Japanese VFs thus can give an interesting case.

The paper aims to make an overview of Japanese VFs from the

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structural, world-wide, and general point. Therefore the approach adopted in the paper is the economic analysis and is focusing on the policy discussion and the management principle of VFs. Theoretically speaking, VFs can be defined as the firms that have the comparative advantage in their idea or information resource endowment such as to generate new innovative business plan, new management team organization, new technology development, new market concept, and so on. However, under the distorted market situation of resources such as capital or management professionals and of products in Japan, VFs have not been able to display their ability as fully as possible. This market situation has been causing considerable inefficient resource allocation and has become one of the structural reasons of the recession and the low economic growth expectation.

Japanese policy authority has recently seemed to discuss why we could not have so more VFs or why we could not yet have pioneering firms such as Microsoft and so on. It has started to pay an attention to VFs, however, the policy designing still assumes the dual economy composed of large corporations who need less policy assistance and small and medium-size firms who need much more. The paper discusses that we need to build more general policy framework upon the basis of theoretical economic calculation to realize the innovative economy in the future. Nevertheless, the policy discussion should consider the continuity element of hitherto Japanese industrial policy approach. The synthesis may lead to the third approach for having more VFs in Japanese economy.

The paper has six sections including this Introduction. Section 2 and 3 are theoretical parts. Section 2 discusses the economic definition of VFs. It analyzes the importance of the competitive mechanism for the new economy driven by VFs. Section 3 discusses the principle of VFs policy

designing. Its basis should be the economic definition of VFs. Without enough consideration of this economic rationality, any policy cannot succeed. It is not how many policy instruments Japan should introduce for VFs but whether the total system reflects the economic mechanism.

Sections 4 and 5 discuss some aspects of the reality of VFs in Japan. Section 4 is an overview of Japanese VFs activities. Their information activities are the main issue because VFs are defined to have comparatively more information resources than other firms. Also it will make a discussion of the reality of Japanese policy. Section 5 then will turn to the private initiative of VFs in order to solve their market imperfections. This is the most effective way to realize their competitiveness. Finally, Section 6 concludes the paper.

## 2. Economic definition of VFs

The section approaches the theoretical definition of VFs through three points of view. Each point will have its policy implication discussed later in Section 3. This section, finally, makes a brief historical discussion about VFs defined by businessmen or business management scholars in Japan in the late 1970s.

### 2.1 Comparative advantage in business idea

Economy has lots of agents who have different resource endowments. Each agent can become better off by the voluntary exchange of resources among various economic agents. The economy can be depicted by this voluntary exchange pattern of resources among agents. In this exchange economy a VF or an entrepreneur can be defined as an agent who has more business idea or business information stock rather than other resources such as capital compared with other agents. The agent is going to challenge to any uncertain business.

In our modern economy, it should be large corporations who have huge business chances or ideas and information stock. However, these large corporations have also more capital or human resources. Indeed, as assumed by Penrose (1959), the firm can be analyzed as an organization who can control or hold as much as capital resources, human resources, market resources, technology capability resources, or business ideas and so on. The large corporations' holding of business ideas or information will also be surely greater than that of VFs. However, what we are paying attention is not the absolute stock but the relative stock.

This comparative resource endowment relationship among newly entered VFs and other firms is a critical point. The disadvantage

condition itself that VBs do not have enough capital resources, human resource, or sales resources does not imply the necessity of policy assistance as long as they can exchange their ideas for other business resources. The different initial condition among any economic agents in terms of the relative resource endowments does not necessary become a reason of policy issue.

If the condition might become a reason for policy intervention, it should be a case where VBs will not be able to make the rational exchange of their ideas or information with other agents for necessary business resources. This case will occur in our real economy mainly because their trading participants cannot understand or believe in the idea or information. VFs may have to pay considerable transaction costs to let their ideas be informed to market participants, however, sometimes they may result not to be able to exchange at all. Under these real situations, we have to introduce any policy intervention, however, the condition that they do not have enough money for example does not presume the policy necessity by itself.

## 2.2 Uncertainty approach assuming uncertainty

Second, VFs or entrepreneurs are defined by K. F. Knight (1921) from a different point. According to his book, *Risk, Uncertainty, and Profit*, he did not assume the perfect market because of uncertainty. The market imperfection is due to the impossibility of rational expectation on the future. Knight sought the reason of this impossibility in the uncertainty and he separated it from the risk on which a mathematical expectation can be properly applicable. He assumed that it is impossible to form such a mathematical expectation in the case of uncertainty. This

is the start of his discussion about the role of entrepreneurs.

