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**Empirical Study of the Demand for Equity Capital
among Japanese SMEs**

BY

Miwako Nitani, Bachelor of Arts (Fine Art)

**A thesis submitted to
the Faculty of Graduate Studies and Research
in partial fulfillment of
the requirements for the degree of**

**Master of Business Administration
School of Business**

Carleton University

Ottawa, Ontario

May 10, 2001

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Miwako Nitani, Bachelor of Arts (Fine Art, Honors)
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Master of Business Administration

Director, Eric Sprott School of Business

Thesis Supervisor

Carleton University

May 2001

Abstract

To stimulate the venture capital market in Japan, several junior stock exchanges have recently been established. However, Japanese SMEs may not have the willingness nor the knowledge necessary for going public as a means of equity financing.

This study examines Japanese SME principals' attitudes towards equity capital using data based on responses to a questionnaire and telephone interviews. It is found that there is indeed a demand for equity capital among Japanese SMEs. The three major reasons for considering going public are: financing; increasing the firm's credibility; and attracting employees. Stock exchanges' image and public trust are found to be an important issue. There appears to be a conflict between easier access to capital and the need for credibility and a reputable image. The need for more flexible, simple and clear listing requirements was noted, as was the need for consistency of evaluation procedures.

Implications for the new junior stock exchanges are identified and remedial action is suggested if these exchanges are to provide suitable exit opportunities for venture capitals.

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I. Introduction: Importance of the Topic

1. Current Trends within the Japanese Venture Capital Market

To revitalize the Japanese economy, it is essential to create and support new businesses that would play a major role in an era of renewed growth for the Japanese economy. However, for a long time starting a new business and letting it grow seemed particularly difficult in Japan, one of the reasons being the absence of an active capital market for venture businesses.

To redress this, Japan is now taking steps to activate its venture capital market. First, the Tokyo Stock Exchange, on November 1999, launched a junior stock exchange with the acronym “MOTHERS (Market of the High-Growth and Emerging Stocks)” for new companies in need of capital. According to Mitsuhide Yamaguchi, the president & CEO of Tokyo Stock Exchange, the primary purpose of MOTHERS is to revitalize the Japanese economy by promoting new industries that will play a major role for the coming generation.¹ Second, JASDAQ, the Japanese OTC market, reformed its listing requirements on December 1998.² With the new system, JASDAQ classifies companies listed into two tiers where tier 1 keeps the old requirements, whereas tier 2’s listing requirements are more relaxed. Third, NASDAQ Japan was launched in July 2000.³ Finally, several local stock exchanges such as Fukuoka and Osaka Stock Exchanges also

¹ Yamaguchi, M., 2000. “*Vision for New Year*” www.tse.or.jp/english/news/release/article/00104_a.html

² JASDAQ, 1999. “*Toroku Seido No Gauyo [The Listing Requirements]*”
http://www.jasdaq.co.jp/web/IOMarket.nsf/flmainSet_E

³ Unlike in North America, NASDAQ is considered as a stock exchange for venture businesses in Japan. Thus, this study includes NASDAQ Japan into a category of venture capital markets.

opened (in 2000, and in 1998 respectively) stock markets (as sub-exchanges) for emerging businesses.⁴

However, it can be argued that creating a stock exchange for venture businesses and relaxing listing requirements is not, in itself, sufficient to promote full development of the Japanese venture capital market: several questions arise concerning the success of these initiatives.

First, one of the characteristics of Japan's capital market is its bank-centeredness. Commercial firms that need financing can more easily raise debt capital from banks rather than equity financing through an IPO. This system has historically limited the development of the capital market, especially a venture capital market. Thus, the first question is whether these new exchanges will, considering this bank-centered system, grow and activate the venture capital market.

Second, Japan does not have a tradition (in terms of its economic system, culture, history, etc.) that supports the growth of a full-fledged venture capital market. This limits investors, as well as their ability to become familiar with a regime of high-risk high-return investments. Japanese investors traditionally did not understand "investing at one's own risk", since they (not only retail- "mom and pop"- but also institutional investors) regard buying stock as a form of lending, and expected to be compensated in case of a crash. Thus, the second question is whether Japanese investors are ready for high-risk high-return investment at their own risk.

Third, in such an environment, Japanese SMEs may not have the willingness nor the knowledge necessary for going public as a means of equity financing. Therefore, the

⁴ Anonymous, 2000. "Fukusho, Bencha Muke Shin Shijo [A New Market for Venture Business in Fukuoka Stock Exchange]" *The Nikkei Financial Daily* February 7th, 7.

third question is whether there is a demand for equity financing among Japanese SMEs and whether the regime and requirements of new stock exchanges meet their needs.

This study focuses on the last question: it is based on an investigation of Japanese SME principals' attitudes towards use of equity capital.⁵ This work probes: the potential demand for equity capital among Japanese small businesses; profiles of companies that would go public; Japanese SME principals' attitudes toward and perceptions of equity capital; Japanese SME principals' perceptions of relevant exchanges (MOTHERS, NASDAQ Japan, and JASDAQ); and finally, whether the listing procedure and requirements of these exchanges are appropriate. The answers to these questions will provide insights about the further development of the Japanese venture capital market.

Analysis of an interview survey of 62 SME principals and a questionnaire survey of 88 SME principals, revealed five important aspects defining their perception of equity capital and junior stock exchanges. First, 30% of the questionnaire survey respondents (Japanese SME principals) stated a desire to go public: it seems that there is indeed a demand for equity capital among Japanese SMEs. Second, we found that the three categories of firms in the sample were comparable (firms whose principals have expressed a willingness to go public; firms whose principals have articulated an unwillingness to go public; and firms whose principals stated no plan to grow their business) at reasonable levels of statistical confidence. The result assures us that differences subsequently observed in principals' perceptions of equity capital are not attributable to differences among firms' and principals' characteristics.

Third, the three major reasons for considering going public are financing, increasing the firm's credibility, and attracting employees (through enhanced credibility).

⁵ For the definition of "principal", see page 12.

For those seeking increased credibility, stock exchanges' image and public trust are an important issue, but several new junior stock exchanges (MOTHERS and NASDAQ Japan) have not yet gained public trust, and thus do not meet two of the SMEs' needs (increasing credibility and attracting employees). As a result, there appear to be a conflict, for SMEs, between a need for easier access to capital on one hand, and the need to enhance their credibility on the other hand.

Fourth, while a majority of interviewees do not think the listing requirements of those junior stock exchanges to be too stringent, 44% asked for more flexible, simplified, clarified requirements.

Fifth, the typical problems encountered by SMEs in the IPO process are the fact that stock exchanges do not evaluate venture businesses but rely for it on security companies (creating confusion among SMEs) and the fact that both are perceived, by sample SME principals, as having no competency to assess venture businesses. Also, predetermined face value of stock price limits liquidity.

From these results, it can be concluded that the future growth of these new stock exchanges and the mobilization of the Japanese venture capital market may depend on whether MOTHERS and NASDAQ Japan, and other junior stock exchanges, will gain social credibility or not. Moreover, in order for stock exchanges to attract SMEs, it is important to make listing requirements more flexible, simple and clear; assign clear responsibilities for evaluating venture businesses; build a relation of trust with potential applicant companies; and enhance liquidity.

2. The Listing Procedure and Requirements of MOTHERS, JASDAQ, NASDAQ Japan, and CDN (Previous Study)

Before investigating the Japanese SME principals' perceptions of and demand for equity capital, it is necessary to know the listing procedures and requirements of these new stock exchanges. Traditionally, the listing requirements of most Japanese stock exchanges are very strict. Such requirements make it almost impossible for young or small businesses to go public: the companies with shares listed on the Japanese stock exchanges average 25 years of age. The listing requirements of MOTHERS, JASDAQ tier 2 and NASDAQ Japan were intended to be less stringent, as these were created for the activation of a venture capital market. Thus, we compared the listing requirements and procedures of following exchanges/tiers: MOTHERS, JASDAQ tier 1 and 2, NASDAQ Japan, the secondary market at the Tokyo Stock Exchange (TSE Section 2), and the Canadian venture Capital Exchange (CDN). This comparison revealed:

1. The exchange with the most stringent requirements was TSE Section 2. The next most stringent was JASDAQ tier 1. The third most stringent was NASDAQ Japan. MOTHERS' and JASDAQ tier 2's requirements are the least stringent. CDN's requirements (in the case the IPO route is used) rank between NASDAQ Japan's and MOTHERS'/JASDAQ tier 2's.
2. MOTHERS' requirements are very similar to JASDAQ tier 2's.
3. MOTHERS does not use a market maker system that would enhance its liquidity. Moreover, it lacks proper mechanisms to compensate for this shortcoming and promote liquidity.

4. **MOTHERS' and NASDAQ Japan's processing periods (3 months, 1~2 months, respectively) is short, compared with other exchanges in Japan: it is similar to CDNX (8~12 weeks). Companies can list on MOTHERS in a reasonably short time.**
5. **MOTHERS' requirements for disclosure are the most demanding of all researched exchanges. However, unlike Canada, where investors are protected by CIPF (Canadian Investor Protection Fund), Japan does not offer any similar mechanism. Moreover, considering the high-risk aversion tendency of Japanese people, stringent disclosure criteria do not seem to be enough to protect investors.**
6. **Traditionally in Japan, stock exchanges do not assess applicant companies. Rather, the lead underwriter (a security company) does it. Stock exchanges simply accept the assessment by the lead underwriter. Following this tradition, MOTHERS, JASDAQ (both tier 1 and 2), and NASDAQ Japan do not themselves evaluate venture businesses but rely on security companies. Thus, the responsibility of security companies in evaluating the businesses' growth potential is a key. Since security companies in Japan tend to lack experience and the competence to evaluate venture businesses, this responsibility might be too heavy for them.⁶**
7. **MOTHERS' listing fees are the lowest in Japan. However, they are still very high compared to CDNX (e.g., CDNX's listing examination fee is about one thirtieth of MOTHERS').**

⁶ Milhaupt (1997), Black & Gilson (1998), Ooghe & bekaert & van den Bossche (1989) and Suzuki (1999) point out the lack of experience and competence of Japanese venture capitalists.

8. Before the launch of MOTHERS, JASDAQ was the only market where relatively small, young firms could list their shares. MOTHERS and NASDAQ Japan will be the first competitor to JASDAQ. Thus, it may be expected that competition among these stock exchanges will activate the Japanese OTC (or, venture capital) market, because both exchanges will continuously strive to improve in order to survive.
 9. There are three ways to list on CDNX: IPO, reverse takeover (RTO), or as capital pool company (CPC). When CDNX's listing requirements, in the case where the IPO route is used, are compared with those of MOTHERS and JASDAQ, they seem, at first, to be more stringent. However, CDNX offers two ways (besides IPO) to list for a company that does not meet its IPO requirements. As opposed to this, MOTHERS and JASDAQ provide only one way to raise capital: if a company does not meet the requirements, there is no alternative.
- Moreover, CDNX's requirements are more flexible than MOTHERS', JASDAQ's and NASDAQ Japan's. They slightly differ according to industry segment, taking the characteristics of each industry into consideration. In addition, if a criterion is not satisfied, it can often be replaced or substituted for by another one. For example, a company with no Net Tangible Assets passes the test if it has more than \$200,000 EBT and adequate financial resources for 18 months. Another remarkable characteristic of CDNX is that it provides a pre-review program named PREP, which helps companies determine, before pre-listing costs are incurred, whether a venture market listing makes sense at this time. Thus, it can

be concluded that CDNX offers more avenues for a possible infusion of capital to venture businesses, and its requirements are more flexible.

In summary, though MOTHERS' and JASDAQ tier 2's entire system lacks the flexibility and mechanisms necessary for sustained activation of the Japanese venture capital market, their listing requirements themselves seem reasonably relaxed. NASDAQ Japan's requirements are not so relaxed but it offers several advantages such as its brand name, internationality, and its well-developed market maker system. Let us now turn to the next obvious question: how is this perceived and how do Japanese SME principals react?

3. Definitions

3-1. Small-and Medium-Sized Enterprise (SME)

There are many definitions of “small business firm”. In Canada, the definition given by Statistics Canada is the most widely used: a small business firm is any firm with fewer than 50 paid employees and annual revenues less than \$5 million. However, in the manufacturing sector, any firm with fewer than 100 paid employees and annual revenues less than \$5 million is a “small business”. Also Statistics Canada defines a mid-sized business as a firm with more than 100 but less than 500 paid employees.⁷

In Japan, “Chusho Kigyo Sho (Ministry for Small and Medium Enterprise) defines a SME as a firm with less than 300 full time employees, or, any company with capital of less than 100 million yen (\$1 million US). Either criterion suffices to define an SME. In the wholesale sector, any firm with less than 100 full time employees, or, any company with a capital of less than 30 million yen (\$ 30,000 US) is an SME. In the retail and service sectors, any firm with less than 50 full time employees, or, any company with a capital of less than 10 million yen (\$10,000 US) is an SME. Also, Chusho Kigyo Sho defines a small business firm as any firm with fewer than 20 full time employees. In the retail and service sectors, any firm with less than 5 full time employees is defined as a small business firm.⁸ Since this study will investigate SMEs in Japan, we use Chusho Kigyo Sho’s definition.

⁷ Keown, A. J., Scott, Jr. D. F., Martin, J. D., Petty, J.W., McPeak, D. W., 1996. *“Basic Financial Management”* Second Edition, Prentice-Hall Canada, Scarborough, Ontario.

⁸ Japan’s Ministry of International Trade and Industry, 1999. *“Chusho Kigyo Hakusho [White Paper of Small- and Medium-Sized Business]”* Second Edition, Kasumigaseki, Tokyo.

3-2. Principal

There are no words in Japanese corresponding exactly to the English “owner” and “CEO”. In Japan, we usually use the word “shacho”, which mostly means the person responsible for the day to day management of the business, usually implying someone who is owner and at the same time CEO, but sometimes s/he could be a CEO who does not own the company, or s/he could be an owner but does not manage the firm.

When conducting the questionnaire and interview surveys, we asked those “shacho” to participate. Since owner or CEO is not an exact translation of “shacho”, we use, for the sake of convenience, the English “principal”. “Principal” in this study means, in most cases, the person most responsible for the day-to-day management of the firm, an owner and at the same time a CEO, but in some cases principal means a CEO who does not own the company.

II. Literature Review

1. Introduction

For this research, the literature is reviewed: to reveal both quantitative and qualitative characteristics of Japanese venture capital markets, to describe the economic environment of Japanese capital markets, to explore financial experts' reactions to MOTHERS, NASDAQ Japan, and reformed JASDAQ, and to investigate the characteristics of Japanese SMEs, as well as their perception of equity capital.

2. Characteristics of Japanese Venture Capital Market

Several authors have described the Japanese venture capital market; most of them consistently note its slow development. For example, Curtis J. Milhaupt (1997) lists (see Table 1) the quantitative differences between the venture capital markets in the U.S. and in Japan.⁹

Table 1: Relative Size of the U.S. and Japanese Venture Capital Markets

	US	Japan	Japan/US
Number of venture capital firms	637 ('93)	121 ('94)	1/5
Total amount invested	\$35 billion ('93)	\$10.175 billion ('93)	1/3
Annual investment	\$3.1 billion ('93)	\$0.759 billion ('93)	1/4
Number of start ups	670,000 ('92)	90,000 ('93)	1/7
New public companies	619 ('94)	149 ('94)	1/4
Companies listed on NASDAQ/Japan OTC market	4902 ('94)	563 ('94)	1/9
Public companies	8296 ('94)	2773 ('94)	1/3
Public companies as % of all companies	0.18%	0.21%	1.2 times

Source: 1072 JURISTO 64, 71 (1995) (compiled from various sources, updated by author), from Milhaupt, 1997.

From the table, we can recognize that the number of new business creations in Japan (90,000) was very small (one-seventh) compared to that in the U.S (670,000), and that the number of companies listed in the OTC market in Japan (563) was one-ninth of that in the U.S. in 1993. Moreover, both the number of venture capital firms and the amount of money invested were very small in Japan (only 121 venture capital firms invested \$760 million in 1993) compared to in the U.S. venture capital market, where 637 venture capital firms invested \$3 billion in funds in 1993. Let us note, en passant, that the annual investment rate in Japan is only slightly greater than that of Canada (\$669

⁹ Milhaupt, C., 1997. "The Market for Innovation in the United States and Japan: Venture Capital and the Comparative Corporate Governance Debate" *Northwestern University Law Review* 91, 856-898.

million in 1995).¹⁰ From the quantitative point of view, Japan lags behind the U.S. in the development of venture capital market.

The Japanese venture capital market differs from those in North America in several respects.

1. **Bank-Centeredness.** The Japanese major banks are fewer in number but larger in size compared with those in the U.S. These Japanese major banks have a central corporate governance role in monitoring management. Conversely, in the U.S., a well developed stock market plays the role of corporate control and governance.¹¹ Thus, Black & Gilson (1998) and Milhaupt (1997) characterize the Japanese capital market as a bank-centered capital market, and the U.S. capital market as a stock market capital market. They argue that bank-centered capital market system seems to have strongly influenced the development of the Japanese venture capital market. This will be discussed at a later point.
2. **Lack of Independence.** In Japan, more than half of the venture capital firms are affiliates of banks, security firms, and insurance companies (of the 121 venture capital firms, 22 are affiliated with major banks, 15 are affiliated with security firms, 40 are affiliated with regional banks, 10 are affiliated with insurance companies, four are owned by foreign companies). U.S. venture capital firms are more independent. Most venture capital firms in the U.S. are independent private

¹⁰ Canadian Venture Capital Association (CVCA), 2000. "1999 Key Observation"
<http://www.cvca.ca/downloads/index.html>

¹¹ Black, B.S., Gilson, R. J., 1998. "Venture Capital and the Structure of Capital Markets: Banks versus Stock Markets" *Journal of Financial Economics* 47, 243-277; Milhaupt, 1997.

partnerships, which constituted 81% of the total investment in venture businesses in 1993.¹²

Moreover, the sources of the funds to Japanese venture capital firms are different from those of U.S. venture capital firms. The major sources of the funds of U.S. venture capital firms are shown in the following table:

Table 2. The Major Source of the Funds of U.S. Venture Capital Firms

The source of private funds	Percentage of all capital commitments
Pension funds	47%
Endowment and foundations	18%
Families and institutions	12%
Banks and insurance companies	11%

From Milhaupt, 1997.

In the U.S., pension funds accounted for 47% of all capital commitments for private finds from 1990 to 1996. Moreover, “angels” are also a major source of capital to start-up businesses. Not only the venture capital firms, but also the other sources of funding, are largely independent in the U.S. In Japan, pension funds are prohibited from investing in venture capital by regulation. Moreover, there are no angels. The sources of the funds of Japanese venture capital firms are corporations (33% of all funds of venture capital firms), banks (24%), and insurance companies (15%).¹³ Both the Japanese venture capital firms and their sources of funds are not independent, but are strongly affiliated with those parent organizations.

