

E ntrepreneurship in Japan — a New Wave?

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The number of business start-ups in Japan is lower than in other industrialized countries. Although many large and famous Japanese companies were founded by enthusiastic entrepreneurs after World War II, not enough companies have been founded since 1990 in comparison to other industrialized countries to drive innovation and create new jobs. On top of this, companies founded in Japan do not resemble start-ups in Western countries. The number of start-ups driving innovation, creating jobs and influencing the Japanese economy has been traditionally very low.

However, there are signs of change. Despite traditional and emotional barriers that many who want to be entrepreneurs in Japan face, increasing numbers of innovative start-ups have been successfully established in Japan.

Companies Founded in Japan

The actual number of small and medium-sized enterprises in Japan is not much lower than in other industrialized countries. There are more than 4.7 million small and medium-sized enterprises, which account for almost 99% of all Japanese enterprises. They also employ 70% of the 63 million Japanese employees. However, the number of newly established enterprises is not as high as in other industrialized countries. The start-up rate in Japan is only 4.5%, whereas it is 9.3% in the United States and in the United Kingdom as high as 10.2%. The Global Entrepreneurship Monitor placed Japan in last place out of 24 industrialized nations for entrepreneurship in 2012.

There are also rumors that Japanese entrepreneurs face a lot more challenges than aspiring founders in other countries. In fact, Japanese entrepreneurs have to face the same challenges as entrepreneurs in other countries. They struggle with initial funding and marketing their business ideas to first customers. They also struggle when growing a firm. Nevertheless, there are some specifics when starting a new enterprise in Japan.

The situation of small and medium-sized enterprises in Japan — like so many things in the Japanese economy — actually does not compare with that of SMEs in other developed countries. Many Japanese small and medium-sized companies face serious management challenges. The main reasons are the intentions of the entrepreneurs. Many Japanese companies are not started because a new and lucrative business opportunity is recognized, but to fulfill a small and often very specific niche in a local market. The local business model is a lot more dominant in Japan than in other industrialized countries. These companies are not busy promoting innovation and creating jobs, but always perform services in their local areas, such as small laundries or free real estate agents. Usually they provide one job (for the founder) and maybe one or two

more for part-timers. These little shops can be seen anywhere in Japan, even in Tokyo. They play a very important role in the local neighborhoods. Also, the high number of small restaurants in Japan contributes to these numbers. So Tokyo has an average number of 160,000 restaurants — 1,000 are opened every month and about the same number each month must close their doors.

Despite the relevance of these businesses for local communities and their attempts to provide more independence for their founders and employees, they do not have a strong effect on the long-term development of the Japanese economy. Nor do they foster innovation or grow beyond a certain size. The number of start-ups based on innovative business models which grow quickly and provide jobs and have a strong impact on their industry is still very low in Japan. Many of these small mom-and-pop stores are not very professionally managed. Low management knowledge and a degree of reluctance to deal in many cases with new technologies are distinctive features of many of these companies. In a survey by Japan's Small and Medium Enterprise Agency under the Ministry of Trade and Industry only 48% of the surveyed small businesses agreed that they successfully use modern information technology. In medium-sized enterprises the answers were more positive at 59%.

But the intentions of these particular companies are obvious. They survive because they serve a local neighborhood with a very specific demand and they do not expand their business either within Japan or overseas. They are only partially successful. The number of companies founded in the Japanese market is about the same as the number failing and leaving the market. There is little growth in newly founded businesses. Although most Japanese small and medium-sized enterprises provide jobs, they do not increase the innovation capacity of the Japanese economy. Criticism of Japanese start-ups is therefore based mainly on the fact that start-ups and the innovations that they establish in their markets are identified as drivers of any economy.

Different Types of Founders in Japan

But who is founding companies in Japan and in other countries? There are generally two types of founders. New companies are mainly founded by either young, highly motivated personalities (often students) who establish a business with an innovative business model. Mark Zuckerberg, the founder of Facebook, or Bill Gates, the founder of Microsoft, are typical in this category. This first group set up businesses often as part of a university research project or with the help of an incubator, business angel or investor.

The second group are mid-career managers with a desire for independence. This group describes managers with many years of specific experience in a certain industry, who have a desire for responsibility or independence and typically leave their jobs between the age of 40 and 50 to found their own businesses. These entrepreneurs use their many years of industry knowledge and extensive industry contacts to establish their first customer base and often develop business models that respond to the needs of a very particular customer group. Depending on the overall intentions of the founders these businesses often grow, but often do not expand over a certain size.

In Japan, however, these types have been hard to find in the past decades. On the one hand, Japanese universities until recently did not focus on supporting their students to found businesses. This is partly due to their function as pure teaching organizations. This is also the reason why Japanese students have little intention of pursuing master degrees and doctoral programs. They are also not so much involved in research as students in other industrialized countries. Japanese students see their university years primarily as a springboard to an established Japanese company.