Entrepreneurs are pivotal players to mitigate this imperfection by challenging to uncertainty. This challenge can give workers their jobs with certain wages and thus the economy can grow. It can give capital suppliers certain rental. Entrepreneurs, on the other hand, have to accept uncertain rewards but they can expect high return by challenging to uncertainty by organizing various resources. In other words, entrepreneurs have special abilities or animal spirits in making an organization although they themselves may not have enough capital, special management capabilities, or special technologies, or even information in some cases. They are innovators from the point of making their new organization suitable to solve uncertainty.

Therefore, without such challenging entrepreneurs in the society, we cannot expect any growth or progress. Workers or capitalists cannot find their opportunities to earn money.

We will show an example of these entrepreneurs discussed by Knight in the Japanese growth history since the end of world war. Soichiro Honda was the founder of HONDA Motor<sup>1</sup>. He was a young engineer of motor bike when he started his business at Hamamatsu, locating between Tokyo and Nogoya. Today HONDA Motor has become one of the most profitable auto manufacturers in the world and diversified its business in the world as a whole. However, when he started his business, its size was very tiny, compared with for example Toyota in those days. After about only 10 years, HONDA had become the biggest motor bike manufacturer in the world.

Having had this splendid growth record, Honda was seen to have very limited abilities of management strategy planning. However, he was

<sup>1</sup> See Horiuchi (1998) for more detail of this discussion.

such a true challenging entrepreneur that he chose Fujisawa as his partner who could complement his limited ability of strategic management planning. Fujisawa joined HONDA and he was seen to plan every management plan in the place of Honda. Honda had succeeded in organizing the best management team for the success of HONDA and thus he was the best example of entrepreneurs in Japan defined by Knight. Now HONDA Motor employs more than 100 thousands workers in the world as a whole.

### 2.3 Dynamic competition

Steady birth of VFs needs another type of VFs in the society. This is because any society cannot have many innovators like Honda in Japan. In the case of motor bike market, following Honda's success, many VFs have entered the market. They are not innovators but follower type VFs. Our society needs such follower type VFs to get more job opportunities. We can find this type of VFs in the discussion of Adam Smith.

Needless to say, Adam Smith is an academic pioneer of modern economics and he analyzed the mechanics of competition in order to achieve the economic efficiency. In his mechanics, we can find an interesting element relating to VFs. In Smith's discussion, the economy is not in any steady state but in dynamically changing situation. Firms have to play an important role to bring the mechanism of competition and the economic efficiency. His invisible hand can be introduced by this role of dynamically changing firms.

They do not need to invent new technologies, new ideas, new markets by themselves. They just need to pay a keen attention to their rivals or innovators or rivals to survive in their market. In other words,



they can exist as followers. They are so necessary that they are majority compared with true innovators. If they do not exist, the economy may have to accept the monopoly distortion caused by any innovators who by definition are very few. Therefore, these followers are indispensable agents in the society in order that the economy can enjoy the fruit of the innovations brought by true entrepreneurs <sup>2</sup>.

The other striking difference between true entrepreneurs and followers can be seen in the comparative resource endowments. The former have the comparative advantage in ideas or information stock and the latter in capital. By this comparative advantage of capital they can catch up the innovators. However, they are also VFs because they are challenging by changing their organization flexibly. These VFs have to adjust flexibly to new profit chances by paying careful attention. They are promoting the penetration of innovation in the economy as a whole <sup>3</sup>.

#### 2.4 Policy oriented definition in the early 1970s in Japan

Here, we will look into an interesting discussion of the policy

<sup>2</sup> See page 755 of the Glasgow edition of Adam Smith (1976). *To buy in one market, in order to sell, with profit, in another, when there are many competitors in both,; to watch over, not only the occasional variations in the demand, but the much greater and more frequent variations in the competition, or in the supply which that demand is likely to get from other people, and to suit with dexterity and judgement both the quantity and quality of each assortment of goods to all these circumstances, is a species of warfare of which the operations are continually changing, and which can scarce ever be conducted successfully, without such an unremitting exertion of vigilance and attention, as cannot long be expected from the directors of a joint stock company.* The discussion is an example of traders but can be applied to any firms. Assuming manufacturers, this discussion relates to the patent. The Smith discussion relates to the case where the protection by patent cannot be applied efficiently.

<sup>3</sup> Therefore, according to this definition, large corporations who can display flexibility can be categorized in this type of VFs. Indeed, HONDA Motor is still one of large VFs in Japan. Also, SONY may be included in this category. See Horiuchi (1998) for HONDA case.

oriented definition of VFs in Japan. Historically speaking, during the early 1970s of the high economic growth period in Japan, VFs were discussed by policy authorities and some management scholars that they are small and young firms and would promote venture business (VB).