Milhaupt (1997) argues that the independence of venture capital firms and sources of the funds are important factors for an active venture capital market.

¹² Milhaupt, 1997.

¹³ Black and Gilson, 1998; Milhaupt, 1997.

Such independence, according to Milhaupt, allows the venture capitalists to concentrate on fostering the most promising new firms and to increase returns without the influence of parent companies that may have different interests in their venture capital investments. In Japan, because of the strong affiliation between venture capital firms and banks, most management staffs of Japanese venture capital firms come from the banks (or insurance companies or security firms). Thus, their behaviors are likely to be influenced by the parents companies' interests. Moreover, their business experiences are likely limited to only in those fields. The management staffs of Japanese venture capital firms tend to be conservative and inexperienced as venture capitalists and to lack the long-term vision that is a desirable skill for venture capitalists. The Japanese venture capital market lacks experienced venture capitalists who are able to assess the prospects of new business and provide non-financial contributions, such as management assistance, monitoring of the performance, and reputational capital, to portfolio companies.¹⁴

3. **Focus on Debt Financing.** Japanese venture capital firms provide capital to venture businesses by setting up loans rather than equity investment. In 1993, loans to 715 venture businesses accounted for 58% of total venture capital investment.¹⁵ The U.S. venture capital firms hold larger equity proportions and more actively manage the portfolio companies.¹⁶

¹⁴ Black & Gilson, 1998; Milhaupt, 1997; Ooghe, H., Bekaert, A., van den Bossche, P., 1989. "Venture Capital in the U.S.A., Europe and Japan" *Management International Review* 29, Number1, 29-45; Suzuki, H., 1999. "New Ventures: Starting up in Japan" *Look Japan*, April.

¹⁵ Milhaupt, 1997.

¹⁶ Black and Gilson, 1998; Milhaupt, 1997; Ooghe, Bekaert and van den Bossche, 1989.

4. Lack of Early-Stage Businesses and Technology Focus. In Japan, investment in start-ups and early stage businesses accounts for only 16% of all Japanese venture capital firm disbursements. This percentage is small compare to that of the U.S. (about 30%) and that of Canada (about 35%).¹⁷ Moreover, Canada's venture capital investment activity focuses more on small companies than does Japan's. Thirty-eight percent of total venture capital firm disbursements in Canada was invested in small companies (those with revenues of less than \$1 million) in 1998. In Japan, the corresponding percentage was less than 1 %. This can be another reason why Japanese venture capitalists are inexperienced. Suzuki (1999) asserts: "[t]here are great number of venture capitalists in Japan: many with more than 20 years of experience. However, the great majority have invested in firms that have already reached reasonable size and strength. For that reason, there is scant know-how for guiding venture companies at the start-up stage".

Moreover, Japanese venture funds do not heavily invest in research and development on new materials or biotechnology. They invest in manufacturing, wholesale, retail sales, and service sectors. Their equity investment is mainly in machinery-related industries, information-related industries, the construction and real estate industries, and service and retail industries, and electronic industry.¹⁸ Suzuki (1999) describes the current trend of venture business in Japan that most of the new companies that recently went public were in the service industry. Examples are "Matsumoto Kiyoshi (discount pharmacy)", "H.I.S (travel

¹⁷ Milhaupt, 1997; CVCA, 2000.

¹⁸ Milhaupt, 1997.

agency)", and "Soft Bank". On the other hand, North American venture capital firms invest mainly in software (20.72% of total disbursements), medical and health care related business (14.4%), consumer-related industries (10.5%), telephone and data communications (10%), and biotechnology (9.2%).¹⁹

5. **Risk Aversion.** Japanese venture capital investment is far less risky compare to the U.S. venture capital investment. Only 9 of 1090 companies listed in Japan's largest venture capital funds failed in 1993 (the failure rate was less than 1%), whereas 10-20% of the U.S. venture capital-backed firms usually fail. The rate of return on Japanese venture capital funds is 40% less than that on the U.S. venture capital funds.²⁰ This is because, as mentioned in the previous section, Japanese venture capitalists are more likely to invest in already quite mature companies, and reluctant to invest more risky cutting-edge technology companies.²¹

Overall, it can be concluded that Japan lags behind the U.S. in development in the venture capital market. The Japanese venture capital market is smaller in terms of the number of venture capital firms and the amount of money available to invest: because it is set in the context of bank-centered capital markets, and because Japanese VCs lack independence, concentrate in debt financing, do not finance early-stage businesses nor new technologies, and are not risk tolerant.

¹⁹ Milhaupt, 1997.

²⁰ Milhaupt, 1997.

²¹ Milhaupt, 1997.

3. Factors of the Slow Development of Japanese Venture Capital Market

A distillation of the works of Milhaupt (1997), Black & Gilson (1997), and Ooghe & Bekaet & van den Bossche (1989) consistently yields the following among explanations for the slow development of the Japanese venture capital market.

1. Japanese people are less entrepreneurial and less willing to take risk.²²
2. The Japanese economy developed without intensive research until the mid-sixties, because it developed mainly by copying the Western technologies. Thus, traditionally high-risk long-term financing was not necessary in Japan.²³
3. Large corporations have the major role for innovation.²⁴
4. Successful entrepreneurs are less admired than top business managers in large companies.²⁵
5. The market for human resources is highly illiquid. Traditionally, large companies hire only recent college graduates and people are traditionally supposed to stay in the same company. Under this “lifetime” employment, it is uncommon for Japanese white collar workers to leave their position at the established company and to start up a new business.²⁶ This tendency makes start up of a new business more risky for Japanese workers, because in the case where the venture business they started fails, the possibility to re-enter to an established company is slim.

²² Black and Gilson, 1997; Milhaupt, 1997.

²³ Ooghe, Bekaet and van den Bossche, 1989.

²⁴ Milhaupt, 1997; Ooghe, Bekaet and van den Bossche, 1989.

²⁵ Milhaupt, 1997; Ooghe, Bekaet and van den Bossche, 1989.

²⁶ Black and Gilson, 1998; Milhaupt, 1997; Ooghe, Bekaet and van den Bossche, 1989.

Moreover, when a worker moves from one company to another company, he/she cannot continue the retirement pension benefit started at the previous company.²⁷

However, the Japanese employment style of “life-time” employment has been changing. Under hard economic conditions, many large Japanese companies have re-structured their organizations, laying off some of their employees. People are now realizing that obtaining a position at a large company does not guarantee their lifetime working position and income.

6. High taxation rates for capital gains (42%) do not promote investment in risky businesses.²⁸
7. Organizational forms that provide venture capital providers with both flow-tax treatment and limited liability do not exist in Japan.²⁹
8. In the U.S., a contracting structure (the agreement between venture capitalists and venture business managers) provides the extensive mix of incentives and protections for venture capitalists and venture capital investors. For instance, contracting structure minimizes conflicts of interests and creates compensation by developing investment returns. In many cases of successful partnership investment, venture capitalists receive 20% of the gains, as well as a management fee. In Japan, contract structures do not provide such incentives and protections for venture capitalists and venture capital investors in their investment. Moreover, unlike the U.S., there are no industry standards that provide a set of contractual

²⁷ Milhaupt, 1997.

²⁸ Ooghe, Bekaert and van den Bossche, 1989.

²⁹ Milhaupt, 1997.

incentives and protections to venture capitalists in their relationship with venture business managers.³⁰

9. Venture capital funds limit the amount of money to invest in their portfolio companies to avoid to be identified as holding companies.³¹
10. Convertible preferred shares and options, utilized in the U.S. venture capital market as incentive and protection for the venture capitalist, are not commonly used in the Japanese venture capital market. Because of complexity of regulations, the issuance of stock options is not practical. Due to the lack of history and tradition, the usage of convertible preferred shares is also uncommon in Japan. Thus, common stock accounts for the majority of equity investment and warrants and convertible bonds account for less than 1% of the total venture capital funds in 1993.³²

³⁰ Milhaupt, 1997.

³¹ Milhaupt, 1997.

³² Milhaupt, 1997.

4. On Bank-Centered Capital Market - Limited Availability of IPO

So far, the characteristics of the Japanese venture capital market and several factors of the slow development of the market have been considered. In this section, one of the characteristics of the Japanese venture capital market, the fact that it exists in bank-centered capital market, is focused upon. Black & Gilson (1998), and Milhaupt (1997) note that a well-developed stock market is essential to the existence of an active venture capital market. A stock market provides venture capitalists the most profitable form of the exit from the venture capital investment, that is, an IPO.³³

An “Exit” for venture capitalists from their investment is crucial to the viability and structure of the venture capital market. Once the portfolio company succeeds, such “exit” allows venture capitalists to reinvest and recycle the venture capital investors’ capital in other early-stage businesses. In other words, through “exit”, venture capitalists liquidate their portfolio company investment in short term. What can be recycled is not only capital. Three important non-financing contributions of venture capitalists, management assistance to the portfolio companies, monitoring of their performance, and reputational capital like an investment bank underwriting an initial public offering (IPO), can be also recycled. Moreover, by looking at “exit” prices, venture capital providers can evaluate the venture capitalists’ skill. Thus, “exits” provide an efficient way to utilize the monetary and non-monetary contributions of venture capitalists. Long-term debt

³³ Black & Gilson, 1998; Milhaupt, 1997.

financing to venture business that Japanese banks frequently do, is not an efficient way to utilize capital.³⁴

There are several other forms of exit (acquisitions, leveraging, etc.). However, Black & Gilson (1998), and Milhaupt (1997) both agree that the availability of IPO, which cannot be very common as an exit in bank-centered capital market, is essential for the development and success of the venture capital market.

The reason is that the availability of exit by an IPO allows the portfolio companies and venture capitalists to enter into an implicit contract over control, in which the venture capitalists agree to return control to a successful portfolio company by exiting through an IPO.³⁵ Bank-centered capital market severely restricts the availability of exit through an IPO. Thus, the implicit contract, which depends on the possibility to exit through IPO, is not available in a bank-centered capital market.³⁶ In fact 15 year-old (or older) companies account for 92% of all companies whose shares are traded on the Japanese OTC market, whereas firms that are less than 10 years old companies account for 42% of all companies whose shares are traded on the U.S. NASDAQ.³⁷

There is a strong relationship between the availability of IPO and an active venture capital market. So, if Japan creates a stock exchange for venture businesses, will it enhance the entire venture capital investment activity in Japan? The answers of both Milhaupt (1997) and Black& Gilson (1998) are “No”. Black & Gilson (1998) point out that such a straightforward strategy has been already tried and failed in some European countries, also due to the bank-centered capital market systems in those countries that

³⁴ Black and Gilson, 1998; Milhaupt, 1997.

³⁵ Black and Gilson, 1998.

³⁶ Black and Gilson, 1998; Milhaupt, 1997.

³⁷ Milhaupt, 1997.

limited the availability of IPO. Moreover, the strategy to try to shift to a stock market-centered capital market from a bank-centered capital market in order to enhance the availability of IPO is dangerous if the strategy does not consider its influence on other economic conditions. Milhaupt (1997) argues that the relationship between the availability of IPOs and the development of the venture capital market is not so strong in Japan, compared to their strong relationship Black & Gilson' model suggested (1998). As noted previously, there are many factors that may prevent the development of the Japanese venture capital market, such as regulations, low labor mobility, strong risk aversion, cultural and historical aspects, characteristics of Japanese corporate governance, so on. Thus, Milhaupt (1997) and Black & Gilson (1998) agree that the best strategy to activate the Japanese venture capital market is to piggyback on stock market-centered capital markets and its supporting institutional infrastructure. One strategy they suggest is to list the stock of Japanese venture businesses on NASDAQ in U.S. as Israel did.

5. Reactions to New Junior Stock Exchanges

Black & Gilson (1998) and Milhaupt (1997) argue that just to create a market is not sufficient to activate the Japanese venture capital market. Within Japan, some researchers doubt the success likelihood of MOTHERS or other junior exchanges. For example, the president of Fukuoka Stock Exchange, Masayoshi Kawamura, thinks the listing requirements of MOTHERS and NASDAQ Japan are still too high for venture businesses.³⁸ As well “The Nikkei Financial Daily” worried about the liquidity of the new market. Since the parent organization of “MOTHERS”, the Tokyo Stock Exchange, is an auction (order driven) system where exchanges materialize when the market receives both sell and buy orders, MOTHERS cannot use the “market maker system” to enhance market liquidity.³⁹

However, there are some positive perspectives for MOTHERS and other new junior exchanges, as well as the entire development of Japanese venture capital markets. Michio Nagai, a managing director of Goldman Sachs, holds a positive perception of MOTHERS. Last January, a major investment bank in the U.S. (Goldman Sachs) and a Japanese high-technology company (Kyosera) established a joint venture, “Kyosera-Goldman Sachs Venture Capital” in Japan. This is a 30 billion yen (approximately US\$300million) fund for Japanese venture businesses. Michio Nagai explained the motivation of this fund: the Japanese economic environment is now ripe for venture capital investment, as the launch of MOTHERS and NASDAQ Japan, reform of

³⁸ Anonymous, 2000. “Fukusho, Bancha Muke Shin Shijo [A New Market for Venture Business in Fukuoka Stock Exchange]” *The Nikkei Financial Daily* February 7th, 7.

³⁹ Anonymous, 2000. “Nisshokyoshijo Ga Ikiru Michi [The Way for the Japanese Stock Market to Go]” *The Nikkei Financial Daily* February 7th, 12.

JASDAQ, will expand the potential for exit, and many Internet-related venture businesses are being started. In fact, venture capital funds are rapidly increasing. Japan now seems to be in a boom of venture capital investment.⁴⁰

⁴⁰ Anonymous, 2000. "Bench Toshi Nihon No Kankyo Totomou [The Economical Environment Has been Arranged for Venture Investment]" *Nihon Keizai Shinbun [Japan Economic Newspaper]* February 7th, 15.

6. Profile of Japanese SMEs

Japanese SMEs face challenges that are similar to those of SMEs in other countries. According to the 1999 edition of “Chusho Kigyo Hakusho (White Paper on Small- and Medium Sized Business)”, almost 70 % of SMEs experienced some difficulty raising capital. In addition, about 50 % had difficulties establishing business relationships and lacked adequate human resources (the salaries offered being too low). Likewise, 70 % of firms experienced a shortage of capital when starting, and almost all SMEs used debt financing and the principals’ personal funds as a source of capital: only 1.5 % of them financed their capital from venture capital company.⁴¹

The 1999 edition of “Chusho Kigyo Hakusho also reveals that only 10.7 % of all SME principals are willing to use equity capital (1 % of them are actually preparing for going public, 9.7% of them expressed a desire to go public “someday”): 56.8 % of them are not willing to use equity capital (the answer of the remainder of 22.5% was “I do not know”).⁴² This result is similar to the result of a study that investigated Canadian SME principals’ perspective on equity financing. That research found that in Canada, most small business entrepreneurs were not aware of sources of equity capital.⁴³ Moreover, of those who were aware of equity capital, the majority of entrepreneurs were not willing to use it due to the threat to control. However, The 1999 edition of “Chusho Kigyo Hakusho” did not discuss about the awareness of source of equity capital among Japanese SME principals. Thus, there is a need to investigate it in this study.

⁴¹ The 1999 edition of “Chusho Kigyo Hakusho”

⁴² The 1999 edition of “Chusho Kigyo Hakusho”

⁴³ Keown, A. J., Scott, Jr. D. F., Martin, J. D., Petty, J.W., McPeak, D. W., 1996. *“Basic Financial Management”* Second Edition, Prentice-Hall Canada, Scarborough, Ontario.

7. Summary of Literature Review

In summary, those are the characteristics of the Japanese venture capital market:

- Not well developed compared to the U.S. venture capital market.
- Small in terms of the amount of money invested and number of venture capital firms.
- Set in the context of a bank-centered capital market,
- Not independent,
- Concentrates in debt financing,
- Does not finance early-stage business nor new technologies,
- Not risk tolerant:

There are many possible factors of this slow development of the Japanese venture capital market: strong tendency of risk aversion, no tradition of high-risk investment, innovation is mainly carried out in large corporation, low labor mobility, strict regulation as well as high tax rate, lack of incentives and protections for venture capitalists and capital providers, etc.

The Japanese bank-centered capital market system hinders the development of its venture capital market, because such a system limits the potential of exit for venture capitalists from their investment through an IPO. Thus, just to open a stock exchange and import IPO strategy does not seem sufficient to trigger real venture capital investment activity in Japan. Moreover, the absence of a stock exchange and lack of availability of IPOs are not the only two inhibiting factors of slow development of an active venture capital market: there are many other factors we have to take into consideration.

Both outside and inside Japan, some individuals view MOTHERS, NASDAQ Japan or other junior stock exchanges with skepticism. Moreover, though most Japanese SME principals have difficulties raising capital, only 10% are willing to use equity capital. Thus, this literature review suggests that there is no guarantee of success for new Japanese junior stock exchanges nor for the emergence of an active venture capital market in Japan.

III. Research Questions

We explore two main research questions and three sub-questions.

The main questions:

- 1) What are the Japanese SME principals' attitudes towards and perceptions of equity capital?**
- 2) Considering these attitudes and perceptions, are the listing procedures and requirements of Japanese junior stock exchanges (MOTHERS, NASDAQ Japan, and JASDAQ etc.) appropriate?**

To answer these questions, three sub-questions will be explored:

- 1) Is there a demand for equity capital in the small business sector?**
- 2) What is the profile of companies that would be willing to go public?**
- 3) How do Japanese SME principals react to the listing procedures and requirements of these junior exchanges?**

IV. The Research Methodology

1. Sample Frame

This research uses two sources of data: data obtained from a questionnaire survey, and data obtained from telephone interviews. These sources are described presently.

1-1. The Questionnaire Sample

This sample is mainly used for investigating whether or not there is a demand for equity capital among small businesses in Japan (first sub-question, p.23) and to establish the profile of Japanese SMEs (and their principals) that would potentially go public (second sub-question). It is also used to explore Japanese SME principals' perceptions of equity capital (first research question) by asking why they want to go public (and which exchange they would select, if willing to go public) and if not, why not.

The "basis" for the questionnaire sample was comprised of: 1) 500 companies randomly picked from a population of all companies established in 1994, and 2) 500 companies randomly picked from all companies established in 1998. The list of these (randomly picked) 1,000 companies (with their name, address, telephone and fax numbers, year of establishment, capitalization, number of employees, and last fiscal year's sales) was purchased from a Japanese commercial data bank, "Shoko Research Inc.". We sent a questionnaire to those 1,000 SMEs (and their principals) and received a response from 88.⁴⁴ Those 88 firms constitute "the questionnaire sample".

⁴⁴ It includes respondents for the questionnaire pre-testing.

1-2. The Interview Sample

It was predictable that we would find only few (if any) SMEs in the questionnaire sample actually in the process of an IPO, or even thinking of equity financing. Therefore, we would not gather much useful information on Japanese SME principals' perceptions of these issues if we had limited ourselves to investigating firms in the questionnaire sample only (actually we found no SME in the questionnaire sample caught in the IPO process). To enrich our understanding of principals' perspectives on financing by means of IPOs and to give us clear opinions/perceptions on equity capital it was necessary to draw on a second sampling frame comprised of firms more likely to be in an IPO process.