The second group of founders, 40 to 50-year-old experts, do certainly exist in Japan. But they remain mostly in their companies and have little intention of leaving them. Many of them have invested many years in their careers in a big Japanese company. They do not want to risk that personal and emotional investment. The second reason is the fact that leaving a Japanese company, especially a well-known and successful one, is not viewed as an attempt to lead a fulfilled life, but often as a sign of something being wrong.

So the “classic” founders in many industrialized countries stay in their jobs in Japan. Despite the fact that they are not founding companies they are using their creativity there. It is a peculiar phenomenon that in Japan the rate of innovative start-ups is low, but the number of patents registered is the highest in the world. In Japan big companies provide space and money for creativity and new product development.

However, this only happens in the traditional environment and strengthens the power of existing *keiretsu*, the huge Japanese business conglomerates. It does not support the Japanese economy to develop more variety and new business models.

Intrapreneurship

Another reason for the low start-up rate in Japan is the high percentage of corporate venturing in large Japanese companies. Corporate venturing or intrapreneurship means a company founded by employees of a corporation, who either have a particularly good product idea or are interested in a new technology or industry. Instead of leaving the firm and looking for an outside investor, these employees found the new company themselves but get supported and funded by their original employer.

In Japan, we find this form of financing especially frequently. The reasons for this preference can be found in the Japanese corporate structure. When a new technology is prominent or new business ideas are developed this is often done by younger employees. A Western company would set up a new department and give these employees freedom of choice or the chance to prove their talent and maybe even develop a new business field. In the traditional Japanese company that's not the case, because promoting younger employees and giving them more power would have a negative effect on the traditional hierarchy in the firm.

To keep the traditional structure intact, a new company is founded and integrated into the *keiretsu* structure. This company provides a fresh start for the founders. They can set up their own new hierarchy, not depending on age, they can take leadership roles and they can focus on developing a new technology and business. However, these companies are usually incorporated into the *keiretsu* business structure. The young company is not fully independent but is still connected to the parent company. This comes with benefits and costs. On the one hand this relationship provides financing and first customers; on the other hand it also controls the development of the new venture and ensures that the venture does not become too independent.

Attitude

The dominance of big Japanese multinationals and their often very Japanese *keiretsu* structure has influenced the attitude of young Japanese towards entrepreneurship. Since the 1990s a job, preferably a full-time job, which comes with a life-time employment expectation has been the major goal of Japanese university graduates and also their parents.

Although many very large and well-known Japanese companies were founded after the war on the ideas of visionaries and today play an important role in the Japanese economy, entrepreneurship is not a positive term among the Japanese public. In particular, young people see a job for life in a Japanese company as their main aim in life. Entrepreneurship is subject to uncertainty and also seen by Japanese parents as an inappropriate life plan for their offspring. Scandals, such as the case of well-known entrepreneurs like Takafumi Horie, who was accused in 2006 of insider trading and was

Photo 1

Photo: Japan Association of New Economy



Hiroshi Mikitani, chairman & CEO of Japan's e-commerce giant Rakuten and representative director of the Japan Association of New Economy (NES), delivers a speech at the New Economy Summit 2013 in Tokyo on April 16, 2013.

sentenced under enormous media hype to several years in prison, have damaged the image of start-ups in Japan even more.

The rigid Japanese recruiting and hiring system which prefers fresh graduates who can be trained and adapted to company wishes easily does not leave a lot of freedom for young Japanese to experiment with different labor types or entrepreneurial freedom. In most industrialized countries young people can start their own company after graduation. Even in cases of failure they may be able to find a job a few years later and many companies even cherish employees with an entrepreneurial spirit. In Japan, however, the risk of never finding a fulltime position (if not getting hired right after graduation) is simply too high. This has not only a negative effect on innovative entrepreneurship, but also on the willingness of Japanese university students to spend a year as exchange students overseas or travel a year and see the world after they graduate.

Fear of failure is also a major reason not to start a business in Japan. Global Entrepreneurship Monitor in 2013 reported that 30% of aspiring entrepreneurs in Turkey or Brazil do not start a business out of fear of failing. In Japan this number is over 50%. This negative attitude is reflected in the low amount of venture capital that is provided to young firms in Japan. In general the amount of funds provided to young entrepreneurs is certainly a lot lower than in other developed countries.

New Developments

But even if start-ups in Japan mean something very different from in other industrialized countries, there are signs of change. In recent years, almost unnoticed by the Japanese media, a small but enthusiastic start-up scene has developed in Japan.

What led to this change is not quite clear. The media image of entrepreneurs has improved over the past years. This is credited to well-known entrepreneurs like Hiroshi Mikitani, chairman and CEO of

Rakuten, who is not afraid of media attention and has shown that Internet start-ups can not only become industry leaders, but that their CEOs can also influence public opinion. He is not afraid to criticize the establishment in Japan and ask for reform (*Photo 1*).

