

The Importance and Necessity of Early-Stage Financial Support for Startup and Venture Companies in Japan

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ABSTRACT

This study focuses on the early stages of startup and venture companies in Japan, examining the support available from these companies' inception to their initial growth. Despite increased government support, many companies struggle to secure funding, and this difficulty highlights the need for more effective policies. In this study, a survey of companies in business incubation facilities nationwide revealed widespread difficulties in funding and fundraising, particularly for operating costs and research and development costs. These findings underscore the importance of improving financial support systems, such as through proposed business growth collateral rights, which should become a vital means of fundraising. The study also found businesses, regardless of industry, had a strong desire for new rights. Companies, incubators, and financial institutions must understand and use these systems to enhance corporate value.

Keywords: Startups, Financial support, Business incubation, Business growth collateral rights

INTRODUCTION

Venture companies and entrepreneurs require adequate and accessible financial support before and during the startup process. In 2022, the Japanese government announced its Grand Design and Implementation Plan for New Capitalism - Realization of Investment in People, Technology, and Startups. The government thereby strengthened its efforts toward startup support policies, especially policies aimed at promoting entrepreneurship, and also declared 2022 as the Year of Startup Creation (Cabinet Secretariat, 2022).

This study focuses on the importance of integrating financial support for each stage and for the preparation stage to the growth stage, emphasizing the importance of post-startup financial support for the companies' survival and development. The Ministry of Economy, Trade and Industry (2022) of Japan has issued guidebooks, while education and support measures until startup have increased and been enhanced. While few venture companies continue to operate until a period of stability (Eisenmann 2021), this study investigated the current situation in Japan. This study focused on the role of

post-startup financial support policies within Japan's innovation system, aiming to clarify such policies' importance. The study used a postal mail survey of startup and venture companies in business incubation centers nationwide to gain insight. Preparations are underway for introducing "business growth collateral rights" in Japan's financial system, and the survey also investigated sentiments on this new collateral system from the business owners' perspective.

Storey (1994) analysed lending and policies for small- and medium-sized enterprises in general. His study did not discuss the importance of support during the startup phase, though clearly discussed collateral's role as a signal for bank financing. However, that study was centered on the situations in Europe and the United States, and on changes over time, so the findings are difficult to apply to the present study. Berger and Udell (1998) emphasized the importance of support during the startup phase, highlighting the need for awareness of the differences in the financial environment between Japan and other countries, including venture capital. Yamori (2019) was based on a postal mail survey conducted in collaboration with the Aichi Guarantee, targeting companies with <7 years of business history and that had used the Association's guaranteed services. That study found 54.6% of respondents reported experiencing financial difficulties within 2 years of starting their business. Uchida et al. (2018, 2019) used an online survey in 2017 and 2018 targeting 1,700 and 1,287 monitors, respectively, who had experience starting a business. Both surveys were part of a project on startup finance supporting regional revitalization. In this survey, about 40% of respondents reported experiencing financial difficulties shortly after starting their business.

The present study targeted companies in business incubation facilities nationwide, focused on the importance of post-startup financial support, evaluated financial support policies, and investigated sentiments on the introduction of business growth collateral rights. It also serves as a post-policy assessment following the government's startup-fostering initiatives that began in 2022.

METHODS

The survey was conducted as follows.

Pre-Survey Interviews

Interviews were conducted to assist with questionnaire development. The interviews were conducted with three businesses selected in collaboration with Ishikawa Create Lab (a business incubation facility operated by the Ishikawa Prefecture Industrial Support Organization), connected with the Japan Advanced Institute of Science and Technology (Ishikawa, Japan). The interviews covered topics such as patents, intellectual property-backed financing, use of support systems during startup, current use of support systems, future use of such systems, post-startup funding, use of bank loans, and management issues. The interview results were used in formulating the final questionnaire.

Selection of Survey Targets

For the selection of survey targets, business incubation facilities with 20 or more occupancy rooms were chosen from the Business Incubation Overview: New Business Creation Support Facility Directory 2003 (which listed 266 facilities). A total of 20 facilities were selected, factoring in that the directory was published around 20 years ago; the Japan Association of New Business Incubation Organizations, which published the directory, is no longer operating; and the Japan Business Incubation Association, the current equivalent organization, does not publicly list facilities. The facilities' current status was confirmed through their websites. The final 20 resulted after narrowing down the selection to ensure diverse industries and regions. Each facility's management office was then contacted by phone to request permission for distributing questionnaires to resident companies and asking for their assistance in distributing the questionnaires. Two facilities declined, one did not respond, and ultimately, the subjects were 17 facilities in 16 Japanese prefectures: Hokkaido, Iwate, Miyagi, Yamagata, Ibaraki, Chiba, Kanagawa, Aichi, Ishikawa, Hiroshima, Kagawa, Tokushima, Ehime, Fukuoka, Kumamoto, and Okinawa.

Questionnaire Distribution

The resident companies themselves were expected to provide responses and the questionnaires could be sent directly to the companies with the facilities' permission (in fact, seven facilities indicated they could not assist with distribution). Ultimately, questionnaires were sent to 293 companies from the 17 facilities.

Survey Overview

The questionnaire survey was distributed via postal mail in October 2022. The survey comprised 22 multiple-choice questions and included a free-entry section for comments. A total of 84 responses were received (82 from corporations, two from sole proprietors), resulting in a response rate of 29%. Of these, 30% included comments in the free-entry section.

