

**Challenges in Japan's startup finance market revealed through comparison with the U.S.
- Ensuring the circulation of risk capital and creating multiple success stories.**

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Kunio Katsube

Managing Director, Head of Investment Research

Japan Investment Corporation

Since the interest rate hike in the United States at the end of 2021, the annual funding amount for startups in Europe and the U.S. has dropped by half from its peak, while the annual funding amount for Japanese startups has also decreased from the peak in 2022 by approximately 20%.

In this context, in order to achieve the government's "Startup Development Five-year Plan" goal of an annual 10 trillion-yen investment in startups, what kind challenges does Japan need to address? This article provides an analysis from a long-term perspective, taking into account a comparison between the Japanese and U.S. markets.

Three key points illustrating differences between Japan and the U.S.

Although the annual equity financing amount for U.S. startups has halved from its peak, it still stands at \$166.4 billion, roughly 30 times the scale of the annual equity financing amount for Japanese startups, which is 800 billion yen. Given the differences in economic scale and the length of history of startup financing between Japan and the U.S., it is understandable that the Japanese market does not match the scale of the U.S. market. Even so, let's examine the factors contributing to this difference in scale.

Each time a startup reaches a certain growth milestone, it reassesses its valuation and raises the necessary funds for the next phase of growth. By comparing the funding progress of startups founded between 2012 and 2014 in Japan and the U.S., we identified three key points.

The first point is that in the early stages of growth, Japan was vastly outnumbered by the U.S. in terms of startup counts. Approximately 15,000 startups were established in the U.S. from 2012 to 2014, while in Japan, there were only about 2,500. A characteristic of startups is their prolific nature paired with a high mortality rate. Without increasing the foundational number that supports the ecosystem, it is unrealistic to expect a rise in the number of unicorns that achieve substantial growth after enduring the selection process.

The second point is the disparity in the amount of funds raised by individual startups at each funding stage. For the U.S. and Japanese startups mentioned above, the average amount raised

at each stage is illustrated in Figure 1.

Japanese startups generally raise roughly half or less of the funds that U.S. startups raise at each stage, from Seed to Series E, although setting an appropriate currency exchange rate for comparison can be a bit tricky. It should be noted that U.S. startups often adopt a blitz-scaling strategy, investing heavily in marketing and prioritizing rapid growth despite large deficits. Additionally, costs, including labor, are significantly higher in the U.S. However, when Japanese startups aim to compete globally, this funding disparity could impact their international competitiveness.

Figure1 <Japan/U.S. : Average funding amount per startup founded between 2012 and 2014>

Japan (n=649 startups ※1)		United States (n=11,694 startups ※3)			
Series (※2)	Funding Amount (average)	VC Round (※4)	Funding Amount (average)	\$1=¥100	\$1=¥150
Seed	¥74M	1st	\$3.7M	¥374M	¥561M
A	¥312M	2nd	\$7.6M	¥756M	¥1,134M
B	¥738M	3rd	\$13.8M	¥1,379M	¥2,069M
C	¥1,344M	4th	\$22.8M	¥2,283M	¥3,425M
D	¥2,505M	5th	\$40.2M	¥4,022M	¥6,033M
E	¥3,301M	6th	\$52.5M	¥5,248M	¥7,872M

(※1) The number of startups established between 2012 and 2014 is 2,512. Among them, 649 startups have an assigned SPEEDA Series and disclosed funding amounts.

(※2) Speeda Series

(※3) The number of startups established between 2012 and 2014 is 15,186. Among them, 11,694 startups have an assigned VC Round and disclosed funding amounts.

(※4) VC Round, defined by PitchBook.

Source: Created by JIC, based on data from Speeda Startup Information Research and PitchBook.
As of October 3, 2024

The third point is the gap in the likelihood of individual startups continuing to raise funds through successive stages. For instance, only 3% of Japanese startups that began at the Seed stage and progressed through each funding stage reached Series E (Figure 2), whereas in the U.S., this figure stands at 6% (Figure 3).

Growth-oriented startups benefit more from pursuing growth strategies while securing multi-stage funding as unlisted companies, rather than being constrained by going public amid growth and taking on the burden of IR roadshows and other requirements. In the U.S., IPO exits during the growth phase are limited, whereas in Japan, many startups exit early through IPOs. Thus, whether startups can continue raising funds and growing as unlisted companies remains a significant issue.