The term VB had been used to refer to innovative and knowledge-intensive business <sup>4</sup>. According to the definition focusing upon the policy implication, VFs are often short on capital or researchers and so on although they have growth potential based upon product development capability. Also, their business risk normally becomes high at the starting stage. Therefore, their business potential cannot be fully or rationally evaluated by ordinal market participants. This is because under real market conditions - where the market cannot predict perfect expectation - they cannot usually have enough channels by which to reveal their business plan or information to their market participants. On the other hand, these participants themselves may not usually have sufficient information or ability to understand the information supplied or to manage their investment risk <sup>5</sup>. We will label this type VFs as POVFs, i.e. policy oriented VFs.

POVFs are seen to be a loose complex of three elements of VFs in the above. First, they are seen as firms who have innovative and knowledge-intensive resources and who do not have enough other resources.

<sup>4</sup> See Venture Enterprise Center (VEC) report of 1993. It was in 1970 when the term VB was coined in Japan by Nakamura and Kiyonari. Also, see Shimizu (1986) for the growth factor analysis of VFs in Japan.

<sup>5</sup> Large corporations have enough business resources and may not be seen as VFs by the first definition. However, by the third definition, they can be seen as VFs if they can behave flexibly. Therefore, according to the third discussion, large corporations are seen to have X-inefficiency in their organization. This should be an economic definition of large corporations. Theoretically speaking, the size itself does not have any rational meaning except for the scale economy in the competitive economy.

This implies the presumption in the discussion of the comparative consideration. Second, they have to face "risk" but the discussion did not distinct it from uncertainty defined by Knight. Therefore, the discussion did not cover the scarce ability to organize business. Third, the discussion paid too much attention upon innovative and knowledge-intensive firms and paid less attention upon followers as the majority.

Japan has kept the regulated policy stance and resulted to limit the entry of new VFs since 1970s. This fact simply proves that the policy stance or the system was not suitable for VFs. Unfortunately, this will become a good lesson showing that policy motivation itself does not lead to any success without rational economic analysis.

### 3. Theretical discussion of the desired policy for VFs

Section 3 discusses how the policy should be designed consistently to the economic definition of the previous section. First, we discuss the economic point and then we make an overview from the cultural point. Private initiative is still important for VFs' growth but this will be discussed later in Section 5.

#### 3.1 Economic elements of the desirable policy framework

If the purpose of VFs policy is to grow the economy by VFs, the policy has to cover all of these three theoretical requirements. If anyone of the requirement will not be introduced, the policy framework will not work perfectly, i.e. it will not cause many VFs in the society. Therefore, the complementarily condition among policy measures is tremendously critical matter. The policy system has to promote the information exchange, the organization opportunities by entrepreneurs, and the entre of follower VFs.

Viewing this condition from the point of the economy as a whole, the policy system for VFs has to accompany with the market regulation with rational incentives in the total system of the economy. Neither of various VFs policy measures can have any loopholes, introduced either intentionally or unintentionally in the total system, because they would weaken these three requirements. Nevertheless, we can show some examples of policy misdesign in Japan. Following are the worst three examples.

First is the case of capital market, i.e. the Over the Trade Counter (OTC) market for small and medium-sized firms. Capital market is the most important to exchange information. OTC market was reorganized in 1990s in order to have more listed firms. It aimed to offer smaller firms more

opportunities to become public by decreasing the application costs and by relaxing the balance sheet conditions. OTC market was expected to work as a capital market for VFs and had a desirable first step.

However, this improvement was introduced without the capital market liberalization. Almost all security companies were not pushed to compete with each other in order to produce the segmented market information of each VF. In other words, VFs could not have enough information production by research oriented security companies and they could not reduce the information asymmetry in the OTC market.

The market prices of listed firms cannot be expected to reflect enough information. Investors therefore could not trust market prices as well as these dealers. The market liquidity was limited and then investors had to face the liquidity risks. This situation has caused a big reason of limited merits for VFs to become public in OTC market.

Although Japanese OTC market was intended to introduce the capital market of National Association of Securities Dealers Automated Quotations (NASDAQ) in Japan but it could not get a similar success to the USA. The reason is simply that Japan did not satisfy the complementarily condition.

We will review very briefly the NASDAQ market in USA. It has grown since the introduction of security market liberalization. Each small security company was persuaded to make differentiated researches of each VFs. This differentiated process was a normal market mechanism for them to survive in the market. This mechanism is the most important force to achieve the success of the capital market policy for VFs.

It is these VFs that need trustful market information of security companies, i.e. of analysts with specialist ability. By the information activities of security companies in each segmented market, promoted by

market competition, the capital market can mitigate the information asymmetry among investors and VFs.

Therefore the complementarily condition of policy, i.e. that it satisfies three elements all together is crucial for the birth and growth of VFs in the society. By this complementarily condition, each policy measure can mitigate the information asymmetry among market participants in each market such as capital market, labor market, technology market, product market and so on.