Since "Nikkei Venture Directory" listed firms with rapid sales growth and unique technologies, it was assumed that we could find among those, more firms (or principals) that would be actually in an IPO process and have knowledge on equity capital, than among firms in the questionnaire sample (from a "basis" of randomly picked firms established in 1994 and 1998). This was why we constructed "the interview sample" based on the "Nikkei Venture Business Directory" as second sampling frame.

Therefore this sample was used to investigate the Japanese SME principals' attitudes towards, and perceptions of, equity capital (first research question, p.23), as well as reactions to the listing requirements of recently opened junior stock exchanges (third sub-question).

Telephone interviews have two advantages over a questionnaire technique. First, interviews allow the principals to describe their perspectives in appropriate detail and in their own words (instead of having to choose among imposed alternatives). Second, many small business principals may be less than expert in financial management. They

may not be familiar with various terms, may use terms inconsistently or erroneously, may not be aware of financing alternatives and in short, may not speak the “language of finance”. Interviews enabled us to investigate perceptions and attitudes in depth, by understanding the context of the principals’ responses, or catching more subtle nuances and the rationales behind responses.

The “basis” of the interview sample was comprised of 345 SMEs established since 1989 and listed in the year 2000 edition of “Nikkei Venture Directory”. Nihon Keizai Shinbun (Nikkei; Japan Economic Newspaper) annually publishes the “Nikkei Venture Business Directory”, a directory of firms identified as venture businesses by Nikkei. A company is a venture business if it satisfies three criteria: first, it is relatively young, or it recently started a new business (even if the company itself has a long history); second, it uses a unique (original) technology or know-how; third, its growth rate in the past several years was high. In 2000, Nikkei identified about 5,000 companies as venture businesses (according to these criteria), and sent them a questionnaire. The year 2000 edition of the directory contains 2,592 companies that answered, with the following information on each:

1. Name of the company
2. Address, telephone and facsimile number, home page address
3. Year of establishment
4. Nature of business (sector)
5. Last three fiscal years’ sales and net income
6. Capitalization

7. Name(s) of the officer(s) as well as number of officers
8. Name(s) of the principal owner(s) and percentage of management ownership of the firm
9. Name(s) of venture capitals invested in the firm
10. Main suppliers/clients
11. Number of employees
12. Number of patents
13. Name(s) of company (ies) co-operated
14. Name of the main bank
15. Intention to go public

We randomly picked, as a “basis” for the interview sample, 345 companies established within the last 10 years (starting from 1989) among those 2,592 firms listed in the year 2000 edition of the directory, and sent “Request for interview” letters. Of those 345 firms, 62 who accepted and answered the interview constitute our “interview sample”. Among these 62 firms, 50 were considering an IPO, 12 were not.

2. The Questionnaire

A questionnaire was sent, by computer facsimile system, to 1,000 Japanese SME principals (“basis” for the questionnaire sample). The questionnaire consists of five sections:

I. General profile of the firm

- Sector;
- Last fiscal year’s net income;
- Forecasted sales 3 years from now;
- Number of officers;
- Percentage of management ownership of the firm;
- Identity of principle owner(s), such as parent company, ex-company of the chief officer, etc;
- Is/are there (a) financial manager(s) in the firm, and if so, status of the manager(s), whether as principal, employee, or outside accounting firm.

II. Principal, general profile

- Gender;⁴⁵
- Age;
- Final degree;
- Number of companies principal had experienced before starting the current business;
- Number of occupations before starting the current business;

⁴⁵ Here we asked about the person most responsible for managing the day-today operation of the business.

- Number of years of experience as a business manager before starting the current business;
- Number of years of experience in the industry to which her/his current business belongs, before starting it.

III. Principal's plans for growth of the firm

IV. When principal plans some growth, is there any willingness to go public, and if so/if not, the reason(s);

V. In the case of a declared willingness to go public, his/her preferred stock exchange(s) to list.

A copy of the questionnaire (translated to English) is attached as Appendix A.

At the beginning of June 2000, the questionnaire was pre-tested on 9 Japanese small business principals known to us, in order to evaluate its validity. From the end of June to the beginning of August 2000, the questionnaire was sent to 1,000 SMEs by fax. To reduce non-response bias, one "reminder" was sent one week later, and the cut-off date for responding was August 31st, 2000. Data analysis started in September 2000.

3. The Interview

For the telephone interview, the following open-ended questions were posed:

a). To principals willing to go public

- 1. Why would you like to go public?**
- 2. What, do you think, is/are the disadvantage(s) of becoming a publicly traded company?**
- 3. What is/are the difficult aspect(s) of the IPO process?**
- 4. What do you think of the listing requirements of the recently opened/reformed junior stock exchanges (MOTHERS, NASDAQ Japan, JASDAQ, etc.)?**
- 5. What do you think of the evaluation procedure by stock exchanges, or security companies?**
- 6. What, in general, do you think about the recent changes in the Japanese venture capital market: the launching of new stock exchanges for venture businesses (MOTHERS, NASDAQ Japan, etc.) and JASDAQ's reform of its requirements?**
- 7. Which exchange(s) would you prefer to list, and why?**
- 8. Why, do you think, is the Japanese venture capital market underdeveloped?**

b). To principals not willing to go public

- 1. Why don't you go public?**
- 2. Why, do you think, is the Japanese venture capital market underdeveloped?**

c). Moreover, for uniformity and in order to sustain consistency between interview data and questionnaire data we added the following list of questions to all principals (regardless of their willingness to go public):

1. Forecasted sales 3 years from now;
2. Principal's age and final degree;⁴⁶
3. Principal's number of companies s/he had experienced before starting the current business;
4. Principal's number of occupations before starting the current business;
5. Principal's number of years of experience as a business manager before starting the current business;
6. Principal's number of years of experience in the industry to which her/his current business belongs, before starting it;
7. Is/are there (a) financial manager(s) in the firm, and if so, status of the manager(s), whether principal, employee, or outside accounting firm;
8. Other information on the firm and principal not provided in the "Nikkei Venture Business Directory".

All interviews were audio-taped and transcribed. The transcriptions were analyzed using NUD*IST, a recently developed and widely-used means of computer aided coding and analysis of qualitative data.

Interviews were conducted between June 20 and August 31, 2000. It was preceded by a "Request for interview" faxed to principals of 345 firms picked from the

⁴⁶ Gender of principal was identified at the time of the interview (telephone).

“Nikkei Venture Directory”. The cut-off date for the response was August 31st, 2000.

Data analysis started in September 2000.

4. Process

In carrying out the surveys (both questionnaire and telephone interview), we had two main concerns: 1) to reduce the cost 2) to increase the response rates. The cheapest way to send a questionnaire to 1,000 firms and a Request for interview letter to 345 firms in Japan was by fax (computer facsimile system) from Canada.

However, using the computer facsimile system had its difficulties. When the computer failed in sending all pages, it tried again automatically (maximum three times) until it succeeded to send all the pages. This means that when the computer failed at the fifth page of the questionnaire (for instance), sometimes the receiving company received the first five pages three times. This irritated some, who complained that it was a waste of paper to get the same stuff (but without the last few pages) three times.

Traditionally, conducting a survey in Japan is difficult. The White Paper on Marketing Research (1996 edition), published by Japan Marketing Research Association, reported that annually 18% of the Japanese population participate in a survey, and that response rates have been noticeably decreasing in the past few years. Moreover, according to Tomohiko Sato, a government official working for Somu-cho Tokei-ka (Management and Coordination Department, Statistics Division), even for the population census and other government surveys, where refusal to answer means a fine, the response rates are below 50% (50% prefer paying a penalty, rather than responding to the survey!). “Nikkei Research”, a Japanese leading market research company, points at several factors that decrease response rates:

1. The general public looks at surveys with “suspicion” or finds them “a bother”.

2. The Japanese public, in general, is not accustomed to participating in research, unlike in Western Europe and North America.
3. Many Japanese fear invasion of privacy, and possible solicitation calls of all kinds (sales, etc.)
4. Japanese still tend to balk at the idea of telling their life story to strangers (by answering a questionnaire/an interview).

Thus, it was essential for us to devise ways to increase the response rate and collect reliable data for this research. Therefore:

1. We put the names of three Japanese associations that offered to nominally sponsor this research, on the cover page of the questionnaire and Request for interview letter. They were: The National Small Business Information Promotion Center, the New High-tech Venture Business Foundation, the Fukuoka Stock Exchange. We actually asked 34 Japanese associations/organizations, but only got permission to quote their names from the above three. It was necessary to elicit a reaction of trust from the firms questioned, a feeling that “this survey is worth trusting”, and we hoped that indicating these “sponsors” would increase the credibility of our endeavor.
2. Reminders: a “follow-up” letter was sent one week after the questionnaire.
3. Offering summary results as an incentive. In the Japanese code, it is considered rude to ask someone a favor without anything in return. “Nikkei Research” reports that research/surveys conducted in Japan most often require the recourse to various incentives. Some respondents, especially businesses or academics, make receiving results of the research a condition for their participation. They

often refuse to co-operate if they see no benefit to their company/organization. Offering a summary of the findings is considered effective, especially when one asks questions about company's strategies or investment plans. Thus, in the cover letters (both for the questionnaire and Request for interview), we informed principals that results would be made available to them if they so wished, and asked for the appropriate address to send them.

With these three devices, we had a response rate of 31% for the interview survey (out of 345 firms asked for an interview, 62 accepted). However, by the time we had sent a questionnaire to 400 firms, we noticed that the response rate was still extremely low (1.5 %: out of 400, we received only 6 responses!). Moreover, we received several complaints: faxing a questionnaire without prior notice was rude (lack of consideration). Thus, after having sent the questionnaire to 400 firms, we changed our strategy. We, therefore, first made a telephone call to the firms, asking for permission to fax a questionnaire, which we did when they accepted.

This procedure required us to make 600 telephone calls, making the questionnaire survey more time consuming. However, with the advance notice, we could reduce the cost of the questionnaire survey: the cost of faxing a 7-page questionnaire to the remaining 600 firms, without notice, was \$270 CDN; to make a telephone call to 600 firms and send a questionnaire to only those accepting, it was \$144 CDN.⁴⁷ Also, this advance notice acted as a guarantee that our survey was not combined with any sales activities (which many people feared most) and increased the response rate from 1.5% (6

⁴⁷ $(0.15 \times 600) + (0.45 \times 120) = 144$. The telephone call to ask for permission to send the questionnaire took, on average, 1 minute, and on average 2 firms out of 10 accepted. The cost for calling/faxing to Japan was 15 cents per minutes.

out of 400) to 12% (73 out of 600): though 80% principals refused to be sent a questionnaire, more than half of those who accepted did actually respond and complete it. In addition, we no longer received complaints from respondents. Rather, when the computer facsimile system failed to send all 7 pages, the respondent (instead of complaining) had the courtesy to contact us for the missing pages.

As a result, our response rate for the interview survey was 31%, 8.8% for the questionnaire.⁴⁸ The higher response rate for the interview survey can be attributed to the fact that: 1) the firms had already answered the questionnaire for “Nihon Keizai Shinbun” (this is why they are listed on the 2000th edition of “Nikkei Venture Business Directory”): so managers/employees in those firms do not reject offhand the idea of answering a survey; 2) they are more likely to be interested in equity financing (high sales growth rates) than those who received the questionnaire (randomly culled from all SMEs established in 1994 and 1998). As for the questionnaire: had we proceeded with advance notice from first, we might have had higher response rates. We consequently recommend proceeding with advance notice, when carrying out a questionnaire survey in Japan.

⁴⁸ It includes respondents for the questionnaire pre-testing.

5. Research Analysis

Five major steps were employed when using data from questionnaire (Q), interview (I), or both (Q&I):

- 1 (Q&I). Establishment of general profiles (central tendencies). Using descriptive statistical methods, this step analyzed data obtained from Sections I and II of the questionnaire. In addition, the general profile of firms and principals in the interview sample was also explored by analyzing the data on firms' (and principals') characteristics (such as sales, number of employees) obtained from the "Nikkei Venture Business Directory" as well as telephone interviews. We then compared the profile (firms and principals) in the interview sample and in the questionnaire sample.
- 2 (Q). Demand for equity capital among small businesses. This step analyzed the questionnaire results in Section III, by calculating the percentages of SMEs anticipating/planning some growth, and of those willing to go public.
- 3 (Q). Profiling companies (principals) likely to be willing to go public (answer to the second sub-question). Using the one-way ANOVA tests, we investigated whether or not there are differences in firm characteristics (such as number of employees, sales, expected sales growth rate) among firms of the following three categories: willing to go public, not willing to go public, and not eager to grow. This step used data obtained from Sections I, II, and IV in the questionnaire.
- 4 (Q). Japanese SME principals' attitudes towards and perceptions of equity capital (answer to the first research question). This step analyzed data obtained from Sections IV and V in the questionnaire and, by using descriptive statistical methods, investigated: 1) for those willing to go public, the reason why, 2) for those willing to

go public, which venture stock exchange(s) they would like to list, and 3) for those not willing to go public, why.

- 5 (I). In depth analysis of Japanese SME principals' attitudes and perceptions. Each telephone interview was taped (audio), verbatim transcripts were typed. The verbatim transcripts of the interviews were analyzed using standard qualitative data analysis techniques (NUD*IST).⁴⁹ Structured analysis of qualitative data allows explanation and clarification of responses: in spite of developing alternatives before conducting a survey, this type of analysis allowed us, ex post, to identify categories of responses after the interviews were concluded.

This fifth step gives us the answers to:

- The third sub-question: what listing requirements would be appropriate for meeting actual small business principals' needs in equity capital?
- The first main question: Japanese SME principals' attitudes and perceptions of equity capital (the answer is included in the result of analysis step 4).
- The second main question: considering the Japanese SME principals attitudes and perceptions, are the listing requirements of Japanese stock exchanges for venture businesses appropriate?

⁴⁹ NUD*IST is an acronym for Non-Numeric Unstructured Data Indexing, Searching, and Theorizing. The program is a research standard. Interview guides are available on request for those who may wish to pursue related research.

V. Findings

1. Profiles of Sample SMEs and Their Principals

1-1. Profiles of SMEs and Their Principals: Questionnaire Sample

1-1-1. Firm Size

Number of Employees: Twenty-four percent of the firms (in the sample) report fewer than five employees; 56% less than ten employees; and 94% fewer than 50 employees. The mean number of employees is 16.6. However, the distribution is positively skewed, with a median of employees is 8. One reason for this positive skewness is that two firms in the sample, reported 123 and 150 employees. After trimming 5% of outliers, the mean is 12.45 (for details see Appendix E, Table E-1).

According to data from Chusyo Kigyo Hakusho, the average number of employees for all Japanese SMEs is approximately 8.8. A t-test did not reject the null hypothesis that the average number of employees for the questionnaire sample (12.45) is equal to the population mean (8.8) at the 0.5 level of significance. Therefore, we assume firms in the questionnaire sample to be reasonably representative of the population of Japanese SMEs.

Capitalization: Approximately 30% of the firms report less than 10 million yen (\$125,000 CDN) of capitalization; 68% less than 20 million yen (\$ 250,000 CDN); and 93% report less than 100 million yen (\$1.25 million CDN).⁵⁰ The mean is 152 million

⁵⁰ Entire this paper, 100 yen is assumed to be equivalent to \$1.25 CDN.

yen (\$1.9 million CDN). Again, the distribution is positively skewed, with a median level is 10 million yen. One reason for this positive skewness is that one firm reports 2,000 million yen (\$25 million CDN) and another 9,000 million yen (\$112.5 million CDN) of capitalization. After a 5% trim of outliers, the mean level is 19.6 million yen (\$ 245,000 CDN) (for details see Appendix E, Table E-2).

Sales: Thirty-eight percent of firms report less than 100 million yen (\$1.25 million CDN) of sales; approximately 90% less than 1,000 million yen (\$12.5 million CDN). The mean is 656 million yen (\$8.2 million CDN). Again, this distribution is positively skewed, with a median is 150 million yen (\$1.875 million CDN). One reason for this positive skewness is that two firms in the sample generate large sales volumes: 8,200 million yen/\$102.5 million CDN, and 11,562.0 million yen/\$145.0 million CDN. After a 5% trim of outliers, the mean is 344 million yen (\$ 4.3 million CDN) (for details see Appendix E, Table E-3).

Net Income: Seventeen percent of firms report a negative net income, and 58% have less than 10 million of net income. The mean is negative (−10.72 million yen / \$ -134,000 CDN), and the distribution is negatively skewed (the median level is 2.7 million yen / \$33,750 CDN). One reason for this negative skewness is that four firms in the sample report 1,000 million yen (\$12.5 million CDN), 68.9 million yen (\$ 861,250 CDN), 40 million yen (\$ 500,000 CDN), and 19 million yen (\$ 237,500 CDN) of loss. After trimming 5% of outliers, the mean level is positive, 5.66 million yen (\$ 7,075 CDN) (for details see Appendix E, Table E-4).

1-1-2. Firm Characteristics

Founding Year & Sector: The sample includes 35 firms founded in 1994, 44 firms founded in 1998, nine firms founded before 1994, and one firm founded after 1998 (firms founded before 1994 or after 1998 are the respondents for the questionnaire pre-testing). The sample firms are evenly distributed across sectors, including various forms of manufacturing (36.6% of respondents), various service subsectors (51.2%), with the balance in the housing and construction sector (12.2%) (for details see Appendix E, Table E-5 and 6).

Number of Officers: Management teams of firms in the sample are generally small: 85% of the firms report three or fewer officers and 20% of firms report one officer (for details see Appendix E, Table E-7).

Ownership: More than 60% of the sample firms' managers own 80% or more of the firm, and 45% of the firms are owned 100% by the managers. On average, the chief officers of the firms collectively held 67% of the ownership interest in the firms. Twenty-three percent of the firms are wholly or partially owned by a parent company. Six percent of firms are owned by business partners, and only 2% of firms have received venture capitals (for details see Appendix E, Table E-8 and 9).

Financial Management: One firm in three (33%) reports a financial manager, usually (71.4% of firms with a financial manager) the principal. Only 14% of firms with a financial manager used an external consulting firm, and the remaining 14% of those firms hire an employee as a financial manager (for details see Appendix E, Table E-10 and 11).

Expected Sales Growth Rate: Generally the questionnaire sample firms expect a high growth in sales during the next three years (2003), the average sales growth rate is 67%. Although 11.5% of firms expect a negative growth, 73% of firms expected a rate of growth in excess of 10% of growth (for details see Appendix E, Table E-12).

1-1-3. Profile of Principals

General Profile: Men manage all but two sample firms (98%). Almost three-quarters of the principals (74%) are between 45 and 64 years of age, and most of them (72%) hold university or post-graduate degrees (for details see Appendix E, Table E-13, 14, and 15).