Figure2 <Japan: Funding transitions of startups established between 2012 and 2014>

(Unit:# of startups)

Status \ Speeda Series (※1)	Seed	Series A	Series B	Series C	Series D	Series E	Total (Occurrence rate)
# of startups (※2) (The probability of reaching each Speeda Series)	801 (100%)	577 (72%)	383 (48%)	197 (25%)	70 (9%)	22 (3%)	-
IPOed *	2	19	21	13	3	7	65 (8%)
M&A	27	22	10	3	2	2	66 (8%)
Out of business	12	7	9	5	1	0	-
No further funding	183	146	146	106	42	10	-
Go to next Speeda Series	577	383	197	70	22	3	-

* Market Value Distribution (valued by closing price of October 2, 2024) (Unit:# of startups)

Less than ¥10 Billion / unknown	2	14	13	6	2	2
¥10 Billion ≤ <¥30 Billion	0	3	4	5	0	2
¥30 Billion ≤ <¥100 Billion	0	2	3	2	0	1
¥100 Billion ≤	0	0	1	0	1	2

(※1) Speeda Series, defined by Speeda Startup Information Research.

(※2) The total number of startups established between 2012 and 2014 is 2,512 (including those with undisclosed funding amounts). Among them, 801 startups have an assigned SPEEDA Series. Some figures are estimated by JIC.

Source: Created by JIC, based on data from Speeda Startup Information Research.

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Figure3 <U.S.: Funding transitions of startups established between 2012 and 2014>

(Unit:# of startups)

Status \ VC Round(※1)	1st	2nd	3rd	4th	5th	6th	Total (Occurrence rate)
# of startups (※2) (The probability of reaching each VC Round)	15,186 (100%)	8,107 (53%)	4,965 (33%)	2,995 (20%)	1,693 (11%)	918 (6%)	-
IPOed *	40	41	34	22	32	22	191 (1%)
M&A	1,177	770	548	339	183	89	3,106 (20%)
Out of business	2,783	781	284	127	41	21	-
No further funding	3,079	1,550	1,104	814	519	338	-
Go to next VC Round	8,107	4,965	2,995	1,693	918	448	-

* Market Value Distribution (valued by closing price of October 2, 2024) (Unit:# of startups)

Less than \$100M / unknown	29	20	23	9	18	9
\$100M ≤ <\$300M	4	9	4	5	5	1
\$300M ≤ <\$1B	2	7	2	3	3	4
\$1B ≤	5	5	5	5	6	8

(※1) VC Round, defined by PitchBook.

(※2) The total number of startups established between 2012 and 2014 is 15,186 (including those with undisclosed funding amounts). Some figures are estimated by JIC.

Source: Created by JIC, based on data from PitchBook.

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A strong preference for stability may be restricting the growth of entrepreneurship

Now, let's consider the factors behind these three points.

First, the issue of the limited number of startups is directly caused by a shortage of aspiring entrepreneurs in Japan. Undoubtedly, underlying this are social factors such as a cultural fear of failure and a strong preference for stability.

However, there are opportunities to shift these social factors. For example, in Finland, Nokia—which once accounted for a third of Finland's exports—suffered losses after facing competition from the iPhone, which launched in 2007, and Android phones, losing three-quarters of its market value by 2010, which led to its first major restructuring since its founding. At the same time, Nordic IT startups such as MySQL, Skype, and Spotify found success. The decline of Nokia and the rise of successful IT entrepreneurs—two extreme yet impactful events—diminished the illusion of stable employment at large companies among young people and engineers, while increasing psychological acceptance of entrepreneurship¹.

Recently, serial entrepreneurs have become active in Japan, and the number of university graduates and retirees from large companies joining startups is said to be on the rise. To further increase the number and quality of entrepreneurs, it is essential to strengthen entrepreneurial education at universities, talent development through accelerators, and support for serial entrepreneurs.

The issues of small funding amounts at each stage and the low likelihood of startups continuing to secure funding into later stages have causes on both the startup and investor sides.

On the startup side, the problem lies in the limited scale of entrepreneurs' ideas and business models, which are often too small to attract investor interest. From this perspective, there is a need for startups that address major social issues and pursue global business development to compete internationally.

On the investor side, the issue is a shortage of players capable of identifying promising startups and providing continuous, large-scale investments. Developing such talent is essential.

Attracting investment from international investors

While funding for startups in Japan faces these challenges, the government has launched a "Five-Year Startup Development Plan," with the goal of raising annual investment in startups to 10 trillion

¹ Harvard Business School "Entrepreneurial Finance in Finland?" (March 2013).

yen. So, what will be the key to achieving this target?

Currently, the primary investors in Japanese startups include corporations (including their corporate venture capital, or CVC, arms) at 27%, financial institutions (including VCs affiliated with these institutions) at 15%, independent VCs at 14%, and international investors at 8%².

However, since corporations and financial institutions do not prioritize startup investment as their main business, the scalability of their investment amounts is limited. Therefore, it is unrealistic to expect that investment from these entities will grow at the pace needed to achieve the government's plan. This is where the role of independent VCs and international investors becomes crucial.