Second, we will discuss this point by looking into the incentive design to entrepreneurs. It should to be made carefully and rationally to consider that there can be two types of incentives. First is the pecuniary incentive reflecting their economic contribution. The second one is the non-pecuniary incentive. Entrepreneur who can get enough monetary rewards from their business can be eligible to any social appreciation in the society.

Nevertheless in Japan, the society cannot easily accept wealthy people as respective success people. This is mainly due to the regulated market history in Japan that most of financially rich people were believed to be protected by the regulation policy.

However, Japanese people are going to appreciate success entrepreneurs in high technology markets. Namely, the liberalized market condition such as in the high tech markets will make people respect for real success entrepreneurs.

The rational and careful incentive in liberalized society will become an important signal to cause many follower VFs. It becomes a necessary condition for the growth by continually entering VFs. Therefore, the combination of the incentive designing and market deregulation is another

important example of the complementarily condition for the dynamic economy by VFs.

Third, the complementarily principle has also to be satisfied in the incentive design for other agents as well as entrepreneurs. Entrepreneurs need several resources supplied from many agents in order to organize their business. These agents holding necessary resources should be able to expect enough incentives to join their business. Their expectation should be made under the competitive condition, i.e. the mutual and rational exchange of their specialist resources with entrepreneurs. This should be made on the equal partnership. To do this equal partnership exchange as efficiently as possible, the policy has to introduce the suitable system. Nevertheless, even the taxation system such as the stock option does not give much incentives to part the VFs projects.

### 3.2 Cultural aspects of VFs policy

On the other hand, there may be an opinion emphasizing upon the cultural background about few VFs in Japan. Namely, even if the system would have introduced the theoretically desired economic points, Japan might not have many VFs because of various cultural factors such as the conservative preference of Japanese people.

However, we can show that such cultural factors are also influenced by the economic mechanism. In other words, if we would introduce the theoretically desired economic requirements in the policy designing, many cultural background may adjust to the new economic circumstance for VFs as shown in the following important example.

Among various cultural factors regarding VFs, the most relevant is the education policy. Education policy can effect the venture mind of

students. Most of graduated students in Japan are still recently going to find their jobs in large corporations or government institutions. Among large corporation sectors, the most popular is the banking sector even in 1990s in Japan for students or their parents. They are seeking as economically stable and socially high status jobs as possible by joining banks, which will still be expected to be protected by regulation and thus be insulated from the competition force.

However, on the other hand, this behavior of students also reflects that they cannot expect enough benefit from joining small firms or VFs under the current Japanese system. In other words, the opportunity cost to abandon to join VFs is expected to be too limited assuming the current incentive system. On the other hand, that to abandon to join large corporations is expected to be too large not only in terms of pecuniary but also non-pecuniary. Therefore, students do not go to small firms or VFs but go to large corporations. These small or VFs cannot employ talented students as much as possible. Therefore, VFs cannot organize the best management team. This is purely economic mechanism.

Education should be the most important environment to influence the growth path of the Japanese economy. However, as discussed in the above, the influence mechanism is not political but economic. Students are not originally dependent or conservative. They can adjust to the regulation conditions or the incentive system in Japan. Their dependence upon large corporations just shows that they have enough ability to make a rational economic calculation. If they can find enough incentives in VFs such as more liberalized stock option with favored taxation, they will choose them as their job chances. The economic criterions, therefore, can apply to the education policy design.



The universities are not free from the competitive influence. In the future Japanese universities are going to compete more with each other. However, most of universities will not have strong intension to support VFs growth but to survive in the advanced education markets. This selfish stance of universities nevertheless, they will become a powerful engine for Japan to have more VFs just as security companies in U.S.A. to adjust to the liberalization <sup>1</sup>.

In conclusion, the complementarily condition in the competitive market is the most important for that the society will get enough VFs and job opportunities. Japanese system is now slowly changing to this desired direction.

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<sup>1</sup> Japanese universities are one of typical examples which have kept the seniority wage system. Therefore, more talented people are biased to earn money outside and to allocate as less time as possible for organization jobs or routine education assignments. The quality of education has to be decreased much. Also, students tend to appreciate their teachers who work outside rather than teachers working more inside. This is an example of negative chain equilibrium such as prisoners' dilemma. Now in Japan, some universities have started business school divisions and other related offices. The next step necessary for the success is to introduce the consistent incentive system for academic staffs

#### 4. Reality of Japanese VFs

First, it overview the potential of new firms in Japan and then it summarizes several stylized facts about new firms in Japan. Third, we will overview the reality of policy framework.