Working Experience: On average, principals of the sample firms report experience with two different companies and in two different occupations, 9 years at management capacity and 14 years of experience in industries related to their current business, prior to starting their current management job (for details see Appendix E, Table E-116, 17, 18, and 19).

1-2. Profiles of SMEs and Their Principals: Interview Sample

1-2-1. Firm Size

Number of employees: In terms of (5% trimmed) average number of employees, firms in the interview sample are significantly larger (44.44 employee) than those in the questionnaire sample (12.45 employees, at the 0.005 level of significance). In the questionnaire sample only 3.4% of the firms have more than 100 employees, in the interview sample it is 24% (for details see Appendix E, Table E-1). A t-test strongly rejected the null hypothesis that the mean for the interview sample (44.44) is same as the population mean (8.8) at the 0.005 level of significance.

As is true for the questionnaire sample, the distribution of number of employees in the interview sample is positively skewed (mean is 55.4; median is 15.5). Five firms (in manufacturing sector) in the interview sample report more than 200 employees. However, even after trimming 5% of outliers, the mean remains high, is 44.4 employees.

Capitalization: Whereas the questionnaire sample includes only 2% of firms with a capitalization of more than 500 million yen (\$6.15 million CDN), 10% of the firms in the interview sample report a capitalization of more than 500 million yen. The mean level of capitalization for the interview sample is 213.6 million yen (\$2.67 million CDN) (median of 56.5 million yen / \$706,250 CDN and 5% trimmed mean of 127.7 million yen / \$ 1.6 million CDN). All mean, median, and 5% trimmed mean of capitalization for the interview sample are larger than those for the questionnaire sample (for details see Appendix E, Table E-2). However, a t-test did not reject the null hypothesis that 5%

trimmed means of capitalization for the questionnaire sample and interview samples are the same, due to the large levels of standard deviations ($t = 0.79$, $p = 0.4$). As is true in the questionnaire sample, the distribution of capitalization for the interview sample is positively skewed (two firms reporting a high levels of capitalization, 1,745.9 million yen / \$21.8 million CDN, and 3,589 million yen / \$44.9 million CDN).

Sales: Compared to the questionnaire sample in which only 10 % of firms reported sales more than 1,000 million yen (\$12.5 million CDN), the interview sample comprises 28% of firms with more than 1,000 million yen of sales. All mean, median, and 5% trimmed mean levels of sales for the interview sample are higher than those for the questionnaire sample, the difference in 5% trimmed means between two samples is significant at the 0.05 significant level (for details see Appendix E, Table E-3). Again, the distribution of sales for the interview sample is positively skewed: mean is 1,319 million yen (\$ 16.5 million CDN), median is 323 million yen (\$ 4 million CDN). Three firms report sales of at least 9,000 million yen (112.5 million CDN) in the interview sample

Net Income: It is interesting to note that 31% of firms in the interview sample report negative net incomes, whereas only 17% of firms in the questionnaire sample report negative net incomes. While the mean levels of net income for both the questionnaire and interview samples are negative, the average loss for the interview sample is larger (44.5 million yen / \$556,250 CDN) than that for the questionnaire sample (11 million yen / \$137,500 CDN) (but not significant at any reasonable level of significance). The distribution for net income for the interview sample is negatively skewed (as is true for the questionnaire sample), which indicates that the interview sample includes some firms

with large losses. For example, one firm in the interview sample reports a loss of 4,259 million yen / 53.2 million CDN), and four firms report losses of more than 30 million yen ((\$ 375,000 CDN). After trimming 5% outliers, the mean level for the interview sample (15.5 million yen / \$193,750 CDN) is higher than that for questionnaire sample (but not significant at any reasonable level of significance). Also the median level for the interview sample (4.3 million yen / \$53,750 CDN) is higher than that of the questionnaire sample (for details see Appendix E, Table E-4).

1-2-2. Firm Characteristics

Founding year & Sector: The sample firms are evenly distributed both across year of establishment (from 1989 to 1998). They are also evenly distributed across sectors that include various forms of manufacturing (43.5% of respondents), various service subsectors (53.2%), with the balance in the housing and construction sector (3.2%) (for details see Appendix E, Table E-5 and 6). A chi-square test did not reject the null hypothesis that the distribution of firms in the interview sample across sectors is same as that in the questionnaire sample ($t = 0.87$, $p = 0.5$).

Number of Officers: Management teams of firms in the interview sample are significantly larger (3.9 people on average) than those in the questionnaire sample (2.7 people) at the 0.001 level of significance (for details see Appendix E, Table E-7).

Ownership: The management teams of 42% of the interview sample firms own 80% or more of the firm and 22% of firms are 100% owned by management. These percentages

are smaller than those for the questionnaire sample, but the means of management ownership in the questionnaire and interview samples are similar (67%, 64% respectively), and a t-test did not reject the null hypothesis that the two means are the same ($t = 0.44$, $p = 0.4$). For the interview sample, the percentage of firms owned wholly or partially by a parent company is smaller (8%), the percentage of firms owned by business partners (25%) and percentage of firms that have received venture capitals (27%) are larger (for details see Appendix E, Table E-8 and 9).

Financial Manager: while only 33% of firms in the questionnaire sample report a financial manager, in the interview sample, a majority of firms (82%) report a financial manager. A chi-square test rejects the null hypothesis that the distributions of firms with and without a financial manager in the questionnaire and interview samples are the same at the 0.005 level of significance. The percentage of firms where a principal is the financial manager (60% of firms with a financial manager) and the percentage of firms hiring an external accounting firm are smaller for the interview sample (8%) than that for the questionnaire sample (71%, 14% respectively). The percentage of firms hiring an employee as a financial manager is larger for the interview sample (33% of firms with a financial manager) than that for the questionnaire sample (14%) (for details see Appendix E, Table E-10 and 11).

Expected Growth: As is true for the questionnaire sample, firms in the interview sample expect high rates of sales growth during the next three years: 96% of firms expect more than 10% of annual sales growth. A t-test did not reject the null hypothesis that the

average expected sales growth for the interview and the questionnaire samples are the same at any reasonable level of significance (for details see Appendix E, Table E-12).

1-2-3. Profiles of Principals

General Profile: As is true for firms in the questionnaire sample, a majority of firms (97%) in the interview sample are managed by males. Sixty-three percent of principals are between 45 and 64 years of age. The interview sample is comprised of 10% of firms with principals between 25 and 34 years of age, whereas the questionnaire sample is comprised of only 2% of such firms. However, the average age of principals for the interview sample (50 years old) is similar to that for the questionnaire sample (52 years old), a t-test did not reject the null hypothesis that the means of age for two samples are the same at any reasonable level of significance. As is true for the questionnaire sample, a majority (70%) of principals of the firms in the interview sample hold university or post-graduate degrees (for details see Appendix E, Table E-13, 14, and 15).

Experience: For the interview sample, on average, principals report experience with 2.4 different companies, and in 2.1 different occupations, and 13 years of experience in industries related to their current business, before starting their current management job. These averages are similar to those for the questionnaire sample (2.0 companies, 2.0 occupations, and 14 years) and t-tests did not reject the null hypothesis that these averages are the same in the two samples at any reasonable level of significance. Principals in the interview sample report an average of 6 years of management capacity,

which is significantly (at the 0.05 level) shorter than that for the questionnaire sample (9 years). (for details see Appendix E, Table E-16, 17, 18, and 19).

1-3. Summary

1-3-1. Suitability

Questionnaire Sample: All firms are identified as “small and medium size business” according to the definition of “Chusho Kigyo Sho”. The firms in the sample are consistent with this definition insofar as a t-test did not reject the null hypothesis that the average number of employees for the questionnaire sample (12.45) is equal to the “Chusho Kigyo Sho” population mean (8.8) at the 0.5 level of significance. Therefore, we assume firms in the questionnaire sample to be reasonably representative of the larger population of Japanese SMEs.

Interview Sample: All firms are identified as “small and medium size business” according to the definition of “Chusho Kigyo Sho”. In terms of number of employees, firms in the interview sample (44.44) are significantly larger than the “Chusho Kigyo Sho” population mean (8.8) at the 0.005 level of significance. This difference was to be expected, since the interview sample was drawn from a sampling frame (“basis”) comprised of firms more likely to be in an IPO process.

1-3-2. Characteristics of Samples

Firms in the interview sample are significantly larger than those in the questionnaire sample, in terms of average (5% trimmed) number of employees and sales volume (at the 0.005, and 0.05 levels of significance respectively). The average capitalization and the average net income for the interview sample are also larger than

those for the questionnaire sample (after 5% of outliers are trimmed), but not significant ($t = 0.79$, $p = 0.4$).

Two large firms in the questionnaire sample positively skew the distributions for number of employees, sales and capitalization, and four firms with large losses result in a negatively skewed distribution for net income.

As is true for the questionnaire sample, there are, in the interview sample, some large firms in terms of number of employees, capitalization, and sales, resulting in positively skewed distributions for these three variables. The average net income for the interview sample is smaller (but not significant at any reasonable level of significance) than that for the questionnaire sample, because the interview sample includes one firm with a loss in excess of 4,000 million yen (\$ 50 million CDN) and four firms with losses in excess of 30 million yen (\$ 375,000 CDN). Those five firms with large losses in the interview sample result in a negatively skewed distribution for net income. After trimming 5% outliers, the mean net income for the interview sample is larger than those for the questionnaire sample (but not significant at any reasonable level of significance).

Management teams of firms in the interview sample are, in terms of number of officers, significantly larger than that in the questionnaire sample (at 0.001 level of significance). Firms with a financial manager are observed more frequently in the interview sample (82%) than in the questionnaire sample (33%), and the difference is significant at the 0.005 level. The percentage of firms owned by their business partners and the percentage of firms that have received venture capital are larger for the interview sample (25%, 27% respectively) than those for the questionnaire sample (6%, 2%). Average percentages of management ownership of the firm in the questionnaire and

interview samples are similar (67%, 64% respectively), and a t-test did not reject the hypothesis that the two averages are the same ($t = 0.44$, $p = 0.4$). Both in the questionnaire and interview sample, a majority of firms expect a rapid growth in sales during the next three years.

Most firms in both samples are managed by males, between 45 and 64 years of age with university or post-graduate degrees. Business experience reported by principals of firms in the questionnaire sample are similar to experience reported by those in the interview sample, in terms of number of companies (2.0, 2.4 respectively), number of occupations (2.0, 2.1), and number of years of experience in the industry to which their current business belongs (14, and 13 years), before starting their current business (t-tests did not reject the hypothesis that the averages of these variables for two samples are the same at any reasonable level of significance). However, average number of years of management experienced by principals of firms for the questionnaire sample is significantly longer (9 years) than that for the interview sample (6 years) at the 0.05 level.

2. Japanese SMEs' Demand for Equity Capital

Table 3: Going Public Intention

Growth Intention	With Growth Intention					Without Growth Intention
Number of firms	53					34
%	60.9					39.1
Going Public Intention	Within 1-2 yeas	Within 3-4 years	Waiting for an opportunity	Do not know	No going public intention	
Number of firms	0	8	18	12	15	
%	0	9.2	20.7	13.8	17.2	
Cum %	0	9.2	29.9	43.7	60.9	100.0

* Total number of firms is 87: one respondent did not answer

Sixty percent of respondents (53 firms) sought the continued growth of their respective firms. Moreover, while none of the respondents were planning to issue an IPO within the next two years, 30% were either planning to go public within 3 to 4 years or were waiting for an opportunity to go public: there seems to be a demand for equity capital among SMEs. This percentage is much higher than that reported by Chusho Kigyo Hakusho (1999) (who reported that about 10% of respondents intended to go public). This difference may be attributable to the fact that MOTHERS and the other new exchanges had not opened at the time of the Chusho Kigyo Hakusho survey was conducted (nor had plans for these new exchanges been announced). This difference may be consistent with the argument that the establishment of the new exchanges for venture businesses has stimulated Japanese SME principals' interest in equity financing. Or, this difference may, to some extent, also be attributable to the differences in the sizes of firms in the sampling frame relative to the somewhat smaller average size of businesses in the population.

This section also reports on a comparison of the attributes of firms whose principals have expressed a willingness to go public in the questionnaire sample (26 firms). The attributes of these firms are compared, using one-way ANOVA, with the corresponding attributes of two alternative categories of firms: those whose principals have articulated an unwillingness to go public (15 firms); and with those whose principals stated no plan to grow their business (34 firms). This was done to ensure the three groups are otherwise comparable with each other. We investigate the following 13 variables, using a one-way ANOVA test:

- Capitalization,
- Number of employees,
- Sales,
- Net income,
- Number of officers,
- Percentage of management ownership of the firm,
- Age of principal,
- Education level of principal (degree),
- Number of companies previously experienced by principal (before starting the current business),
- Number of occupations previously experienced,
- Number of years of management previously experienced,
- Number of years previously experienced by principal in the industry to which his/her current business belongs,
- Expected sales growth.

A one-way ANOVA tests did not detect any systematic difference among these three groups at any reasonable level of statistical confidence. This may be attributed to the small sample size. Nevertheless, this result provides some assurance that any differences observed among principals' perceptions of equity capital do not result from differences in firms' and principals' characteristics.

3. Japanese SME Principals' Attitudes towards and Perceptions of Equity Capital

In the previous section, we found that approximately 30% of respondents to the questionnaire sample were willing to go public. This section explores principals' attitudes towards, and perceptions of, equity capital in both the questionnaire and interview samples. Three questions were posed:

1. Why would you go public?
2. What do you think are disadvantages of going public?
3. Why would you not go public?

The first (why go public) and second (disadvantage) questions were asked to the principals who were willing to go public, and the third question (why not go public) was asked to the principals who were not willing to go public.

3-1. Why Principals Decide to Go Public

This sub-section explores why the sample principal would go public. The question ‘why go public’ was asked to the principals who were willing to go public in both the questionnaire and interview sample.

3-1-1. Why Principals Decide to Go Public: Questionnaire Respondents

Out of 88 principals in the questionnaire sample, 26 were willing to go public and were asked to choose one or more reasons from among the following six: financing, increasing the firm’s credibility, publicity, issuing stock options, other. The breakdown of respondents across these reasons is shown in Figure 1 (no respondent chose the sixth, “Other”).

Figure 1: Reasons for Going Public (Questionnaire Sample)

* Percentages represent in total 26 questionnaire respondents, those who showed willingness to go public.

** The sum is not 100% because of occurrence of multiple responses.

For 16 respondents (62%) the reason is financing, 18 (69%) would/will go public in order to increase the firm’s credibility, for 12 respondents (46%) it would/will enable them to issue stock options, and 11 (42%) expect an effect of publicity in going public.

It is interesting that a higher proportion of respondents should choose “increasing their firms’ credibility” rather than “financing” as a reason. To explore this issue in more depth, the question was also posed, in open-ended form, to 50 principals of firms in the interview sample. All of these principals had expressed an interest in going public (in “Nikkei Venture Business Directory”).

3-1-1. Why Principals Decide to Go Public: Interview Respondents

Fifty principals (interview sample) considering an IPO (out of 62 principals in the interview sample) were asked why they would go public. In this case, predetermined alternative answers were not provided, which allowed the respondents to describe their reasons for going public in their own words. After these interviews, we identified (using NUD*IST) six categories of reasons among their responses: financing, attracting employees, increasing the firm’s credibility and making it known (publicity), investors’ intentions, attracting managers, and “other”. The breakdown of respondents across these six reasons is shown in Figure 2.

In this case, the most frequently-cited reason for going public is financing (80%). There are two second most frequently-cited reasons (48% each): to attract employees and to increase the firm’s credibility and make it known (publicity). These are the major three reasons for going public cited by interview respondents. Compared to these three reasons, the proportions of respondents citing other reasons for going public (investors’ intention 6%, attracting managers 4%, miscellaneous 8%) are small.

Figure 2: Reasons for Going Public (Interview Sample)

* Percentages represent in total 50 interview respondents, those who showed willingness to go public.

** The sum is not 100% because of occurrence of multiple responses.

Reasons for going public described by interview respondents in each category are further broken down into several sub-categories. The breakdown is shown in Figure 3. Subsequent pages detail and quote the reasons put forward by respondents for these categories. These quotes enrich and describe more fully the categories presented in the charts.

Figure 3. Reasons Why Go Public: Interview Respondents Answers Breakdown

Reason 1: Financing

The principals in the interview sample cite, as the primary reason for going public, the need for additional financing (80%). They specified several aspects of the need.

These included:

- The need to expand the business (52% of respondents);
- The need to finance R&D (32%);
- Preference for direct financing rather than debt financing (18%);
- The need for stable working capital (12%);
- Others (8%).

Reason 1-1. Financing for Business Expansion (52%)

The principals who cite business expansion as a reason for going public are primarily concerned with financing additional plant investments. For example:

“Financing for establishing and building the local care center for old people and operating ‘Group Home (old people’s homes operated by their families alternately taking care of them)’ ,

“Financing for building plants and branch offices (stores)” ,

“Increase capital for plant investment to improve the environment of our school, to offer better services to our students, and to develop an Internet education system” .

Other principals who also cite business expansion as a reason for going public are concerned with increasing their market share, or expanding their business by M&A. For example:

"Financing for expanding the market share of our products internationally",

Reason 1-2: Financing for R&D (32%)

Principals who state their needs for additional financing for their R&D projects as a reason express a desire to produce original products/services. For example:

"We would like to be a maker that produces original products. Thus, R&D, especially long term R&D, for the development of original products is essential".

Reason 1-3: Financing: Direct Financing Rather than Debt Financing (18%)

Some principals who stated a preference for direct financing (rather than debt/ VC financing) point out Japanese banks' stringent terms of credit, VCs' high requirements, and complicated procedures for borrowing money from these financial institutions. The details of difficulties in debt/ VC financing described by the principals are as follows:

"Venture capitals try to control us, though the amount of capital we can gain from them is small",

"Banks accommodate loans according to a business's past financial performance and its properties that can be put in pledge. On the other

hand, direct financing allows venture businesses raise capital according to their potentials."

Reason 1-4. Financing Working Capital (12%)

Twelve percent of principals show a need of additional financing for stable working capital and reduced risk of bankruptcy. One principal states:

"Payments from our customers are usually credit or check. We would like to reduce the debt caused by these account receivables".

Reason 1-5. Financing for other purposes (8%)

Other reasons for the principals needs for additional financing include concerns with subsidiary companies and shareholders. One principal thinks that going public is a better way to increase shareholders' wealth than selling his firm:

"As for maximizing shareholders' wealth, going public is better than selling. The shareholders' wealth increases at the time of the acquisition, but that's it. If we go public, as long as the company is growing, our shareholders can increase their wealth. Moreover, if we sell, we completely lose ownership of the company, more radically than if we go public".