In the U.S., large institutional investors, including public employee pension funds, corporate pension funds, and university endowment funds, invest in VC funds, enabling VCs to make large-scale investments in startups using these substantial resources. In contrast, independent VCs in Japan rely primarily on LP investments from corporations and financial institutions for their funding³. To expand the scale of independent VC in the future, it is essential for independent VC to gain the trust of institutional investors, such as public pension funds, insurance companies, and corporate pension funds, and increase the amount of commitment entrusted to them by these investors.

International investors are also important players. In other ecosystems, such as Europe and India, many international institutional investors are included in the investor composition of major startups⁴. International institutional investors actively participate in the funding of these local startups. In Japan, international investors, who had not been active since the boom period in 2021, have recently increased their appetite to invest in Japanese startups again. Prominent international VC and large international pension funds have participated in large funding deals by unique startups in the AI and SaaS fields, such as Sakana AI, Loglass, SmarHR, and Dinii. It is essential to encourage the entry of international investors with abundant funds and a cross-border investment approach into the Japanese market.

In order to expand the market, it is essential that following two scenarios come to fruition: (1) independent VCs increasing their commitment from institutional investors and boosting investments in Japanese startups, and (2) international investors increasing cross-border investments in Japanese startups. A prerequisite for these scenario is that investment in Japanese startups brings favorable investment returns, or fostering expectations of such returns among investors. Therefore, we are eager to see the emergence of successful investment cases symbolizing Japanese startups and further accumulation of solid performance track records of

² SPEEDA Startup Information Research "Japan Startup Finance 2024 First Half" (August 2024).

³ Venture Enterprise Center "VEC YEARBOOK 2023"

⁴ JIC "Startup Finance Market Review" (September 2024).

VCs in the future.

Circulation of Risk Capital

The money that investors put into startups is collected through exits and reinvested in new startups, repeating this cycle. Ensuring that this cycle functions smoothly is important for the ecosystem to secure new funding for startups.

In the current market correction cycle, while startup exits through IPOs and M&As are very sluggish in the U.S., the number of IPOs in Japan remains stable and the number of M&As is increasing. Relatively speaking, the circulation of risk capital in Japan may appear to be in better shape than in the U.S.

However, the situation is different when compared over a longer time frame. As is evident from comparing Figures 2 and 3, the ratio of startups exiting through M&A in Japan is significantly lower than in the U.S.

In the U.S., big tech companies have frequently acquired startups through M&A. Notable examples include Google's acquisition of YouTube, Facebook's acquisition of WhatsApp, and Microsoft's acquisition of GitHub. These American companies have strengthened their human resources, technology, products, and market dominance through acquiring numerous startup.

In Japan, examples of large startup M&As include DeNA taking control of Allm, medical startup, and Mitsubishi UFJ Bank making Kanmu, payment startup, a consolidated subsidiary. However, excluding these, large M&As are still limited. Recently, M&A activities by emerging listed IT companies in Japan have been increasing, and we hope to see large M&As more.

In Japan, the ratio of startups exiting through IPOs is significantly higher than in the U.S. However, about 60% of these startups that exit through IPOs remain micro-cap companies with a market capitalization of less than 10 billion yen. Listed companies with insufficient market capitalization and liquidity are less likely to attract institutional investors' attention, making it difficult for them to continue raising capital and growing after listing.

In the United States, liquidity has been actively facilitated through secondary transactions, where investors buy and sell their stakes in startups. While secondary transactions were not traditionally common in Japan, there is a growing need for VC funds nearing the end of their fund life to liquidate their startup stakes to return capital to LP investors, as well as for startup founders to cash out their holdings. Consequently, there are more instances where existing investors sell their shares concurrently with new fundraising efforts by startups.

In the future, it will also be necessary to expand funds specializing in the purchase of secondary

shares and platforms for trading unlisted stocks. It will be increasingly important to create an environment that provides investors with diverse exit routes and offers startups more opportunities to continue growing.

In the government's Startup Development Five-year Plan, Japan Investment Corporation (JIC) plays a role in strengthening the supply risk capital to startups. JIC provides fund equivalent to approximately 12% of the total fund raised by all VCs in Japan through its commitment to subsidiary VC funds and non-JIC affiliated VC funds. JIC also provides advice to VC funds on building sound and robust organizational structures to help them gain greater trust from institutional investors and secure commitment from these institutions. As a result, the total commitment from LPs that decide to join after JIC's investment decision is approximately 1.7 times the size of JIC's own commitment.

In addition, JIC is implementing various initiatives to strengthen the ecosystem. It supports the growth of emerging managers through investments in over 20 emerging VC funds. JIC also promotes the entry of international investors who have the willingness and capability to connect the Japanese ecosystem with global ecosystems by investing in international VCs such as NEA in the United States, and Atomico in the United Kingdom.

JIC invests in secondary funds to promote the circulation of risk capital. With thorough research and dialogue with the market, JIC will continue supply risk capital to business sectors aligned with its policy objectives through investments in its subsidiary VC funds and non JIC-affiliated VC funds going forward.