##### 4.1 Potential of new firms

From the theoretical point of innovative power of VFs, they are categorized into two classes, innovative and follower VFs. The former necessitate higher and more innovative ability and are very fewer than the latter in any society. Furthermore, in our real society there are a lot of various interim types among both types. The wide distribution of VFs from the former innovative VFs to the latter follower reflects the distribution of people with various backgrounds. Each entrepreneur starting business has own motivation as well as background such as parent influence, education carrier, or business carrier. These initial conditions imply wide varieties of entrepreneurs at their start-up.

Indeed, Japan has a big pool of various entrepreneurs. According to some surveys, more than 15 % of businessmen working for firms, mainly for large corporations, do have strong intension to start their own business <sup>1</sup>. Their background varies very much in terms of business carrier, technology ability, management ability and so on. Some of them are very innovative and others are just followers such as starting retail business.

This potential amount of various start-ups in Japan will increase in the near future because of increased unemployed people due to the restructuring of large corporations. Indeed, Japanese large

<sup>1</sup> See Horiuchi (1977, 1998). The overview of this section is from the two sources.

corporations are estimated to have about 10 % of over employed people than the normal level because of life-time long employment system. They are often called people sitting close to the window, i.e. close to the outside labor market. Some of them may have strong motivations to start own business and some will be pushed to be unemployed without any clear motivations. This contrast situation will widen the diversification of VFs in Japan.

*White Paper on Small Business Corporations* edited by the Agency of Small Business Corporation, one branch of MITI (Ministry of International Trade and Industry), divides start-ups firms into four categories; 1. Purely independent start-ups, 2. Spined-off driven start-ups, 3. Start-ups in the same market supported by the previous relationships, and 4. Start-ups by corporate division policy. Among these four types, most of the third and the fourth are follower type. The first category includes wider varieties by carrier of business starters. The Paper analyzes that most of the first type have entered the retail or service businesses by investing a small amount of capital. Their business carriers are very limited such as only part-time jobs or sometime no business experience at all. However, there may be some cases in the first type that have high potential to become innovative VFs in the future and the authority seems to consider this type as hopeful VFs.

Also, the policy authority expects that the second category will lead innovative businesses. This is because they have accumulated more advanced business carrier, technology backgrounds, or marketing knowhow while they had been working for large corporations and so on. Some start-ups in the above first type and the second type are seemed as the real targets of VFs policy in Japan.

#### 4.2 Stylized facts on new firms birth in Japan

First, the birth rate of new firms has been decreasing continually since the late 1980s in Japan. Second, they have raised most of funds by borrowing from private banks as well as government institution banks such as Peoples Finance Corporation or Credit Guarantee Association. Third, venture capital funds have channelled money to firms not in the start-up stage but in the later stage. The amount of fund supply through venture capitals is estimated to be less than 1/5 of the total of venture capital funds in USA. Fourth, due to limited varieties of informal network, nationally or in each local area, Japan has not yet had enough angel investors. Generally, the amount of each angel investment is considerably smaller than that of venture capitals but the total is expected to be much greater than that of venture capitals. Fifth, the number of firms listed in the OTC market is quite fewer than that of the NASDAQ market. Sixth, the cost to become public in the OTC market is estimated to be nearly the same to that of the NASDAQ but other requirements such as profitability or stability of business have conditioned the applicants firms. In effect, most of listed firms have longer business history than 20 years. Seventh, high technology oriented firms are minority in the OTC market. Eighth, these negative facts nevertheless, the OTC market is targeted as the strategic market for VFs.

Almost all of these eight facts are concerning the fund raising of VFs. Fund raising centers the most important issue for VFs. In USA, the NASDAQ market has supplied funds to VFs and on the other hand in Japan the OTC market has not. The reason is already analyzed in the previous section.

Fund raising market condition is also important for investors such as venture capitals or angels. The NASDAQ market can supply these investors the opportunity to sell their equity holdings whenever they want. As discussed in section 3, the NASDAQ market has higher liquidity. The most crucial matter for investors is whether they can collect their investment whenever they want. They have no strong intension to make new industry or firms grow but to earn high return by investments. If they have to envisage longer time to collect their investments due to the lack of market infrastructure, their investment risk will become greater and they will decrease their investment. This effect then will hamper fund raising of VFs. Japanese situation is a typical case of this negative chain reaction between investors and VFs because of regulated OTC market. In this real situation, private banks could get a higher share of funds for VFs<sup>2</sup>.

Comparing venture capitals investment between Japan and USA, it is apparent that USA venture capitals are more active than Japanese venture capitals. They have invented several investment ideas to diversify the risks such as by arranging partnership. This is because venture capitals need investment money from institutional investors. Also, venture capitalists could get enough incentives because they are the key agents deciding the venture capital investment. VFs could become public within a few years after the business start in USA and investors could collect their investment. On the other hand, the Japanese situation seems to be a mirror image of this USA situation. The incentives to venture capitalists in Japan are more or less similar to those of notorious salarymen. The OTC market has low liquidity and has few specialist security dealers in the

<sup>2</sup> In the late 1990s when banks have been suffering with non-performing loans, this borrowing channel is going to be cut by banks.

regulated competition. In effect, VFs could not enjoy this infrastructure even if it has high potential for them.