Reason 2. To Attract/Motivate Employees (48%)

One of the second most frequently cited reasons for going public was attracting and motivating employees. Principals mention the following in their responses:

- To attract best possible employees by increasing the firm's credibility (30% of respondents);
- Financing needed in order to attract best possible employees by offering better salaries, working conditions, etc. (12%);
- To motivate existing employees by becoming a publicly traded company (8%);
- To motivate and attract employees by offering stock options (8%);

Reason 2-1. Attracting Employees through Increased Credibility

Principals describe the shortage of labor force as a serious problem and attribute it their firms' lack of public credibility. For example;

"It is essential for our company to recruit talented employees (best brains), especially engineers. There is a difference between publicly traded companies and not-publicly-traded ones in terms of the ability to attract those talented employees. Going public increases our firm's credibility and makes it easier to gather talents",

"We would like to increase our firm's credibility and let it be better known by going public in order to gain talented employees especially IT specialists. One of our main sections, IT consulting, is not currently doing well as we expected, because of the shortage of IT specialists",

"We would like to go public to get our firm better known so as to attract talented employees. Our firm's main property is patents. Thus, we need

employees who have good knowledge, experience, and competence to utilize the potential of these patents to its maximum. The competence of the individual employees is the key for future growth of our firm”.

Reason 2-2. Gaining employees by financing (12%)

Some principals state needs for financing in order to increase the labor pool. One respondent described:

“We need labor force because our company sells our product by house-to-house calls”.

Reason 2-3. Motivating Employees (16%)

Sixteen percent of principals think that going public will motivate their employees.

For example, two respondents state:

“We expect a plan to go public will make our employees more aware of their responsibility as members of this firm” ,

“Going public is a dream of our employees, especially those who have worked for our firm since it was founded. A plan to go public motivates employees”.

For half of this group, stock options would also be a positive motivator. For example:

“We can attract employees by issuing stock options to employees” ,

“Going public enables us to issue stock options. Issuing stock options to our employees is a good way to return our profit to our employees”.

Reason 3. Publicity & Credibility (48%)

Another frequently cited reason for going public is to increase the firm's credibility and make it better known. Principals specify two main aspects of this need:

- The need to enhance the image of their products/services, customers' trust, and business relationships (44%);
- The need for proper recognition of their technologies (6%).

Reason 3-1. Enhanced Image, Customers' Trust, and Business Relationships (44%)

Forty-four percent of principals hope that going public will enhance the image of their products/services, customers' trust, and business relationships. For example:

“Becoming a publicly traded company promotes a better image for our products”,

“By satisfying the listing requirements, we should expect to increase our credibility”,

“We would like to increase business opportunities by enhancing our firm's credibility and make it known”.

Reason 3-2. Technology Recognition (6%)

A few (6%) of principals expressed frustration that their technology was not acknowledged properly, and attribute this to their business being small and not very well known. They see going public as a good opportunity to make their technology better known and recognized. This “accreditation” role of going public has also been noted by Lerner (1999) among others.⁵¹ Several principals describe it in those terms:

“SMEs in Japan tend to be looked down at and technologies developed by SMEs are likely undervalued. Many large companies just see SMEs as their subcontractors. We want our technologies to be valued properly, and decided to go public”,

“Most innovations and new technologies in Japan have been developed in SMEs (by craftsmen) especially in environmental industries. However, it takes time for such innovations and technologies to be recognized, because SMEs are usually not known. In order for our technologies to be evaluated properly, we make our firm known and increase our credibility by going public”.

Reason 4. Investors’ Intention (6%)

Six percent of principals cite (as reason for going public) the fact that their present shareholders (VCs, angels, etc.) expect them to do so.

⁵¹ Lerner, J., 1998. “ ‘Angel’ Financing and Public Policy: An Overview” *Journal of Banking & Finance* 22, 773-783.

Reason 5. Attracting Managers (4%)

Four percent of principals think that being a public company enhance the opportunity to choose the firm's leaders from public. One principal describes this notion in detail:

"Being a public company enhances the opportunity to choose its leader from the public at large. I want this firm to be a publicly traded open one, not my personal belonging, and will choose the new CEO from the public at the time of my retirement. In my opinion, any company should be public, since a private company tends to be more exclusively subjected to the principal's personal interests, whereas a public company thinks more of public interests".

Reason 6. Other (8%)

Other reasons for going public were: one more possibility of financing (in addition to relying on banks, etc., 4%), going public seen as a social obligation: "every firm should be publicly held" (2%), avoiding social problems (2%). In the latter case, the principal said:

"When one manages a business related to environment, one cannot avoid the "buraku" people.⁵² Traditionally, in Japan, the environment business, especially sewage business, has been under their thumb, and entering the environmental business with an epoch-making technology (as we did)

⁵² "Buraku" people are the offspring of people who had been categorized in the lower social class as "outcast" and subjected to stringent social restrictions before the 19th century. Today, though outright discrimination against them has disappeared, invisible discrimination still remains.

often creates strong resistance on their part because of reduced market shares. We cannot be confrontational as they nowadays have close links with the political and “yakuza” (Japanese mafia) power. In order to avoid gangsters' obstructions, we would like to go public through NASDAQ Japan or NASDAQ and get an infusion of US capital, since Japanese gangsters cannot obstruct US capital”.

Summary

In a nutshell, going public is viewed by the Japanese SME principals not only as a good opportunity to raise capital, but also, and this should not be overlooked, as a good tool for attracting/retaining employees, enhancing their firm's credibility, and making it known. As a matter of fact, Chusho Kigyo Hakusho (1999)⁵³ reported that a high proportion of SME principals (about 50%) experienced difficulties establishing business relationships and lacked adequate human resources, which they attributed to lack of credibility and publicity.

The three most important reasons for going public are:

- Financing,
- Credibility,
- Attractiveness (attracting and motivating employees).

In subsequent sections, it will be seen that new stock exchanges present principals with a dilemma: how to trade these needs off against each other.

⁵³ The 1999 edition of “Chusho Kigyo Hakusho”

3-2. Disadvantages of Going Public

This sub-section investigates what the sample SME principals consider as disadvantages of going public. The question “what are the disadvantages of going public?” was posed only to the principals in the interview sample.

While most interview participants are at some stage of planning an IPO, going public is seen to entail some disadvantages. Using NUD*IST, principals’ responses about negative aspects of going public were categorized into 4 groups: no disadvantages, investor relations (reporting to investors, shareholders meetings, etc.) and disclosure-related issues, reduction of control, and “others”.

Figure 4 reports the relative frequency of these categories of responses. In Figure 4, we see investor relations and disclosure-related issues, as well as loss of control as the primary disadvantages perceived by interview respondents. Forty-two percent of respondents see no disadvantage in going public.

Figure 4: Disadvantages of Going Public (Interview Sample)

* Percentages represent in total 50 interview respondents, those who showed willingness to go public.

** The sum is not 100% because of occurrence of multiple responses.

Disadvantage 1. Investor Relations and Disclosure-Related Issues (52%)

Fifty-two percent of principals are somewhat wary of investor relations and disclosure-related problems. On one hand, approximately half of those who state that investor relations and disclosure are a problem do not give any specific reason for their reluctance. Their answers are vague:

“It will be difficult to establish a solid trustworthy relationship with shareholders”,

On the other hand, the other half (approximately) of respondents specify the reasons for their reluctance. These include:

- Complicated procedures, paper work, and costs associated with investor relations and disclosure (12% of respondents who are willing to go public);
- Disclosing firm information (10%);
- Difficult to concentrate on their business (6%).

Disadvantage 1-1. Complicated procedure, paper work, and costs (12%)

Twelve percent of respondents fear the complicated procedure, paper work, and costs associated with investor relations and disclosure. Their answers include:

“Clerical work for disclosure will be complicated”,

“For investors relations and disclosure, we will need additional human resources”.

Disadvantage 1-2. Disclosing Information (10%)

Ten percent of principals think that disclosing their firms' specific information may bring negative outcomes. These include:

"Our technologies may be copied",

"We are reluctant to let our customers know our annual sales and profit from quarterly or annual financial reports. They may ask price reductions knowing our profit, cost of goods sold, etc. ",

"It will probably be difficult to keep our R&D projects under wraps".

Disadvantage 1-3. Difficult to Concentrate on Their Business (6%)

Six percent of principals state that work on investor relations and disclosure would be an obstacle to concentrating on their business. Two respondents clearly specify the reason:

"I see two reasons why investor relations and disclosure will mean more work for me. First, I think that a firm's growth depends on the principal's energy: the greater the energy the principal devotes to his/her firm, the more the firm grows. However, after going public, it will be difficult for the principal to concentrate on his business, s/he will have to spend time and energy communicating with shareholders. Second, I think that the principals' sensibility and intuition are more important for the well being of the firm than logically legitimated business plans. In my experience,

intuition almost always gives me a right answer in the decision-making process. However, after going public, we will have to give our shareholders a logically legitimate explanation for a decision arrived at by intuition",

"We will have to devote energy and time to shareholders relationships. For example, dividends policy will be a big issue for us. Moreover, we will have to be careful about not only what we do but also about how we are perceived".

Disadvantage 2. Reduced Control (42%)

Forty-two percent of principals cite loss of control as a possible negative consequence. They think that going public may force them to change their way of making decisions, make it difficult to invest in high-risk R&D, affect their independence, and destroy the principals' wealth. Here are some answers:

"It will probably be difficult to invest in high-risk R&D and to make fast decisions corresponding to quick changes of the business environment",

"Our way to make decisions will be changed",

"It will be difficult to manage our firm as we want",

"The most important thing for me is to keep my high-percentage of ownership in the firm. I saw many cases where firms became rich by

going public, while the ex-principal principals became poor. I do not want to get poor” ,

“It will probably be difficult to keep our company's independence and neutrality, two important features of a consulting firm” ,

“The ownership of our firm will be instable. We will have to strive to keep more than 51% of the ownership of our firm: for that we will have to limit the infusion of new equity capital. If we lose the majority of ownership and the shareholders require me to leave, I will loose my current position (CEO)” ,

Other Disadvantages (12%)

Other disadvantages cited by principals include: unstable company's stock price (8%), and the threat of intervention by gangsters (4%). One principal shows his concern about increasing risk for the stock price:

“Going public may increase the risk of instability for our firm's stock price, since it will be influenced not only by our business performance but also by the market condition” .

In Japan, there is an occupation called “Sokai-ya”. Its primary job is to organize shareholder meetings “on behalf “ of a firm's management and it is typically managed by Japanese gangsters. Some principals are concerned by its existence:

“There are a number of cases where the Japanese gangsters contact and threaten companies just after their IPO. Protecting us against gangsters would be costly”.

No Disadvantage (42%)

Forty-two percent of respondents report no disadvantage in going public. It is interesting that investor relations- and disclosure- related issues as well as the possibility of losing control are viewed, by some principals, as good opportunities to improve and positive rather than as negative aspects of going public. For example:

“I do not think about any disadvantage of going public. We have nothing we do not want to disclose. Paper work associated with disclosure will probably be tough, but it will be a good opportunity for us to organize our financial results”.

“We are not worried about losing our firm's control by going public. If our shareholders judge me inadequate as a CEO, and if it is good for our firm to change CEO, I will be pleased to leave. I am ready to do anything good for the firm”.

Finally, some principals cannot see any disadvantage, admitting that it might be because of their lack of knowledge about it.

Summary

While substantial number of principals do not identify disadvantages to going public, others do report potential disadvantages. It should be noted that the sample used here comprised principals who, a priori, had expressed plans to go public. Therefore, the finding that 42% see no disadvantage is arguably high relative to the general population of Japanese SMEs.

Two major disadvantages to going public dominated principals' responses: issues associated with investor relations and disclosure (52%), and loss of control (42%). We now turn, therefore, to an exploration of why some principals have decided not go public.

3-3. Why Principals Decide not to Go Public

This sub-section explores why some principals are not willing to go public. The third question, “why would you not go public?”, was in both the questionnaire and interview samples.

3-3-1. Why Principals Decide not to Go Public: Questionnaire Respondents

Principals in the questionnaire sample who did not want to go public, were asked to choose one, or more, reason from among the following six: no growth intention,⁵⁴ loss of control, no need of capital, costs associated with IPO, complicated IPO process, obligations associated with disclosure, and “other”. The breakdown of respondents across these five reasons is shown in Figure 5 (no respondent chose the sixth reason “Other”).

Figure 5: Reasons for Refusal to Go Public (Questionnaire Sample)

* Percentages represent in total 49 questionnaire respondents, those who showed no intention to go public.

** The sum is not 49 because of occurrence of multiple responses.

⁵⁴ First we had asked firms with plans for growth only, whether they want to go public. However, for reasons of uniformity with the interview sample, we decided to include “no growth intention” as a reason for not wanting to go public.

The most frequent reason (34 out of 49 respondents: 69%) is that they do not plan any growth. Compared to this, the percentages of respondents citing other reasons are small: outside this main reason, it is hard to find any determining factor standing out. Nevertheless, we can say that the second and third most frequently cited reasons (fear of losing control of the firm: 18%, and disclosure obligations: 12%) are consistent with disadvantages identified in the previous section.

3-3-2. Why Principals Decide not to Go Public: Interview Respondents

Twelve principals (interview sample) who are not considering an IPO (out of 62 principals in the sample) were asked why they chose not to go public. After analysis of the interview transcripts (using NUD*IST), their answers were categorized into six groups: 1) no need of capital/small business size/no growth intention, 2) costs and procedures associated with IPO, 3) parent company's decision, 4) no need of publicity, 5) loss of control, and 6) lack of adequate stock exchange. The breakdown of respondents across these six reasons is shown in Figure 6.

Figure 6: Reasons for Refusal to Go Public (Interview Sample)

* Percentages represent in total 12 interview respondents, those who showed no intention to go public.

** The sum is not 12 because of occurrence of multiple responses.

With a small sample (12 interview respondents who are not willing to go public), and a fairly even distribution, it is difficult to identify a particular reason standing out. Nevertheless, consistent with the finding in the questionnaire sample, the reason most frequently cited by interview respondents (7 out of 12 respondents), is the no growth intention of their firm (thus, we can conclude that the most important factor for rejecting the idea of going public, is this decision to not grow). Fear of increased workload for management work and high-taxation for large firms explain why they do not want to grow. For example:

"I enjoy doing product (machinery) design. If we grow, I will have to concentrate on managing instead of designing machines. Thus, I do not want our firm to grow".

Respondents, in both questionnaire and interview samples, who cite other reasons are few, and there appears to be no consistency between these two samples (e.g., in the

questionnaire sample “loss of control” and “disclosure obligation” are the second and third most frequently cited reasons, while in the interview sample the numbers of respondents for these two reasons are only two and zero, respectively), it is hard to determine other reasons (beside “no growth intention”).

However, we found some responses interesting that illustrate a Japanese management idiosyncrasy: three interview respondents mention a question of benefit to the parent company or the conglomerate, as a reason for not considering an IPO. From a Western point of view, we may wonder how going public could affect negatively the parent company or the conglomerate. One response quoted here may be helpful to understand this type of relationship between each individual firm and the conglomerate:

“Our company is part of a conglomerate (a group of companies), with no publicly held company in the group. Companies in the group often work together and cooperate, and we always manage our own firm considering the group’s profitability rather than our company’s profit only. If we go public, it becomes difficult to think of both the shareholders’ profit and our group’s profitability at the same time”.

Finally, two principals are not willing to go public because they do not see any appealing stock exchange. They indicate that the current state of Japanese stock exchanges for venture businesses is not favorable for launching an IPO. This is consistent with results in later sections, where we will find that some exchanges have image problems and have not gained the public trust yet.

Summary

The primary reason for not wanting to go public, in both questionnaires and interviews, is the no growth decision of the firm. Beside this reason (because the numbers of respondents citing other reasons are small) it is hard to determine the relative importance of other reasons.

However, interviews revealed an interesting aspect of the Japanese management system: three respondents state that going public is not a good idea, from the point of view of their parent company's or the conglomerate's interest, because it is difficult to think of profitability for firm's shareholders and for the whole group at the same time. Behind or under this opinion, we will, if we analyze, find the typical Japanese management idiosyncrasies and corporate governance system (such reactions would not be observed in North America). It would be interesting to investigate relations between parent and subsidiary companies, among companies within a conglomerate (keiretsu) in Japan, and compare with other countries. Such investigation would probably reveal interesting differences in management and corporate governance across countries. We would like to suggest this as a further area of study, since it is beyond the scope of this study.

4. Japanese SME Principals' Perception of the IPO Process

Given principals' goal for IPOs (financing, credibility, employee motivation) and the disadvantages they identify (disclosure and investor relationship, loss of control), we now explore how the principals view the new Japanese junior stock exchanges as mechanism for IPOs.

This section, therefore reports Japanese SME principals perceptions of the IPO process. The six questions asked were:

1. What is/are the difficult part(s) in the preparation procedure for an IPO?
2. What do you think of the listing requirements?
3. What do you think of the evaluation process?
4. What do you think of the recently opened/reformed junior stock exchanges?
5. Which exchange would you like to list and why?
6. What do you think is/are the obstacle(s) to creating an active venture capital market in Japan?

Except the fifth question, these questions were asked only to principals in the interview sample (as opposed to the questionnaire) because: 1) we wanted to limit the number of questions in the questionnaire to increase the response rate; 2) the number of firms in the questionnaire sample in the IPO preparation process was expected to be small (actually after receiving the responses, we found no firms in the questionnaire sample preparing an IPO).

4-1. Difficult Parts in the IPO Process

Based on NUD*IST analysis of the transcripts of the interview responses, we identified six categories of responses: 1) paperwork; 2) negotiation and “presentation”; 3) “unwritten” requirements; 4) showing a stable financial performance; 5) other difficulties; 6) no difficulty in IPO preparation. The breakdown of relative frequencies is shown in Figure 7.

Figure 7. Difficult Part in IPO Process (Interview Sample)

* Percentages represent in total 50 interview respondents, those who showed willingness to go public.

** The sum is not 100% because of occurrence of multiple responses (and no response at all in some cases).

From these results, it appears that the paper burden and reporting requirements (70%) are seen as major undesirable (though necessary) aspects of the process of going public. Compared to this, the percentages of respondents who cite other difficulties are small. “Negotiation & Presentation” meant introducing the firm and explaining the nature of the business to security companies and stock exchanges (convince them that it is plausible and promising). Twenty percent of principals have some difficulty with this procedure.