Investing in Start-Ups Japanese Style

But even if the idea of start-ups has entered the Japanese economy, business in Japan is still done the Japanese way. One interesting aspect is the fact that a high number of big companies are involved in this field.

In Europe governmental or provincial agencies try to increase the number of start-ups by providing subsidies and implementing start-up competitions. In the US professional angel investors or venture capital firms provide necessary funding and support for young corporations starting a new business. In Japan, however, this role is often taken — not surprisingly — by big corporations. Companies like Sony invest in Japanese venture capital firms. One of the most famous Japanese incubators, EGG JAPAN, is sponsored and supported by real estate giant Mitsubishi in Marunouchi. KDDI is promoting its own start-up competition.

One of the reasons for the corporations to become involved is the fact that intrapreneurship is a means to leverage on corporate patents, but is not used often enough to promote them. Some companies sit on their unused patents for many years and waste opportunities. It makes more sense to support entrepreneurs in using them more actively.

Another reason is that the traditional Japanese business model is often not flexible enough to react quickly to global competition and *keiretsu* market changes. Fearing the future, investing in new ventures seems a good idea and an easy way to participate and support innovation in many fields.

And finally, the Japanese affinity for big and stable forms is hindering many young firms in their growth. Potential first customers of a start-up find it risky to do business with them, not knowing how long they will exist and whether they can provide sufficient, reliable and long-term services. It is a lot easier for young firms to succeed if a well-known and influential company supports the new idea.

Nevertheless, there has been an increasing number of young Japanese starting up businesses these past few years. Many of these business models have been developed specifically for the Japanese market and benefit from traditional Japanese attitudes and ways of working.

Why the Japanese Economy Needs More Entrepreneurs

Whether the current wave of new businesses leads to a lasting change for the Japanese economy will be seen over the coming

Photo 2

Photo: Japan Association of New Economy



A session at the New Economy Summit in 2013

years. Young companies can be considered as a mirror of an economy. In this sense, necessary signs of change are obvious. And even if the traditional Japanese companies are still the main focus of government strategies and reforms, the government of Prime Minister Shinzo Abe has realized that young firms are the future of the country and that the focus must shift from protecting and focusing on large corporations to enabling new businesses to grow and play an active part in the Japanese economy. They can react more readily to change, use modern technology with greater ease and switch their business models if necessary. The traditional locality of Japanese SMEs must not be neglected either. Especially since the Fukushima disaster, it has become clear that many Japanese regions depend on a high number of healthy local businesses for their long-term economic survival.

First steps have been taken already to remove the minimum capital requirement for limited liability companies which allow anyone to start a company without any financial limitations. Another program is a start-up loan program which allows prospective entrepreneurs to borrow up to 7.5 million yen without a guarantor. However, when looking at the website of the SME Agency, the focus is still on supporting the survival of family businesses and local shopping streets. The idea of SMEs also being innovation- and technology-oriented companies started by young and ambitious entrepreneurs is still not replacing the “traditional Japanese SME”.

Yet even in this field changes are visible. A new and young industrial association by the name of the Japan Association of New Economy organized the first New Economy Summit in 2013 which gathered more than 1,000 executives and experts from the world of IT and the Internet who agreed on the need for radical innovations in the IT sector (Photo 2). At the moment there are plans to provide tax reductions to firms investing in start-ups and there are also serious attempts to support venture capital firms in providing capital to start-ups. And as the number of success stories increases and the media image of entrepreneurs and their role in society improves, the start-

up wave may create a long-term change.

The main challenge, however, will be to convince young and entrepreneurial-minded Japanese to leave the traditional path and take the risk of starting their own venture. But as Japan's corporate giants cannot guarantee life-time employment anymore and increasingly struggle with tougher global competition, entrepreneurship may prove to be a profitable solution for many Japanese.

The Future

However, the number of new firms in Japan is still not high enough. To have a long-lasting impact on society the Japanese economy needs a lasting and value-creating stream of new firms. The government is hoping to increase the number of newly founded ventures by 100,000 per year. In 2020 the number of business start-ups should be double that of today. It remains to be seen whether this ambitious goal can be achieved.

In any event, one major effect can be observed already. Many of the new young companies not only create some jobs but also develop a more contemporary Japanese style of management. They take risks, develop profitable strategies and still show a Japanese attitude towards business based on team spirit and loyalty. Motivation and inspiration play an important role in developing business models and human resource management. And at root they all have one very influential and famous Japanese attitude: *ganbaru* — the idea of not giving up until a goal is achieved. This attitude will hopefully be a role model for all other players in the Japanese economy too.

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Photo: photolibrary



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