#### 4.3 VFs policy measures overview

The reality of the Japanese policy framework in 1990s is an insufficient complex mixture of too many measures. These policy measures were introduced in the mid 1990s such as to expand fund raising market, to supply incubator facility, to organize technology centres or to supply technology subsidy, or to supply business training services and market information - as detailed by Horiuchi (1998). Every Ministry has focused upon VFs because they were seen as one of important sectors where the government money would be allocated.

Japanese policy has the following three typical facts. First, the policy menu covers wide choice of instruments and the number of applications is great. According to the *1994 Handbook of New Business Assistance Policy* edited by MITI, the number of policy measure amounted about to 500 in total, including local government measures. It has paid a considerable amount of money for policy designing and executing. However, Japan did not have many VFs. The policy should be seemed to be inefficient or miss-designed.

Second, most of central government measures are targeted to small firms such as by length of business history, intensity of research and development expenditure, field of business, and so on. In addition, most of local government assistance policy qualified the applicants by business location or duration of business within the region. Totally speaking, most of the policy measures for VFs in Japan are regulated not by the originality or business potential but by the relevance to the local

economy or the experience of the applicants<sup>3</sup>.

Third, as already mentioned from the point of fund raising destination for business start-ups, most of government assistance are concentrated upon lending from such as Peoples Finance Corporation, Small Business Finance Corporation, or Credit Guarantee Association. The direct finance channel from government fund is very limited, less than 1 % of total fund assistance. This low dependence on direct finance is a reflection of Japanese finance system depending heavily upon indirect finance, i.e. the banking system. On the other hand, U.S.A. has higher dependence upon direct finance as well as research and development subsidy oriented measures.

To achieve the policy aim of more VFs growth in Japan, it is first of all necessary to realize the efficiency of policy by throwing away these negatives. Capital market liberalization is the most effective measure for this purpose because it can raise the direct finance, and any VFs can access to the market as long as they are seen to have enough business potential by many investors. It is not the role of policy authority where the money should be allocated.

This market solution can save transaction costs of intermediation of capital. Therefore, the OTC market liberalization is considerably urgent. Nevertheless, the OTC market is still in troubled condition and thus some VFs are going to search their independent solutions not in Japan but in overseas markets.

<sup>3</sup> Furthermore, to succeed in the measures for applicants they need to file a lot of application form. In effect, it is said that the number of pages of the application documents will determine the success. This means that those people who have the ability to edit the business plan but do not have the true entrepreneurship are often able to get the assistance.

## 5. Joint business of venture firms

The section turns to the private initiative of VFs in order to mitigate the market imperfection by organizing joint businesses (JBs) among themselves. First, it discusses the rationality of JBs with an emphasis upon the information exchange. Second, it analyzes the reason why Japanese VFs prefer overseas JBs rather than local JBs in Japan. Third, the discussion covers more advanced joint activities and the desirable organization of JBs.

### 5.1 Economic rationale of partnership JBs

JB is a cooperative business among members who are willing to share the information in order to extract the growth potential of each member as extensively as they can. Theoretically speaking, for example, it aims to tackle on the lack of business resources, such as capital funds, production capacity, R&D capacity, or sales channels and so on. Also, it may seek to reduce business risk.

In reality, we can find three major patterns of JBs from the point of the exchange of information with an emphasis upon overseas JBs; 1. Exchange of production information in Japan for overseas marketing information, i.e. export of Japanese products, 2. Exchange of marketing information in Japan for overseas product information, i.e. import of overseas products, and 3. Exchange of R&D information or capability among both, i.e. international cooperative R&D<sup>1</sup>.

<sup>1</sup> An in-depth survey in 1991, conducted jointly by the Venture Enterprises Center and the Machinery Promotion Association and some researchers including the author, aimed to examine various aspects of overseas JB management of 19 Japanese VFs: namely i) resource exchange pattern, ii) management, iii) business impacts, and iv) partner information search. These firms have promoted their overseas JB for various purposes, such as production, marketing, R&D, or specific information activities and so on. See Horiuchi [1992] for the detail result of the survey. There are four



JBs are usually organized by a limited number of members having specialist knowledge, specific purposes, and trusts. A paramount importance is how each partner will find its counterparts with whom it can organize a JB relationship. The membership of JB organization is the most important matter for any JB to achieve the efficient cooperation. The serious information asymmetry problem can be minimized by controlling membership. Members can expect to control organization instabilities in the long-run. However, the membership can cover not only local firms in Japan but also overseas firms, and of all sized.