Difficulty 1. Paperwork (70%)

Under the disclosure requirements of traditional existing Japanese stock exchanges applicant companies have to submit all detailed relevant information pertaining to: nature of business, business plans and feasibility, senior managers and their families/relatives, administrative structure (not only the firm's organizational structure but also relationships with all companies that have interests in the firm, as well relationships with suppliers, clients/customers, etc.), and current state of the sector to which the applicant company belongs. Providing engaging documents that embrace the above information appears to be difficult for applicant companies. Recently opened junior stock exchanges (MOTHERS, NASDAQ Japan, and reformed JASDAQ) require similar, though not so detailed, information. Thus, approximately two-thirds of interview respondents (70%) who are considering IPO find it difficult to provide such documents. For example:

"We have to submit too many documents. I do not think that all these documents are needed to evaluate our business, such as information on our families and relatives. Moreover, we do not want to violate their privacy",

"We are required to submit documentations about related companies, families and relatives. We suppose that security companies and stock exchanges want to make sure applicant companies have no relationship with the Japanese gangsters. However, this creates a problem because some companies related to us do not want to disclose their information",

Several principals cite a shortage of human resources, or the high cost of hiring staff for required paperwork, as a problem. As one principal remarks:

"We hired an accounting professional for the paper work associated with the IPO, but to find a good professional was not easy: accounting or financial professionals having some experience with the IPO process were very scarce". Moreover, hiring a professional is expensive: it costs at least 5,000,000 yen (\$ 62,500 CDN) annually",

Moreover, some state that conservatism and formalism of stock exchanges and government offices (where applicant companies also have to submit several documentation) make paperwork more cumbersome. There are set rules and procedures for applicant companies to follow in preparing required documentations:

"Stock exchanges and the Regional Financial Office (Revenue) are extremely conservative and formal. We have to follow many useless conventions when preparing the documentation. For example, there is a certain format, e.g., how to start or end the documents. When stating our reasons for going public, we must start with a set formula: 'The Japanese economy is nowadays-----'. If that sentence is missing, the document will not be accepted",

“Every document submitted to government offices has to be prepared by a judicial scrivener, but I think this custom is ridiculous and costly. What he does is just transposing into the official format, what we have written. Everything in the procedure is too formal” ,

“For new businesses, especially in biotechnology, the traditional way of cost accounting does not apply. However, we have to prepare our financial report following the old way, otherwise it would not be accepted” ,

“We have to be extremely careful when preparing the documentation. Japanese public organizations/government offices do not overlook any little mistake” .

Applicant companies are required to submit a business plan. One of the evaluation criteria being precisely the extent to which business is unfolding as planned, hence, following the plan becomes a must. Devising feasible but promising business plans becomes a major and difficult task for applicant companies:

“While we are developing a business plan, external factors (regulations, etc) are constantly changing. Thus, to prepare a business plan is very difficult: by the time we are ready to submit it, it is already out of date” .

Thirty percent of principals (willing to go public in the interview sample) state that preparing the so-called “second-part” of the documentation is especially difficult. “Second-part” refers to the documents in which applicant companies have to explain their administrative structures (not only within the company, but also relationships with customers, suppliers, parent/children companies, etc). In those documents, applicant companies have to prove conformity with a list of criteria such as: no cross-ownership with customers and suppliers, parent company must be publicly traded etc. Thus, in order to satisfy these requirements, some applicant companies are forced to re-structure the firm’s organization and business relationships. Preparing the “second-part”, including administrative re-structuring, is perceived as extremely difficult by some principals:

“We have to re-design administrative structures and business relationships. Otherwise, it is very difficult to ‘pass’ the second-part”.

“To re-configure administrative structures and business relationships in order to submit a satisfactory ‘second-part’ documentation is difficult”.

“Because our firm has been growing very fast, managing this rapid growth is all we can do. We do not have time to be perfect and orderly. For example, financially/administratively, we are still not very well organized. In order to go public, we have to re-organize our administrative structure, which is very tough.”

Difficulty 2: Negotiation & Presentation (20%)

Twenty percent of principals find it difficult to negotiate with stock exchanges and security companies and to “present” their business so as to make it look convincingly worthwhile.

“We are an IT-related industry. It is very difficult to explain our technologies and business plan to security companies. The newer the technology we introduce, the more difficult it becomes to make them understand”,

“It was difficult to make exchange and security companies understand this new type of airline business and new type of cost administration”,

“We have to spend time and energy to “present” our firm to stock exchanges and security companies. That is, we have to work to make our firm ‘look good’”.

Difficulty 3: Satisfy “Unwritten” Requirements (14%)

As it was expected in our previous study on comparison of listing requirements among junior stock exchanges (page 8), the fact that in Japan, it is up to security companies, as opposed to stock exchanges, to actually evaluate venture businesses has created confusion among applicant companies. Fourteen percent of principals point out that the actual test for going public is different from the written requirements: there is a

discrepancy between regulatory requirements by stock exchanges and security companies' actual criteria:

"Security companies do not want to take any risk at all. So even when stock exchanges relax their listing requirements, security companies very often do not follow through",

"Nowadays, many companies want to go public. Consequently security companies do not easily underwrite businesses with sales just above the minimum required by MOTHERS, NASDAQ Japan or JASDAQ. To find a good security company for going public actually takes more than just what is required by stock exchanges",

"Listing requirements at MOTHERS, or NASDAQ Japan, are supposedly more relaxed than at traditional Japanese stock exchanges. However, we maintain that listing requirements anywhere in Japan have not really changed yet. Even with requirements officially relaxed by exchanges, security companies still demand more. For this, I do not think that even MOTHERS or NASDAQ Japan will really be seen as exchanges for venture businesses",

"I want security companies' assessment criteria to be crystal clear. Also we want to know exactly who has the last word in this evaluation procedure. Stock exchanges, or security companies?"

Difficulty 4. Showing a Stable Financial Performance (10%)

Ten percent of principals struggle for stable sales/profits:

“Stock exchanges want financially stable companies (i.e. stable sales and income). To satisfy this requirement, we have to develop wider stable customer chains”.

5. Other difficulties (18%)

This includes: developing a strategy to keep more than 51% of ownership (4%); due diligence (2%); improving employees awareness as members of a publicly held company (2%); firms answering “everything” (is difficult) (2%).

To the above we have to add 8% of firms that could not answer because they still had not tackled the preparation work for going public (8%).

6. No difficulty (16%)

It is only a minority of respondents (16%) who encounter no specific difficulty completing the IPO procedure. Moreover, for some, this is because they hired consulting or auditing firms to do the work:

“Because we had the whole work done by a consulting firm, we had no difficulty with it (but it did cost a lot)” ,

Summary

We found disclosure-related paperwork to be the major difficulty typically encountered by SMEs going public (70%). This category includes: conservatism and formalism of Japanese government organizations (as well as stock exchanges), lack of human resources and/or the cost of hiring employees for the required paperwork, preparation for the “second-part” documentation that sometimes requires applicant companies to restructure the firm’s organizations and business relationships, they all make this disclosure-related and reporting work particularly difficult.

Compared to this, percentages for other difficulties are small. For example, the percentage of respondents for the second most frequently cited difficulty, negotiating with and presenting their business to security companies and stock exchanges, is 20%.

The fact that, in Japan, security companies (not stock exchanges themselves) actually evaluate venture businesses, have created confusion among applicant companies. Fourteen percent of principals indicate that the actual criteria they effectively have to satisfy are more stringent than the requirements officially announced by stock exchanges: the gap between the actual test to pass and the regulatory requirements by stock exchanges exists. As one principal states, security companies should clearly, unambiguously, communicate their assessment criteria to SMEs, and security companies’ and stock exchanges’ respective roles should also be clearly defined for everybody. We will discuss in detail the evaluation procedure in a next section (section 5-3).

4-2. The Listing Requirements

This section explores the sample SME principals' perception of listing requirements. In the previous section, we found that there are actually two types of listing requirements: those officially announced by stock exchanges, and "unwritten" standards required by security companies. To avoid confusion, when the question "what do you think of listing requirements?" was asked to interview respondents, "listing requirements" was specified as official ones announced by stock exchanges.

Based on NUDIST analysis of the transcripts of the interview responses, we identified four different and somewhat contradictory categories of responses: the requirements should be: 1) simplified, clarified, and made more flexible; 2) more stringent for disclosure; 3) relaxed; 4) they are appropriate as they are now. The breakdown of relative frequencies is shown in Figure 8.

Figure 8. Perception of the Listing Requirements (Interview sample)

* Percentages represent in total 50 interview respondents, those who showed willingness to go public.

** The sum is not 100% because of occurrence of multiple responses (and no response at all in some cases).

The most frequent opinion (request) is that listing requirements should be simplified, clarified, and made more flexible (36%). The second most frequent response asks for more stringent disclosure (18%).

Opinion 1. Simplified, Clarified, More Flexible Requirements (36%)

Thirty-six percent of interview respondents willing to go public state that the listing requirements should be simplified, clarified, and made more flexible. Recall that 70% of principals willing to go public identified as the main difficulty in the IPO procedure (section 5-1), therefore some respondents state, for example:

"We want to know how much detailed information is necessary for the required documentation (disclosure). I can write 100 pages about my business, but I can also explain it in 3 pages",

In addition, 12% of respondents suggest that the requirements should be differentiated across industries:

"The listing requirements do not fit companies in the manufacturing sector, especially those with the core of their business in R&D. I have a feeling that the listing requirements of those new stock exchanges are made for the Information sector. For example, one of the evaluation criteria is the number of patents an applicant company owns. In the IT sector it is fairly easy for a firm to buy a/a few patent(s) in order to go public. Listing requirements for the manufacturing sector should be different from those for IT industries",

“In general, sales figures are smaller in the manufacturing than in the IT sector: thus to apply the same listing requirements to both IT and non-IT industries is unfair. The requirements for the manufacturing sector should be lower than those applied to IT industries”.

Other suggestions by respondents sought a way for requirements to be more flexible:

“MOTHERS and NASDAQ Japan require applicant companies to submit two years of audited financial reports before going public, which is not always useful (a one-year audit should be enough). It would be better to have a choice between two-years and one-year with a little penalty attached”,

“Stock exchanges should allow venture businesses alliances (companies grouping and going public as one entity)”.

Opinion 2. More Stringent Disclosure (18%)

We find 18% of principals emphasize the need for more thorough disclosure requirements. There are two reasons (cited by the respondents) for insisting on thorough disclosure: first, in order to provide more information to investors; second, in order to avoid “misfit companies” from being listed. In Section 5-4, we find 20% of SMEs

concerned by the negative image of some new stock exchanges due to dubious companies being listed. This 18%, here, is a consequence of the negative image concerns:

“Stock exchanges should require from the applicant/listing companies thorough disclosure, and provide the information to investors, in order to make them fully responsible for their choice of investment” ,

“Disclosure requirements should be more stringent. Otherwise not only "real" companies but also companies in paper can list” .

In the previous study (mentioned in the Introduction) comparing listing requirements of several junior stock exchanges (MOTHERS, JASDAQ, NASDAQ Japan, and CDNX), we found MOTHERS to be the most demanding for disclosure. In spite of that, several principals ask for even more stringent disclosure requirements, because, so they say, MOTHERS has listed some “misfit” companies.

“For the sake of transparency, MOTHERS should ask for more information, and in turn make it broadly available to investors. One has the feeling that some companies get listed through unfair procedures (because of a privileged relationship to some security company/stock exchange). I want fair stock exchanges” .

Opinion 3. Requirements' Bar too High (8%)

On the other hand, 8% of principals willing to go public state that the bar for listing requirements should be lower:

“Stock exchanges should not set up too stringent requirements. My basic idea is that stock exchanges should list all applicant companies without screening, so as to allow for a lot of variety. Then, stock exchanges should offer all necessary information on their listed companies to investors, and leave it up to them to choose investment”.

Summary

One-third of respondents (36%) think that there is a possible space for requirements to be simplified, clarified, and made more flexible. Only 8% suggest to further relax the requirements: for 18% of the sample SME principals, they are not stringent enough (especially for disclosure requirements), and for 6% they are adequate. This may be because we asked about the “official” requirements by stock exchanges rather than “unwritten” (but actual) ones by security companies. Eighteen percent want more stringent requirements for disclosure. This suggestion reflects their concern about the mediocre image of some of those new stock exchanges (more about this later in the study). While in section 5-1, we found that a majority (70%) of principals willing to go public see disclosure- related and reporting paper work as the difficult part of the procedure for going public, findings in 5-2 allow us to conclude that some of them (18%) consider it a bare minimum needed for stock exchanges’ credibility and consequently the availability of equity financing.

4-3. The Evaluation Process

To the question “what do you think of security companies’ and/or stock exchanges’ evaluations of venture businesses?”, 32% of respondents answer that security companies/stock exchanges do not have the necessary competency to assess businesses, and 8% would like a more thoroughly researched (situation and background of the applicant company and sector it belongs to) assessment (Figure 9).

Figure 9. Perception of the Evaluation Process (Interview sample)

* Percentages represent in total 50 interview respondents, those who showed willingness to go public.

** The sum is not 100% because of occurrence of multiple responses (and no response at all in some cases).

1. No Competency (32%)

Thirty-two percent of principals question security companies’ and/or stock exchanges’ ability to assess venture businesses. For example:

“At meetings with people from the security company, we often feel as if lecturing them on software businesses instead of discussing our financial situation. They know nothing about software industry. If we wanted, it would be might be easy for us to deceive them. They say that not the

business plan but the principal's personality is important for their evaluation, but I am wondering how they can evaluate a business without knowing (and understanding) its content/nature",

"Security companies do not have the know-how to evaluate venture businesses. They should have a marketing section that assesses the demand for the business evaluated, and a technology section that understands and assesses the technologies. Also, academics should work with security companies to evaluate venture businesses",

"Security companies and auditors should specialize. For instance, some security companies would specialize in IT industries, and others would specialize in evaluating the manufacturing firms. Japanese security companies are all the same, and lack the skills to assess venture businesses".

"I want security companies and stock exchanges to evaluate venture business with a long-term perspective. I want them to assess our potentials, more than our past financial reports".

Some principals indicate (as "evidence" for security companies'/stock exchanges' inability to assess businesses) that firms listed on the new stock exchanges do not seem to have any high growth potential:

“Business plans of firms listed on MOTHERS are often not realistic and provide no concrete action plans (e.g., for approaching customers, expanding market share, maximizing profit, etc). This indicates that security companies are not able to distinguish plans on paper from realistically feasible plans”,

2. Thorough Evaluation (8%)

Eight percent of principals would like security companies and/or stock exchanges to conduct a research on applicant companies and the sector to which they belong (rather than satisfying themselves with the documentation submitted by applicant companies).

For example:

“Security companies and stock exchanges should not rely exclusively on documents submitted by applicant companies, they should conduct investigations by themselves to check applicant companies' background, and bear entire responsibility for their evaluation. Relying too much on documents submitted by applicant companies, makes it easier for those to hide scandals”.

3. Evaluate Goodwill and Ethics (6%)

Finally, 6% of respondents think that security companies and stock exchanges should give more weight to and assess more stringently ethics and good will. This answer is related to findings in later sections, i.e., the negative image of some of those new stock exchanges due to the presence of dubious companies.

Summary

Thirty-two percent of the principals deny security companies and stock exchanges the competency necessary to assess venture businesses. However this cannot be interpreted as evidence that security companies and stock exchanges do really lack such competence. It may reflect principals' overestimation of their business. Nevertheless, it remains that some SME principals are not satisfied with security companies'/stock exchanges' evaluation. This finding is important: if security companies and stock exchanges are not able to build a relation of trust with applicant (potential applicant) companies, it will not be easy for them to accomplish their objective of nursing and supporting new businesses.

4-4. Views on the Junior Stock Exchanges

This section explores (sample) SME principals' perceptions of recent changes in the Japanese venture capital market (that is, the launching of new stock exchanges for venture businesses: MOTHERS, NASDAQ Japan, etc. and JASDAQ's reform of its requirements). Figure 10 depicts the breakdown of general opinions discerned from NUD*IST analysis of the interview transcripts.

Figure 10: Views on the Junior Stock Exchanges (Interview Sample)

* Percentages represent in total 50 interview respondents, those who showed willingness to go public.

** The sum is not 100% because of occurrence of multiple responses (and no response at all in some cases).

As shown in Figure 10, 28% of respondents believe that the recent changes geared towards facilitating access to capital markets to growth-oriented SMEs, are useful. However, concerns are also expressed. Twenty percent of respondents think that those new exchanges will be of no help to SMEs because some of them list “dubious” companies, 18% because their requirements are “inadequate” for rapidly growing companies, and 12% think that such a rapid change in the Japanese venture capital market is “dangerous” because it will create confusion or chaos in the market. “Other”

includes 6% of respondents for whom these new exchanges will not successfully support venture businesses because the exchanges' liquidity is expected to be low, and another 6% who think that lack of competition among security companies may defeat the objective of activating the Japanese venture capital market. Overall, principals who have a somewhat negative view or reaction account for 52% of respondents. The following details and quotes reflect some respondents' opinions/reactions.

1. Good News (28%)

Twenty-eight percent of principals see the launch of many exchanges for venture businesses as good news, because it enhances the availability of financing, recognizes the small business sector, and enhances investors' awareness of high-risk high-return investment.

"Increased availability of direct financing is good news for small businesses. VCs are good sources of financing, but they easily turn into a trickle at the first opportunity (bad news, etc.). Thus, small businesses need a stable source for long term financing. It will support the start-ups and re-activate the Japanese economy",

"The new exchanges triggered a boom of venture businesses, enhancing people's recognition of small businesses. Before (these exchanges), we, venture businesses, were looked down at, as just "subsidiaries, or, viewed as 'gamblers', unstable, adventurous. Thus it was difficult for us to get public recognition and credit, and to attract talented employees.

However, thanks to the boom, people start recognizing "venture businesses" as small, but interesting companies with a potential to grow, and are likely to give birth to a new business environment in Japan",

"New stock exchanges for venture businesses bring benefit to Japanese SMEs. First, the launch of NASDAQ Japan will increase Japanese SMEs' chances of being listed on NASDAQ US. Second, stock exchanges for venture businesses will increase investors' awareness of high-risk high-return investment, and understanding that they invest at their own risk⁵⁵".

2. "Dubious" Companies Listed (20%)

Twenty percent of principals were concerned that dubious companies might be listed. Since "increasing credibility to attract employees" is one of the main reasons to go public, stock exchanges' credibility has also become a concern. For example,

"There are too many companies listed having only ideas to offer, but with dubious operations and a negative income. The existence of such companies on new exchanges deprives us, sound companies, of opportunities for direct financing. Companies managed on a sound basis hesitate to list their shares next to deceptive ones, they do not want to be viewed as being in the same league",

⁵⁵ This is specific to Japan: traditionally, investors (not only retail- "mom and pop"- but also institutional investors) looked at buying stock as a form of lending, and expected to be compensated in case of a crash.

"The launch of these stock exchanges is basically good for start-ups. However, some companies listed on those exchanges are in bad shape. They lower their listing exchange's reputation, and also the public's trust in other, though soundly operated, companies",

"I hope that several "doubtful" companies currently listing will not survive, so that I might become optimistic about the future of the new exchanges".

Some principals see, in apparently untrustworthy listed companies, evidence that stock exchanges/security companies are unable to assess venture businesses:

"I doubt that security companies assessing such firms and letting them go public had proper competence to measure their real potential".

3. Inadequate for Rapidly Growing Firms (18%)

Eighteen percent of principals remain skeptical that the new exchanges could meet the needs of rapidly growing firms and consequently fulfill their role of providing support to venture businesses. The primary reason has to do with the complicated procedures for going public. For example;

"Managers with firms in a phase of rapid growth do not have the time and energy to devote to paper work of this kind, they have to focus on the growth of the business. However, those firms are precisely the ones more likely to need an infusion of capital. Thus, stock exchanges with such

complicated procedures do not really provide the needed support to venture businesses looking for capital.”

