

Amendment of the Law for Facilitating the Creation of New Business

By Kusunoki Shinji

I. Introduction

The business start-up rate has trailed the business failure rate in Japan since the 1990s. The unemployment rate has also been high. Under these conditions, venture businesses have much to contribute to economic revitalization, which makes their proliferation desirable. Nonetheless, there is a vicious circle making it hard to foster venture businesses in Japan: (1) the corporate culture favors large companies, such that the best human resources tend to look for jobs with the larger firms; (2) there are few outstanding venture supporters and venture capitalists that can both evaluate and cultivate new enterprises; (3) risk capital is unavailable because there are no appealing investment opportunities; thus (4) creating an environment that prevents failed businesses from getting a second chance.

Revisions have recently been made to the Law for Facilitating the Creation of New Business in order to break out of this vicious circle and to institute an independent growth mechanism for venture businesses. Aiming to achieve significant growth through initial public offerings (IPO), measures have been devised for assisting entrepreneurs that have plans to cultivate new business fields (venture businesses that want to make an IPO).

The amendment of the Law for Facilitating the Creation of New Business went into effect as of March 2.

II. Outline of the Amendment of the Law for Facilitating the Creation of New Business

The Law for Facilitating the Creation

of New Business was enacted in December 1998 for the purpose of promoting the creation of new businesses. It emphasized: (1) promoting new businesses; (2) supporting business activities that use new technologies within small and medium-sized businesses; and (3) cultivating a business environment that uses local industrial resources. The amendment



The Nasdaq Japan Club - a meeting of venture entrepreneurs who want their companies to be listed

Partnership”

This law defines “new business field cultivation” as business activities undertaken for the purpose of achieving significant growth and development, activities that cultivate new business fields by providing new products and services, or by improving the production or sales of goods using new technologies or improving the methods of providing services. A “Qualified Limited Partnership” is defined as a limited partnership under the Law for Limited Partnership Act of Venture Capitalists’ Investment that is approved by the Ministry of International Trade and Industry to provide hands-on support to venture businesses. Specifically, partnerships are required to fulfill the following conditions for approval: (1) the limited partnership agreement must establish instructions for providing hands-on support, through such means as appointing the directors of the invested company; (2) the

limited partnership agreement must call for the provision of semi-annual financial statements; (3) when the general partner of the limited partnerships is a venture capital firm, the limited partnership agreement must name the “key man” who primarily manages the investment of that limited partnership; (4) the general partner must invest 1% or more of the total commitments and (5) the limited partnership (excluding those that have a special relationship with general partners) must invest one-third or more of the total commitments.

(2) Approval of the Business Plan

To apply for the support measurements based on this law, the venture businesses must submit a business plan

of the law adds new support measures for IPO-style venture businesses planning significant growth and development. In addition, simplification of the application procedures will be available for companies with investment from qualified limited partnerships under this law if they fulfill certain conditions, such as the possibility of providing hands-on support. In addition, a system is established in which the Industrial Structure Improvement Fund can be used to provide funds to Special Investment Business Unions.

Outline of Legal Measures

(1) Definitions of “New Business Field Cultivation” and “Qualified Limited

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to the appropriate ministers by the end of fiscal 2004 which must be approved by them on the following points: (1) the business must be for the purpose of achieving significant growth and development (e.g., making an IPO within five years); (2) it must cultivate a new business field by providing a new product or service; (3) the product or service must be recognized as contributing to the upgrading of technologies involved in these business activities, the improvement of business efficiency, or the increased convenience of everyday life for the nation; and (4) the business implementation methods and fund-raising methods should be appropriate for the actual operations of the business. These approval procedures are being simplified for venture businesses with investment from Qualified Limited Partners. When it is clear that the following conditions are being fulfilled and Qualified Limited Partners are actually providing hands-on support, they no longer need to submit documents on condition (4). Specifically, invested companies that want to receive approval must meet the following conditions: (a) the Qualified Limited Partnership must have at least 20% share of all issued stocks, or have invested at least ¥100 million, (b) a general partners must provide hands-on support to that company by serving as a director or by having the right to attend meetings of the board of directors, and (c) the company must not be a subsidiary of a general partner.

(3) Outline of Support Measurements

Approval under this law can be obtained by all entrepreneurs regardless of the size of their business or the number of years they have been in business, but of the support measurements below, "(a) (exception of commercial law on issuing non-voting right preferred stocks)" and "(b) exception of commercial law on issuing stock options" can only be applied to companies before an IPO.

(a) Exception of Commercial Law on stock issuance without voting rights

To make it easy for founders to raise capital for business expansion while maintaining management rights, while also meeting the needs of investors who are more interested in future capital gains than in short-term dividends or voting rights, an exception of Commercial Law is built in to the regulations for issuing preferred stocks without voting rights. Specifically, in consideration of venture businesses, for whom it is difficult to continuously produce preference dividends, the deferment period on voting right restoration when there are no preference dividends has been extended from one to three years, and the maximum issuance of such securities approved under commercial law has been increased from one-third to one-half of all issued stock.

(b) Exception of Commercial Law on issuing stock options

Stock options are rights to purchase stock at a predetermined low price and were established under commercial law as a means of providing incentives to executives and employees. However, because this is a system in which there is no risk of the stock price falling and in which future capital gains can be used as a source of compensation, it is also effective as a system for compensating not only executives or employees, but also the successes of those who contribute to the company's development, such as those who provide services to the company.


This law has established an exception to allow the issuance of stock options to people other than executives and employees (only people listed in the approved business plan) if 1) they have the knowledge and skills needed for achieving business growth, and 2) if the appropriate conditions regarding the achievement of business growth have been placed on the holders' rights to exercise those options. Also, the maximum issue of options approved under commercial law has been expanded from one-tenth to one-third of all issued stock.

(c) Exception of Commercial Law on inspections after the business is established

If the assets received by a venture business independently established from an existing company or a company entering a new business using the administrative resources of an existing company exceed a certain level within two years of the establishment of the company, it must be investigated by a court-appointed inspector. However, a court-appointed inspector does not have intimate knowledge of the company or its business (making it difficult for them to adequately evaluate the know-how or intellectual property rights of a new business) and may have a negative impact on the company's business plan by taking a long time to conduct the inspection and producing unclear inspection results. In addition to this, and in light of the fact that there is no danger of purchasing at an unfairly high price because, with this kind of contract, the price is determined after it is negotiated as a business, a special case has been established to simplify the inspection procedures after a business has been established.

Specifically, it allows companies that receive funding from a Qualified Limited Partnership to be inspected by lawyers, public accountants, and auditors appointed by the company instead of court-appointed inspectors.

(d) Exemption from tax on retained earnings

In addition to the above support measurements under this law, tax incentives that exempt companies from being subject to the tax on retained earnings can also be available if obtained with their approval under this law. 

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