VFs search members from informal sources like friends, trusted business colleagues, or other various personnel networks, as well as by depending upon specialist agents. These sources are expected to have pools of VFs who can understand more precisely about the business risk and potential concerning the JB than other members such as banks or institutional investors. This is because of their long-term and informal relationship among them and of having specialist common knowledge.

After the initial search stage, VFs have to manage the information exchange among members for successful JB. Limited membership can help to understand the management adjustments whenever necessary. Each member is going to contribute to find realistic solutions in order to extract cooperative benefit from the JB in the long-run.

Therefore, the success of JB depends entirely upon the membership. The most crucial point for the successful JBs is whether VFs firms who have JB relationships with German firms, three with the U.S.A. firms, and three with other European firms, such as in Belgium, U.K., or Ireland. Also, there are just as many as firms that have promoted JB with Asian firms in Korea, Taiwan, Singapore, and elsewhere. From the point of view of overseas partners, this diffusion of overseas JB means that they could expand Japanese business by depending upon Japanese VFs. As emphasized by Dodgson [1990], JB in advanced technology industries has become one of the important business strategies for any VFs in the world.

have trustful personnel network or they can access to specialists agents with reputation.

## 5.2 Why VFs prefer overseas JBs?

Within Japan, most of VFs used to have JBs with large corporations. Their JBs are similar to subcontracting business. The reality is that they have JBs with just one division of a large corporation in order to get R&D money, for example. On the other hand, from the view point of the large corporation, it is not the top decision but the division decision to start the JB with the VF.

Top managers of large corporations do not usually monitor the JB nor have any direct relationship with it. Therefore, for example, if any middle manager of the counterpart would be transferred to other division, their JB may have to face the risk of sudden termination, or the risk of unfavorable renegotiation<sup>2</sup>. If large corporations will expect few benefits from the JB, the JB will be stopped suddenly partly because the JB does not usually have formal contract. On the other hand, if large corporations will expect business expansion, they may seek to pursue the project within the organizations by themselves.

If VFs would reject to accept such unfavorable business practises of large corporations in Japan, they may have to have some implicit penalties in the long-run. For example, they may lose an important source of large corporations for R&D, subcontracting business, market information, or technology assistance. Therefore, VFs used to

<sup>2</sup> See some cases in Horiuchi [1992] for this effect. In JB in Japan, most partner searches cannot become independent from the business relationship with large corporations. This goes in tandem with a set of management issues such as no contract, less bargaining power, and time consuming follow-up negotiation.

follow the prevailing business practises in Japan against VFs.

Having this business background, some VFs are going to prefer overseas JB if they have enough management resources or some outside supporters. Recent global business circumstance has been promoting this trend. For example, the market integration in Europe will increase JBs in Europe among various firms such as VFs.

However, the important motivation to prefer overseas JBs is to circumvent implicit regulations controlled by large corporations. VFs may encounter fewer business regulations and can expect more partners who can evaluate accurately their business plans or business potentials. For example, they may be able to have any partnership relationships with major overseas universities but they may not have these relationships in Japan.

In reality, every large firm or research institution believes in the hierarchy maintained by brand status in Japan. Therefore, it is not profitable for VFs to approach them because they do not have any national brand and they are seen to belong to the lower business hierarchy<sup>3</sup>.

### 5.3 Desirability of JBs as the third way to the VFs economy

JB organization is an example of intra-firm organization of the industrial organization theory. Desirable JB combines two mechanism for efficient resource allocation, i.e. the market mechanism and the organization mechanism. Namely, JBs among VFs should be considered as the third way to the economic growth by various VFs. It has neither completely competitive force nor rigid organizational binding force.

To make the efficient combination of both, first of all, JB will be started among several VFs by the private initiatives of small number of

<sup>3</sup> Meanwhile, this lower hierarchy may reflect the limited information disclosure by VFs.

entrepreneurs. Each member decides to join JB organization independently like when it decides to enter any market or not. After having membership, they will not be controlled completely by any contracts like in any formal organization.

First, of the apparent presumption is that each member entrepreneur would never throw away any independence mind as a boss controlling own VF. Indeed, compared with top managers of large corporations, entrepreneurs of VFs are those people who prefer less monitoring by banks, shareholders, or policy authorities. Any desirable joint venture organization has to accept their strong demand for this independent boss behaviour.

Nevertheless, each member is eager for trusted business friends and they are going to organize an intra-firm organization of JB. This behavior reflects the ambivalent attitude of entrepreneurs.

Second, therefore, regardless of their boss behaviour, they can cooperate with each other in this intra-firm organization and can accept any implicitly assigned role. The desirable JB organization needs leadership in the organization to assign such roles. Needless to say, the leader cannot control any other members strongly nor will intend to control deeply. The leader needs to be respected as a trustful intermediary among members. The leader behaves to adjust various interest conflicts of members and to direct the cooperation in the long-run.