“There should be at least one stock exchange where any start-up can list without condition, and if, after a certain time limit, a listed company cannot satisfy the requirements, it will be delisted” ,

“Most government officials, who actually planned the creation of venture stock exchanges, suffer from acute risk aversion (this is why they are where they are), thus do not understand high-risk, unpredictable business. Most of them started in the civil service just after graduation, and have no experience of the business sector. Therefore they do not understand venture businesses and ended up creating stock exchanges with complicated procedures. Such exchanges do not really provide support to rapidly growing venture businesses” .

4. Dangerous (12%)

Twelve percent of respondents are concerned lest such a rapid change in the Japanese venture capital market (more than three exchanges opened, and JASDAQ has reformed its requirements within three years) should prove dangerous, creating confusion, even chaos. Two other principals expect some exchanges to disappear because of rapidly increased competition (among exchanges).

"The recent changes in the Japanese venture capital market are extreme. For a long time, before the reform (of JASDAQ) and the launch (of MOTHERS and NASDAQ Japan), it had been impossible for venture businesses to raise capital through direct financing. Now, there are more than 3 stock exchanges for venture businesses. Because the situation has changed so rapidly, everything is now confusing and chaotic, e.g., stock prices on MOTHERS are extremely unstable. I do not think this is good. I hope that this chaotic situation is temporary and will soon settle down. Moreover, I do not think that all these exchanges for venture businesses are necessary for the Japanese stock market. Some of these exchanges for venture businesses will be closed because of competition",

"In Japan, debt is a very stable source of financing, and the difference between investors (shareholders) and lenders (creditors) is not clear. In such an environment, this rapid change in the venture capital environment (creation of several venture stock exchanges within a short time) creates confusion and is dangerous".

5. Other (12%)

Six percent of respondents who were willing to go public were also concerned about stock exchanges' liquidity:

"In Japan, the face value of a share is fixed at 50,000 yen (\$ 625 CDN). Thus, it is difficult to issue large numbers of shares and increase liquidity by decreasing the price per share",

"Because these exchanges have not yet listed many companies, and because the face value of a share is predetermined, the number of outstanding shares is still small. Thus, they still do not have enough liquidity. Low liquidity scares investors, and consequently it damages the listed companies, gives them a bad image".

Another 6% maintain that competition among stock exchanges/ security companies should be increased.

"Competition among stock exchanges, among security companies, and among VCs, is important for activating the Japanese stock market. With several venture stock exchanges launched and the volume of VCs increasing, competition among exchanges and among VCs is stiff. However, there are still only 4 or 5 security companies eligible as lead underwriters (which means little competition). I hope the number of security companies will increase and competition will force them to improve their competence/services".

Summary

While 28% of principals (willing to go public) see the current trends in the Japanese venture capital market as a favorable change, 52% express doubt that the launch of several venture stock exchanges and the reform of JASDAQ will really provide the needed support for growing SMEs.

In section 5-2, we found that for 18% of principals the disclosure-related requirements should be more stringent in order to avoid listing what appear to be “misfit” companies and to provide enough information to investors. In addition, in section 5-3, we found that 6% of principals stated that security companies and stock exchanges should more stringently assess applicant companies’ good will and ethics. Consistent with these findings, this section found 20% of principals skeptical about the success of the new stock exchanges because they appear to list untrustworthy companies. Since in section 4-1, we found that increased credibility and attracting employees (by enhancing firm’s credibility) are two good reasons for going public, credibility of stock exchanges and listing companies are logically also important to the firms. In the next section we explore that “image” and “credibility” issue as determining criteria for SME principals when selecting an exchange.

4-5. Preferred Stock Exchange

The question “which stock exchange(s) would you like to list?” was asked to principals in both the questionnaire and interview samples. The questionnaire asked only the name(s) of stock exchange(s) on which respondents would prefer to list. In the interviews, we also asked to state the reason(s) for selecting/rejecting the exchange(s).

4-5-1. Preferred Stock Exchange: Questionnaire Respondents

Out of 88 principals in the questionnaire sample, 26 willing to go public were asked to choose one or more stock exchanges on which they would be willing to list: MOTHERS, JASDAQ tier 1, JASDAQ tier 2⁵⁶, NASDAQ Japan, Fukusho Q Board, Osaka Second Tier, and others. (Fukusho Q Board is the second tier of the Fukuoka Stock Exchange, launched as a venture stock exchange in June 2000. Similarly, Osaka Second Tier is the second tier of the Osaka Stock Exchange, opened with the purpose of financing SMEs in December 1998).

NASDAQ Japan and JASDAQ tier 1 were the preferred exchanges (58% and 54% of questionnaires respondents willing to go public, respectively) while MOTHERS was identified as the exchange of choice by 35% of respondents. Only one respondent chose Osaka Second Tier, and no respondent chose Fukusho Q Board. This is probably because Fukusho Q Board and Osaka Second Tier were not well known all over Japan. (Their parent exchanges are regional exchanges, and Fukusho Q board had just opened at the

⁵⁶ JASDAQ tier 2 offers more relaxed requirement than tier 1 (tier 2 requirements are similar to MOTHERS'). JASDAQ tier 1's requirements are most stringent among Japanese junior stock exchanges (more stringent listing requirements than MOTHERS or NASDAQ Japan).

time of the survey). No respondent chose JASDAQ tier 2. One respondent chose “other” but s/he did not specify the name of the exchange s/he is considering.

4-5-2. Preferred Stock Exchange: Interview Respondents

Out of 62 principals in the interview sample, 50 principals considering an IPO were asked on which stock exchange(s) they would prefer to list. In this case, predetermined alternative answers were not provided. After the interviews, we identified 5 stock exchanges cited by the principals as preferred exchanges:

- 12 SME principals would like to list on MOTHERS (24%),
- 19 SME principals would like to list on JASDAQ tier 1 (38%)⁵⁷,
- 17 SME principals would like to list on NASDAQ Japan (34%),
- 2 SME principals would like to list on NASDAQ US (4%),
- 1 SME principal would like to list on Tokyo Stock Exchange tier 2 (2%).⁵⁸

To explore this issue in more depth, two questions were posed in open-ended form, “why do you prefer the exchange?” and “why do you not want to list on the exchange?”

1. Reason(s) for Selecting an Exchange

We asked why an interviewee chose a particular exchange, and identified (based on a NUD*IST analysis of transcribed interview data) six categories of reasons: relaxed requirements; simple IPO procedures (short processing period); the exchange’s concept

⁵⁷ No respondent chose JASDAQ tier 2. This was probably because the tier 2 was not well known among SMEs: no interviewee knew of it. Since no respondent in the questionnaire and interview samples chose JASDAQ tier 2, in this section “JASDAQ” means JASDAQ tier 1.

⁵⁸ The sum is not 50 because one respondent choose more than one exchange.

fits their business or the exchange's growth potential; good image; liquidity; and internationality. Figure 11 summarizes the distribution of interviewees' reasons for their choice change.

Figure 11: Reasons for Choice of Exchange (Interview Sample)⁵⁹

On one hand, respondents who elect to list on MOTHERS cite the relaxed listing requirements that may facilitate access to capital. On the other hand, respondents electing to list on NASDAQ Japan and JASDAQ (tier 1) identify image and reputation of the exchange as paramount. This ties in with the concerns noted previously about the listing of “dubious companies” on some exchanges (section 5-4).

Two thirds of respondents who wished to list on MOTHERS indicate relaxed requirements as a reason. For example:

⁵⁹ The reason for choosing Tokyo Stock Exchange Tier 2 and NASDAQ US do not appear in this figure. For the Tokyo Stock Exchange Tier 2 (one respondent), it is its high credibility, and for NASDAQ US (two respondents) its internationality. Respondents chose one or more exchanges and cited one or more reasons.

“MOTHERS imposes no restriction on our business relationships. It allows an applicant company whose parent organization is not public, to be listed. Moreover, it also allows applicant companies to have their clients/suppliers as shareholders”,

“We will choose MOTHERS because of its relaxed requirements.”

On the other hand, approximately 50% of respondents who wish to list on JASDAQ or NASDAQ Japan are motivated by these exchanges' good image.

“JASDAQ has a long history and the number of listed companies is the highest in Japan (about 900 companies). Many of those listing companies have high-growth rates. It has the greatest trading volume and high-liquidity, thanks to the market maker system.”

“We think of JASDAQ because it lists only companies with a positive net income. Companies listed on JASDAQ are considered trustworthy. Thus by choosing JASDAQ, we can increase our firm's credibility, more so than by listing with any other exchange”,

“JASDAQ has a long tradition and is quite stable”.

2. Reason(s) for Rejecting an Exchange

We asked why an interviewee did not select a particular exchange, and identified (based on a NUD*IST analysis of transcribed interview data) seven categories of reasons: unstable stock price; image as exchange for IT industry; too new; low liquidity; bad image; stringent requirements; and, does not fit the Japanese market. Figure 12 presents the breakdown of responses.

Figure 12: Reasons for Rejecting Exchanges (Interview Sample) ⁶⁰

The importance of the exchanges' image is confirmed from the respondents' reasons for not selecting particular exchanges. More than 50% of respondents rejected MOTHERS and NASDAQ Japan for image-related reasons. The sample principals' image of NASDAQ is somewhat interesting: 47% of respondents who chose NASDAQ Japan identified its good image as a reason, while 50% of respondents who rejected NASDAQ alleged its bad image.

⁶⁰ Respondents cited one or more reasons.

“We have a sort of dubious image of MOTHERS and NASDAQ Japan. Most of the companies listed on MOTHERS and NASDAQ Japan are in the IT business, and I have a dubious image of them. When I read those companies’ business plans, they are extremely abstract, they do not clearly explain how they intend to expand their market, sell their products and make money. If we list our shares on MOTHERS and NASDAQ Japan, people might think that we are like those dubious companies; we do not want that. Moreover, the stock prices of those companies are extremely unstable”,

“Companies listed on MOTHERS and NASDAQ Japan do not seem attractive to investors. So even if we list on these exchanges, we may not attract capital”.

“MOTHERS and NASDAQ Japan have just started. We are not sure how they will fare one year or two from now”.

Moreover, some principals perceive MOTHERS and NASDAQ Japan as exchanges for IT industries (and because theirs are not IT businesses, they did not select them.

“We prefer JASDAQ, because we see MOTHERS and NASDAQ Japan as exchanges for IT, whereas JASDAQ also addresses traditional sectors”.

Summary

Since two major reasons cited for going public, are to increase the firm's credibility and hence attract employees, the image (of an exchange) is an important issue for SME principals' selection of stock exchanges.

Obviously SME principals expressed some uncertainty with respect to MOTHERS and NASDAQ Japan, while at the same time those seeking capital appreciate their reduced listing requirements. This is consistent with the finding in section 5-4, where 20% of respondents state that the current situation of the Japanese venture capital market is not favorable because several "misfit" companies are apparently listed in the new stock exchanges. Moreover, this is why, in the earlier sections, we found 20% of respondents stating that the disclosure requirements should be more stringent (section 5-2).⁶¹

On the other hand, JASDAQ is perceived by the sample SME principals as an exchange with a long stable history but slightly higher requirements. Thus, SME principals are forced to face a tradeoff between stock exchanges: between relaxed listing requirements and easier access to capital without a good image and stock exchanges with a good image but with higher listing requirements.

For MOTHERS and NASDAQ Japan, it seems an imperative to improve their image. However, it will not be easy. As some of the sample SME principals suggest, they should probably carry out more thorough assessments of applicant companies (and focus more on applicants' ethics and goodwill in the assessment procedure). However, in

⁶¹ In addition, 6% of interview respondents willing to go public state that stock exchanges and security companies should assess more rigorously applicant companies' ethics and good will (section 5-3).

order to assess more thoroughly applicant companies, MOTHERS and NASDAQ Japan may have to require more information (thus, more paperwork) from applicants and will need longer assessing/processing lead times. Therefore they may lose two of their sales points (relaxed requirements and shorter processing period) as a cost of improving their image.

From this finding, however, it is also possible to draw an optimistic view for the future of MOTHERS and NASDAQ Japan. Once they solve this “image” problem, they may have a large demand (applicant companies) and may be able to play an important role in activating the Japanese venture capital market. In short, one of the key for future success of these exchanges (and future development for the Japanese venture capital market) is how and whether they will improve their “image’ in the near future.

4-6. Explanations for Underdevelopment of Japanese Venture Capital Market

Finally, the question “why is the Japanese venture capital market not very active?” was put to all 62 principals in the interview sample, regardless of their willingness to go public. While 32 principals did not have any clear opinion, 30 had had some thoughts about what in Japan prevents the development of an active venture capital market:

1. To 10 SME principals the lack of understanding, by investors, of high-risk high-return investment, is a factor;
2. To 10 SME principals it is the government’s policies (including taxation);
3. To 7 SME principals it is a cultural/social reason;
4. To 2 SME principals it is the fact that Japanese VCs do not fulfill their role.

1. Investors’ Understanding (10)

Ten SME principals point out that lack of investors’ knowledge and awareness of high-risk high-return investment prevents the development of an active venture capital market:

“Japanese have no tradition in taking high risks under their own responsibility, which in turn prevents the development of an active Japanese venture capital market. I hope that MOTHERS and NASDAQ Japan, plus the venture business boom, will be a good opportunity for people to learn what is high-risk high-return investment, and will create a solid background for the Japanese venture capital market”,

2. Government Policies (10)

Out of 10 SME principals who point at government policies as a factor, four of whom specify tax policy:

“The present tax system is a disincentive to letting one's business grow. Many venture businesses try not to increase profit in order to avoid taxes. A high taxation rate for capital gains also prevents the development of an activate venture capital market. Re-forming our taxation system has become an urgent necessity”.

Four principals point at government conservatism:

“Government conservatism stifles Japanese venture businesses and consequently venture capital markets. Very often government refuses (to venture businesses) permission for something new because ‘there is no precedent for it’. And when it gives in, it takes very long to issue the permission. For example (our experience) it took us very long to get a permission from the government to import camping cars from Canada, because government officials took time before deciding in which category the product did belong, housing or automobile! If venture businesses are prevented from innovating, they will never grow”.

Two principals deplore to the fact that government deliberately supports only large firms:

“Government chooses to support large, well established firms with no longer any growth potential, rather than new, rapid growing companies. For example, government offered a large subsidy to Japan’s largest department store about to collapse, whereas it has never offered any monetary support to venture businesses on the verge of bankruptcy”.

3. Cultural/Social Reasons (7)

Out of seven principals pointing out the lack of social support (backing): three maintain that successful entrepreneurs are less admired in Japan than elsewhere:

“In Japan, a successful venture businessman tends to attract criticism.

This is Japanese culture: someone who stands out is likely to be the target of negative reactions”.

Two principals maintain that neither “second chances” nor “going back” is allowed for unsuccessful entrepreneurs. Meaning: once you left your company to start your own business, it is difficult to find employment again in case you failed. Also, if you failed, it is almost impossible to get a second chance starting another business. Thus, starting up a new business is more risky in Japan than in other countries:

“If an entrepreneur has led his/her firm to bankruptcy, s/he will never have a second chance: s/he would encounter tremendous difficulties finding a bank for credit”.

Another two principals, finally, maintain that because Japanese are not innovative, venture businesses are not likely to be started, consequently the venture capital market is not active.

4. Role of VCs (2)

Two SME principals think that Japanese VCs do not play their part properly, and this prevents the Japanese venture capital market from becoming active:

"Now, the number of VCs is increasing in Japan, but their operation is still immature. What VCs offer to venture businesses is only money; they do not offer any advice on management. For example, VCs typically require firms to submit a business plan, before granting financing. When a firm cannot implement (follow) the submitted plan, the VC and the firm together re-write it, instead of VC advising the firm on how to improve its management practices. Another example is that VCs (in stead of counseling them) often oblige venture businesses to issue warrants as a assurance for capital gain".

Summary

How SME principals explain the absence of an active venture capital market is consistent with other academic research. For example, while Ooghe & Bekaet & van den Bossche (1989) argue that Japan has no tradition of high-risk high-return investment, 10 of our SME principals also state that lack of investors' understanding of high-risk high-

return investment is a factor. High taxation rates are pointed out as a factor by both Ooghe & Bekaet & van den Bossche and four SME principals. Milhaupt (1997) and Ooghe & Bekaet & van den Bossche pointed out that successful entrepreneurs are less admired than top business managers in large companies: three SME principals state that successful business principals are often criticized. Black and Gilson (1997) argue that Japanese are less entrepreneurial, and two SME principals maintain that to be an entrepreneur is riskier in Japan than in other countries, because neither second chances nor going back is possible in case of failure. Differences in role of venture capitals between North America and Japan (in North America, VCs are actively monitor management of venture businesses, while in Japan, they just offer money) are pointed out two respondents as well as Balck & Gilson and Milphaupt.

To investigate how each factor affects the Japanese venture capital market would be an interesting issue, though it is beyond the scope of this study. We would like to leave it as an area for further study.

VI. Conclusions

1. Summary of Salient Findings and Implication for the Junior Stock Exchanges

This research arrived at conclusions regarding five aspects of the research issues studied here. First, there is a demand for equity capital. Second, profiles of SMEs that would be willing to go public were developed. Third, the major reasons for go public and importance of exchanges' image were identified. Forth, listing requirements, SMEs' requests were examined. Fifth, typical problems encountered by SMEs in the IPO process were noted.

Given that 30% of questionnaire respondents stated a desire to go public, it seems that there is indeed a demand for equity capital among Japanese SMEs. This percentage is much higher than what is reported by Chusho Kigyo Hakusho (finding that about 10% of respondents intended to go public). This difference may be that MOTHERS and other new exchanges had not opened at the time of the Chusho Kigyo Hakusho survey, nor had plans for these new exchanges been announced: the well-publicized launch of the new exchanges may have stimulated business principals to consider going public. Alternatively, it is also possible that the sampling frame for the questionnaire included firms that might be more likely to go public than other firms in Japan.

We found that the three categories of firms in the sample were comparable (firms whose principals have expressed a willingness to go public; firms whose principals have articulated an unwillingness to go public; and firms whose principals stated no plan to grow their business) at reasonable levels of statistical confidence. The result assures us

that differences subsequently observed in principals' perceptions of equity capital are not attributable to differences among firms' and principals' characteristics.

Three primary reasons for SMEs to consider going public were: the need for capital (financing); increased credibility for the firm (which has many positive effects); and the positive human resource implications of this increased credibility.

For SMEs seeking to increase credibility (and, again, to attract employees by enhanced credibility) by going public, stock exchanges' image and social credibility is an important issue. You cannot enhance your credibility by listing on exchanges with a bad image. However, some new junior stock exchanges (MOTHERS, NASDAQ Japan) were obviously perceived as untrustworthy by sample SMEs. Twenty percent of the interview respondents willing to go public had a negative image of these stock exchanges because they appeared to list untrustworthy companies. Eighteen percent suggested that requirements for disclosure be more stringent to reduce ambiguity of listed companies, to provide more information to investors, and consequently to enhance stock exchanges' social credibility. In addition, a few stated that security companies and stock exchanges should more stringently assess applicant companies' good will and ethics (though the percentage of principals who mentioned goodwill and ethics was only 6%, their opinions cannot be ignored since they reinforce the importance of stock exchanges' credibility for Japanese SME principals). Principals insisted that these untrustworthy companies lowered their listing exchange's reputation and also the public's trust in other, though soundly operated, companies. Stock exchanges with a negative image do not meet two of

the expressed needs: increasing the firm's credibility and attracting employees through enhanced credibility.