Problem Awareness and Survey Items

The main issues addressed in the questionnaire included the importance of financial support for startup and venture companies in Japan, especially in the period immediately after startup; current reliance on bank loans for financial support; significance of fundraising as a critical management issue; and the desire for the business growth collateral rights currently under governmental consideration as a financial support policy.

RESULTS

A total of 32 companies (38%) reported their operating funds were sufficient or presented no difficulties, while 60% had faced difficult situations; of these, 26 (31%) were currently experiencing difficulties (Table 1).

Table 1. Financial situation since startup.

Responses (N = 83)	Number	%
Sufficient funds have been secured since startup	11	13
Funds were not sufficient, but there were no difficulties	21	25
There were difficult periods after startup, but no issues now	25	30
Difficulties have persisted since startup (including effects of the COVID-19 pandemic)	19	23
Difficulties have persisted since startup (excluding effects of the COVID-19 pandemic)	7	8
Do not know	0	0
Total	83	

More than half of the respondents mentioned periods of financial difficulty within 4 years after startup. Six companies (24%) reported financial difficulties immediately after startup (Table 2).

Table 2. Periods of financial difficulty.

Responses (N = 25)	Number	%
Immediately after founding	6	24
1 -2 years after founding	7	28
3 -4 years after founding	5	20
5 -10 after founding	7	28
10+ years or more after founding	0	0
Total	25	

Regarding funding, 32 companies (39%) indicated they had sufficient funds, while the remaining 51 (61%) experienced fund shortages. Notably, 22 companies (27%) reported having no funds for regular operations and 27 (33%) reported a lack of research and development funds (Table 3).

Table 3. Current funding situation.

Responses (multiple answers)	Number	%
Sufficient	32	39
Insufficient fund for regular operations	22	27
Insufficient fund for research and development	27	33
Insufficient fund for equipment	22	27
Others	2	2
Do not know	0	0
Total	105	

At the time of the survey, Japan's Financial Services Agency had a working group on systems to support lending practices focused on the nature of the business, and the Ministry of Justice was deliberating on business growth

collateral rights. A total of 49 companies (60%) expressed a strong desire for early introduction of this security system. In the free-response section on startup-support policies, 26 companies (30%) provided suggestions and recommendations (Table 4).

Table 4. Demand for business growth collateral rights.

Responses (N = 82)	Number	%
Want early introduction	49	60
Not necessary, current collateral system is sufficient	7	9
Do not know	26	30
Total	82	

DISCUSSION

The survey revealed that cash flow and fundraising are challenging in the early stages of business after startup. Many companies lacked working capital and research and development funds – a severe situation. The results were consistent with previous studies. Notably, the survey targeted companies in an environment in which they could receive appropriate advice from consulting services and incubators from the startup preparation stage. This will be further investigated through interviews in the future. The importance of fundraising, sentiments on financial support policies, and sentiments on the introduction of business growth collateral right might vary by industry, company size, and founding history. However, there were no substantial differences regarding fundraising by industry, size, or history. There were also no substantial differences in sentiment about support policies by industry, size, or history. Similarly, there were no substantial differences regarding business growth collateral rights by industry, size, or history. Likewise, no substantial differences were seen regarding patents, insufficient collateral, and other collateral issues. The results clarify fundraising as an imperative management issue regardless of industry, sentiments on past support policies are low regardless of company size, and improvements are required in the future. A desire was also seen for introducing business growth collateral rights regardless of industry.

CONCLUSION

While the survey had a limited group of companies, the results revealed that insufficient support was provided up to the point of business startup and improvements are also needed in post startup financial support. Fundraising was the most important current management issue and many companies clearly were having difficulty raising funds from external sources. The challenges appear especially weighty considering the respondent companies were located in public business incubation centers and an environment in which they could receive sufficient support and advice for their business plans and operations. A similar or higher percentage of companies than in previous

studies (e.g., Yamori [2019]; Uchida et al. [2018, 2019]) reported facing financial difficulties in the early business stages. Insufficient funds for research and development and for equipment were also reported at high rates of around 30% each. Financial institutions evidently need to have more flexible lending practices, considering that startup and venture companies often have limited assets and poor performance. Of the respondents, 60% expressed a desire for the introduction of business growth collateral rights. Yet while this system should expand lending opportunities, 30% of respondents indicated they were unsure about its introduction. This uncertainty suggests the present importance of promoting understanding of the system. Enhancing corporate value is also critical for companies. It is currently unclear whether financial institutions will actively use this system, and that issue warrants further investigation. Few responses indicated that financial support policies for both the startup and post-startup periods were sufficient. The issues behind this require further examination and consideration of more appropriate policies is needed. As the survey grouped questions related to financial support policies, future surveys may need to classify them more precisely, such as into loans, subsidies, and grants (including the use of the Small Business Innovation Research system). Crowdfunding, a form of alternative financing, is becoming more prevalent in Japan, though this topic was beyond the scope of the survey. Crowdfunding's effectiveness in financial support policies is another topic for future research. This survey also helped in recognizing the importance of the nation's public business incubation facilities. Conducting the survey heightened the realization that these facilities facilitate awareness of regional disparities. Regional differences in the momentum of business incubation facilities were recognized, as were facilities in currently revitalizing cities outside major metropolitan areas. As digitization and so-called fintech rapidly progress, the survey also confirmed that it is crucial to investigate and research business incubation's role in nurturing and supporting startup and venture companies and the factors contributing to regional disparities. Further exploring the challenges identified in this study will promote the growth and continuity of startup and venture companies.

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