Third is related to this leadership. Members have to control free rider behavior. This free rider problem is the most critical point for the desirable organization in any joint activities. Simply speaking, the most powerful action to reduce the free rider behavior is to limit the membership within friendly and trustful relations. Indeed, requiring

minimum technology ability for membership may function to solve this management problem. This is because each member can expect others' effort easily. Also, their relative weakness or lack of management resources, compared to large competitors investing in their niche markets, can become a strong binding force for VFs to reduce free rider actions.

Finally, any desirable joint framework has to change dynamically and flexibly. Theoretically speaking, this condition is so important and complex that we cannot deal it here as fully as possible. However, any joint framework supported by mutual trustful relationships may satisfy this dynamic flexible condition in the long-run. This is because of less negotiation required to solve any unexpected problems or organizational instabilities and so on.

This flexible condition for desirable joint organization could be satisfied in Japan although VFs prefer overseas JBs. Indeed, Japanese industrial organization presumes long-run trustful relationships among firms. However, VFs seek JBs not in Japan but overseas. This is mainly because relationships in Japan are controlled by large corporations and VFs cannot seek mutual trustful relationship nor flexibility with them. On the other hand, VFs have more options and flexibility with overseas partners.

Applying this desirable JBs idea, VFs are going to build an infrastructure for more advanced JBs such as International Business Collaboration Council (IBCC), among Japanese and overseas VFs. This is private, non-profit, and international infrastructure or network, organized upon the principle of mutual trust. The aim is not to earn profit but to support foreign VFs planning to invest in Japan from the U.S.A., Canada, Germany, and the U.K. and so on. Membership is limited to VFs having a similar level of technology in several advanced high-tech markets. IBCC

arranges business support service, like branch service supplied by member firms, covering various elements such as marketing research, export and import dealing, or marketing in general, until their local business base is established.

Recently, this overseas approach is also sought by venture capital. GR Associates is an example of venture capital intermediary in the high tech markets. GR Associates performs the role of business matching as a venture capital intermediary between Japan and U.S.A.

The private initiative through JBs in order to solve market imperfections has the high potential in our real world, not only for VFs but also for investors.

## 6. Concluding remarks

The paper discussed the economic mechanism to make the Japanese economy grow by many new VFs. VFs can be analyzed from three theoretical characteristics; having comparative resource advantage of information or business idea stock, having innovative ability to organize new business to face uncertainty, and having follower abilities to lead the growth of the economy as a whole.

The policy has to cover all of these three theoretical requirements. If anyone of the requirement will not be introduced, the policy framework will not work perfectly, i.e. it will not cause many VFs in the society. Therefore, the complementarily condition among policy measures is tremendously critical matter. This means that neither measure of VFs policy can have any loopholes, introduced either intentionally or unintentionally, which would have to weaken the competitive mechanism or to reduce the incentive to entrepreneurs even if it can itself have the potential to improve market imperfections.

The liberalization or competitive policy should have the priority. The policy is so general that it can diffuse the concept of the independent business mind in Japan. The policy can supply business chances for followers VFs.

Japanese policy framework has not yet achieved this complementarity condition and it lacks the systemic design although it has as much as measures. Japan may still need international pressure for this true liberalization.

Increasing overseas JB of VFs can be viewed as a sign to need the pressure. JB organization is an example of intra-firm organization. JBs among VFs will be the third way to the economic growth because JB

organization does not depend entirely upon the market mechanism nor organization mechanism. It has neither completely competitive force nor rigid organizational binding force.

JB among overseas and Japanese members can promote the international trade through the intra-firm trade among partners as well as trade with the rest of the world. Technology information and some cultural information can be shared more deeply among firms of different countries. This interdependent situation can contribute to the growth of world economy and can mitigate economic frictions. Of importance for this contribution is the grass root mechanism or the informal network.

Under such liberalized and interdependent market conditions, the effects of VFs' niche markets on the Japanese business organization will become larger and larger. The leverage of VFs will become larger, based on their network among interdependent firms in the world as a whole and supported by trustful partners relationships, specialist technology and knowhow stock, and flexible management capability. Overseas JB's will become the important sector of the international market integration.

Finally, the discussion of the paper implies the survival strategy of large corporations in Japan who have been struggling with the declining competitiveness. They have to behave like VFs and have to introduce the competitive mechanism in the organization. The old divisions are expected to behave like venture capitalists and the new division like true entrepreneurs. The incentive distribution in the organization has to change considerably.

In the society supported by the VFs mind, there will be no discrimination among large corporations and VFs from the view point of organization design.



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