Consequently, one of the most important implications that can be drawn from the study is that the lack of social credibility of MOTHERS and NASDAQ Japan have created a tension, for SME principals, between the need for easier access to capital on one hand, and the need for credibility and image on the other hand.

This tension is evidenced by the reasons behind principals' choice of stock exchange. Two thirds of respondents who wished to list on MOTHERS indicated relaxed requirements as reason of their choice. Yet, more than 50% of respondents who rejected MOTHERS did so for bad image reasons. Approximately 50% of the respondents who would select JASDAQ or NASDAQ Japan referred to these exchanges' good image (long history, good reputation, stable stock price, etc). However, 50% of respondents who rejected NASDAQ Japan also indicated its bad image as a reason. Obviously SME principals perceived some uncertainty with respect to MOTHERS and NASDAQ Japan, while at the same time those who sought capital appreciated its lowered listing criteria.

Therefore, in order to attract SMEs, it is important that MOTHERS and NASDAQ Japan establish a solid image as stable exchanges operating on a sound basis. However, it does not seem so easy. To assess more thoroughly applicant companies (in order to avoid listing "misfit" companies"), MOTHERS and NASDAQ Japan may have to require more information (thus, more paperwork) from applicants, translating into longer assessing/processing lead times. Therefore they may lose two of their selling points (relaxed requirements and shorter processing period) as a cost of improving their image.

This difficulty of a tradeoff between credibility of stock exchanges and disclosure-related requirements is also indicated by the contradictory responses coming from interviewees: On one hand, 52% of respondents identified disclosure and investor relationship as a major disadvantage of going public, and 70% identified disclosure-related paperwork to be the major difficulty; On the other hand, roughly half of the respondents selected exchanges according to the exchange's image. SME principals want to list on stock exchanges with a good reputation, but are reluctant to disclose their firm's information and to do the paperwork associated with disclosure (which is the condition of an improved exchanges' image).

As for the listing requirements of those junior exchanges, while a majority of interviewees does not think these too stringent, 44% asked for more flexible, simplified, clarified requirements. Some suggested requirements differentiated according to industries. Some stated that conservatism and formalism of Japanese government bureaucracy (as well as stock exchanges) made disclosure-related paperwork, which 70% of respondents identified as the major difficulty, unnecessarily complicated. Eighteen percent of interview respondents stated that junior stock exchanges requiring such complicated IPO procedures (and paperwork) will not be able to support venture businesses (and consequently activate Japanese venture capital market), because managers in rapidly growing firms, precisely the ones more likely in need of infusion of capital, do not have the necessary time and energy to devote to paper work.

The other problems revealed by the study are the fact that stock exchanges do not evaluate venture businesses but rely for it on security companies (creating confusion

among SMEs), and stock exchanges and security companies are perceived, by interviewees, as having no competency to assess venture businesses. Also, predetermined face value limits liquidity.

As for the first problem, 14% of principals indicate that the actual criteria they effectively have to satisfy are more stringent than the requirements officially announced by stock exchanges. Six percent of respondents stated that stock exchanges should assess applicant companies instead of relying on security companies' evaluations. That security companies actually evaluate venture businesses creates confusion among applicant companies.

As for the second problem, 30% of the sample perceiving security companies and stock exchanges as not competent for assessing venture businesses. This cannot be evidence that they actually lack such skill (it may reflect principals' overestimation of their business), but implies that security companies and stock exchanges have not built the necessary relation of trust with applicant (potential applicant) companies.

The last problem was related to the regulation that predetermines the face value of shares. Though the percentage of respondents who pointed to this issue is small (6%), this issue is considerable because such regulation reduces stock liquidity. Low liquidity scares investors, and consequently reduces the attractiveness of shares listed on the junior stock exchanges. Liquidity issue seems more important for MOTHERS, since it does not use the market maker system.

From the above results, it can be concluded that the future growth of these new exchanges and the mobilization of the Japanese venture capital market may depend on

whether MOTHERS, NASDAQ Japan, and other stock exchanges will gain social credibility or not. Moreover, in order for stock exchanges to attract SMEs, it is important to make requirements more flexible, simple and clear. Assigning clear responsibilities for evaluating venture businesses (stock exchanges or security companies), building a relation of trust between security companies/stock exchanges and applicant companies (by assuaging applicant companies' fear of not being evaluated properly), and enhancing liquidity also appear to be important issues for the future success of those new junior stock exchanges.

These findings are consistent with the expectations of Black and Gilson (1998) and others: simply relaxing stock exchange listing requirements is not sufficient if venture capital is to be facilitated.

From venture capitalists' point of view, it also seems essential to ensure that listing requirements for MOTHERS and NASDAQ Japan be sufficient to ensure that dubious companies are not listed and that investors will be attracted in sufficient numbers to provide liquidity. Venture capitalists must perceive that the new stock exchanges will lead to bona fide and liquid exit opportunities. Venture capitalists will not invest in emerging firms unless they can realistically expect that they will be able to exit without having to pay liquidity and risk premia.

To this end, we suggest the following remedy. Where it is difficult to provide SMEs easier/quicker access to capital while also increasing the firm's credibility, it might be possible to segment stock exchanges into two groups according to SME principals' needs: one group for SMEs in need of immediate financing, while the other would focus

on “status/image” of stock exchanges and quality of listed companies, for SMEs seeking additional capital but not at the cost of credibility.

In order to establish a junior exchange granting easier/quicker access to capital, it may be useful to examine practices in other jurisdictions. CDNX provides a tier of temporary listings (“Capital Pool Companies”, CPCs) for emerging firms that are seeking to raise an initial round of financing. CDNX CPCs that meet, in a timely way, certain performance milestones, are converted from temporary to permanent listings. The temporary listings of those CPCs that fail to meet the designated milestones expire. Actually several interview respondents made a suggestion that reminded us of CDNX: “there should be at least one stock exchange where any start-up can list without condition, and if, after a certain time period, a listed company cannot satisfy the requirements, it will be delisted.” Obviously there seems to be a demand for a mechanism similar to CDNX’s CPC tier. Moreover, while CDNX’s requirements (in the case of an IPO) are not as relaxed as these Japanese new junior stock exchanges’ (see page 6: the comparison of listing requirements among junior stock exchanges), its system is nevertheless more flexible, offering more choices to applicant companies. CDNX will be a good reference for Japanese junior stock exchanges when they consider improvements.

3. Limitations and Further Areas of Study

The results of the survey might be positively biased (that is, the survey's average of Japanese SMEs interested in equity capital and willing to go public, may be higher than the actual average), as the respondents are more likely to be a priori interested in equity capital, or with a high potential of success. Thus, while this study found 30% of SMEs willing to go public, the actual percentage is arguably smaller than this figure.

Japan is very different from North America: categories used to describe the Western world (on whatever level, social, cultural, economic, individual or collective) often fit only loosely to the Japanese reality and vice versa. Structures and the elements of these structures (like languages) do not correspond or coincide. Even very simple words like company, stock, employer, employee, owner, CEO, might not have their exact equivalent in the Japanese context or might refer to different realities and experiences. As we have noted (page 4), buying stock does not mean the same thing for the Japanese investor and his Western counterparts. The simple, fairly clear cut, categories of owner and CEO in the West, have no exact equivalent in Japan, where one uses the word "shacho", that can be either or both together. In translating from English into Japanese and back (for questionnaire and interview), there is inevitably a loss of nuances and accuracy in terms of describing Japanese SME principals' perceptions on and attitude towards equity capital. It is difficult to evaluate this "cultural bias".

Further study may include investigating the relative importance of SME principals' needs. In our study, many principals cited both financing and increasing the credibility of their firm as reasons for considering an IPO, but the relative importance of

these two reasons was not taken into consideration. It would shed additional light on SME principals' attitudes/perceptions to measure this relativity factor

It would also be interesting to investigate how much social/cultural factors influence Japanese SME principal's attitudes/perceptions. For example, we would like to examine, as a further study, whether this recurrent firm's credibility notion is idiosyncratic for Japan, or Asia, or just a universal phenomenon. The comparison of SME principals' attitude towards and perception of equity capital across countries (both Asian and Western countries) might give us additional insights on early stage financing and the differences between East and West in matters of corporate governance.

This study focuses on the Japanese SMEs' views on equity capital and on the venture capital market. These attitudes, perceptions, prejudices, etc., facilitate or thwart the development of a market. However, as a review of the literature revealed, and as several SMEs indicated, there are many more factors that potentially or actually prevent the development of an active capital market in Japan. These include government (taxation) policies, lack of investors' understanding of high-risk high-return investment, social/cultural reasons, role of security companies and venture capitals, etc. To investigate those factors would be interesting and important. For example, 30% of our respondents questioned the stock exchanges' and security companies' competency for the evaluation of venture businesses, which implies a lack of trust on the part of applicant (potential applicant) companies. It would be interesting to investigate how evaluation processes are different in North America and Japan, and whether there is a possibility for Japanese stock exchanges and security companies to improve their relationship with applicant companies. Differences in the role of venture capitals in North America and

Japan would also be worthwhile investigating. However, all this is beyond the scope of this study. We would like to leave it as potential areas of further study.

Further studies should also include investigating the issue of liquidity of junior exchanges, as well as their role in enhancing the availability of IPOs. MOTHERS, NASDAQ Japan, and other regional junior stock exchanges are very recent developments and it is premature to judge whether these initiatives have already increased the availability of IPOs, whether they provide liquidity, and whether they have mobilized Japanese venture capital investment. There is already a need of more research, with larger sample sizes.

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Appendix A: The Questionnaire (English Translation)

A Request for the Survey

Dear Sir/Madame:

The School of Business at Carleton University, Ottawa, Canada is conducting a study of venture capital in North America and Japan. As part of the project, I am undertaking the research relating to Japan. I am writing to ask for your assistance.

The study will explore:

- Japanese SME owners' attitudes towards equity capital;
- Their perception of the stock exchanges for venture businesses recently opened (or updated and renovated) in Japan (such as Mothers, reformed JASDAQ, NASDAQ Japan, etc.).

The purposes of this study are:

1. Obtain the Japanese SME owners' actual demands for equity capital
2. Make it easier for the SME owners to raise capital by making several suggestions considering the SME Owners' actual demands
3. By doing so, contribute to the further development of the SMEs which is essential for the revitalization of the Japanese economy

The following organizations are supportive of this study and are interested in the aggregated findings. Under no circumstances, however, will any information specific to your firm, be revealed to these or any other parties.

- **The National Small Business Information Promotion Center**
- **New High-tech Venture Business Foundation**
- **Fukuoka Stock Exchange**

This research is now surveying owners of small and medium-sized enterprises from across the country to grasp accurately their perceptions and attitudes to use of equity capital. Thus, by means of this brief letter I would like to ask you to fill out the attached questionnaire.

I knew your name and fax number though the list of companies provided by Shoko Research Inc.

The questionnaire should take no more than 10 minutes of your time.

Your answers will be kept **absolutely confidential** and strictly used for this research. No information related to individual companies but only aggregated data will be revealed.

If you require additional information, please call Miwako Nitani at 045-832-4355.

The summary of findings of this study will be sent to the persons who co-operate the interview once it is completed.

The cooperation of the Japanese SME owners is essential for the success of this research study. The Carleton University School of Business, and I, would deeply appreciate if you could answer the questionnaire.

We thank you in advance for your co-operation,

Sincerely,

Miwako Nitani

School of Business
Carleton University

The Carleton University School of Business is responsible for all the interviews; the co-operator does not have any responsibility for it.

A Survey on the Japanese SMEs' perception and Attitude toward Equity Capital

The questionnaire should be filled out by the person most responsible for managing the day-to-day operation of the business (owner or CEO of the business).

In the event that you find one or more of these questions to be sensitive, please feel free to skip these questions and proceed to others.

Please fill out the following questionnaire and send it back to Miwako Nitani by fax.

Please note that the cut off date is 31st of August.

I. General profile of the enterprise

1. What kind of industry does your firm involve? (Mark one only)

A. Manufacture

1. Food 2. Textile/fiber 3. Lumber/Paper 4. Chemical/medical supplies

5. Grass/ceramics 6. Steel/metal 7. Machinery 8. Electricity/electronics

9. Machinery for transportation 10. Precision machine 11. Publisher/printing

12. Other manufacture: please specify _____

B. Housing/Construction

C. Service

1. Information Service 2. Software 3. Retail and wholesaler 4. Food and drink

4. Other service: please specify _____

D. Other industry: please specify _____

2. The last fiscal year's net income _____yen

**3. What do you forecast for your firm's annual sales revenue 3 years from now (2003)?
_____ %**

4. How many chief officers are there in the business? _____

5. What aggregated percentage of the business is held by the management? _____ %

6. If there is, who are the principal owners of the business besides the chief officers?
(A principal owner is defined as a person/organization who has more than 10% of the ownership of the business)
- The parent company of the business
 - Business Partner
 - Venture Capital
 - Other: please specify: _____
7. Is/Are there (a) financial manager(s) in your business? A. yes B. no
- 7-1 If yes, who is s/he?
- The principal(s)
 - An employee
 - An outside accounting firm
 - Other: please specify _____

II. General profile of the owner(s)

Please specify about you:

- Gender: A. male B. female
- Age: A. less than 25 years old B. 25~less than 35 years old
C. 35~less than 45 years old D. 45~less than 55 years old
E. 55~less than 65 years old F. more than or equal to 65 years old
- Final degree: A. High School B. Technical College C. University
D. Post Graduate E. Other (please specify) _____
- Number of different companies you experienced before starting your current business (excluding "keiretsu" and parent/subsidiary companies or case of being on lease):

- Number of different occupations you experienced (besides a business manager) before starting your current business (e.g., doctor, editor, teacher, etc.): _____
- Number of years of experience you have as a business manager before starting your current business _____ years
- Number of years of experience you have in the industry to which your current business belong before starting your current management job: _____ years

III. Your Perception on Equity Capital

1. Do you have growth intention for your company?

- a. Yes, we seek growth for our firm b. No, I am satisfied the present situation

If your answer is **a**, please proceed to the following questions

If your answer is **b**, this is the end of this questionnaire; thank you very much

2. Does your firm have a willingness to go public?

- a. We are preparing to go public (we want to go public within 1~2 years) → go to question 3, 4, 5 and 7
 b. We want to go public within 3~5 years → go to the question 3, 4, 5 and 7
 c. We are waiting for an opportunity → go to the question 3, 4, 5 and 7
 d. We do not want to go public → go to the question 6 and 7
 e. We do not know why?

 →go to the question 7

f. Other: please specify

 →go to the question 7

3. On which exchange do you want to list your share (please circle as many as apply)?

- a. Mothers b. JASDAQ tier 1 c. JASDAQ tier 2 d. NASDAQ Japan
 e. Fukusho Q Board f. Osaka Second tier
 e. Other: please specify _____

4. What is/are the reason why you would like to go public (please circle as many as apply)?

- a. A capital increase
 b. Increase credibility
 c. Make the company known
 d. Availability of issuing stock options
 e. Other: please specify:

5. How much amount of capital you would like to increase at the time of IPO?

_____ million yen

6. What is/are the reason(s) why you do not want to go public (please circle as many as apply)?
- a. We do not want to lose the control of our firm
 - b. We are quite satisfied by the current capital structure of our firm
 - c. The cost to go public is too expensive
 - d. The procedure of going public is too complicate
 - e. The obligation of going public is too heavy
 - f. Other: please specify _____

To which address should we send the results of this study?

The Company' Name: _____

Your Name: _____

Address: _____

This is the end of the questionnaire: Thank you very much for your time

Appendix B: The Letter for a Request for Interview (English Translation)

A Request for Telephone Interview

Dear Sir/Madame:

The School of Business at Carleton University, Ottawa, Canada is conducting a study of venture capital in North America and Japan. As part of the project, I am undertaking the research relating to Japan. I am writing to ask for your assistance.

The study will explore:

- Japanese SME owners' attitudes towards equity capital;
- Their perception of the stock exchanges for venture businesses recently opened (or updated and renovated) in Japan (such as Mothers, reformed JASDAQ, NASDAQ Japan, etc.).

The purposes of this study are:

1. Obtain the Japanese SME owners' actual demands for equity capital
2. Make it easier for the SME owners to raise capital by making several suggestions considering the SME Owners' actual demands
3. By doing so, contribute to the further development of the SMEs which is essential for the revitalization of the Japanese economy.

The following organizations are supportive of this study and are interested in the aggregated findings. Under no circumstances, however, will any information specific to your firm be revealed to these or any other parties.

- **The National Small Business Information Promotion Center**
- **New High-tech Venture Development Foundation**
- **Fukuoka Stock Exchange**

This study is now surveying owners of small and medium-sized enterprises from across the country to grasp accurately their perceptions and attitudes to use of equity capital.

Thus, by means of this brief letter I would like to ask you to accept an interview.

I knew your name and fax number though "Nikkei Annual Corporation Reports of Venture Business" published by Nikkei Newspaper Inc.

The interview will ask about the following issues and take approximately **15 minutes**.

1. The reason why you would (not) like to go public,
2. The benefit and shortcomings of going public
3. The difficulty you encountered in preparation to go public
4. The listing requirements of the Japanese junior stock exchanges
5. The evaluation process
6. The current state on the Japanese junior stock exchanges
7. Your preference of stock exchange(s) to list and the reason
8. The reason why the Japanese venture capital market is underdeveloped

We do not believe that any of our questions involve sensitive material, nonetheless your answers will be kept **absolutely confidential** and strictly used for this research. No information related to individual companies but only aggregated data will be revealed.

The summary of findings of this study will be sent to the persons who co-operate the interview once it is completed.

Participation in this voluntary survey is important to the accuracy of the survey results. If you could accept it, please fill out the attached "Answering Sheet" to give us your preferred date and time for an interview, and send it back to us by fax **before 31st of August**. The interview should be answered by the person most responsible for **managing the day-to-day operation of the business (owner or CEO)**. If you require additional information, please call Miwako Nitani.

The Carleton University School of Business, and I, would deeply appreciate if you could accept this interview and give your opinion on the infusion of equity capital.

We thank you in advance for your co-operation.

Sincerely,

Miwako Nitani

School of Business
Carleton University

Carleton University School of Business alone takes entire responsibility for the survey and its conclusions.

Appendix C: Model of Telephone Interview (English Translation)

(for firms going public)

Hello, this is Miwako Nitani at Carleton University, Canada. Could I speak to Mr. ?
This is Miwako Nitani at Carleton University, Canada, who has sent a fax to request a telephone interview. Thank you very much for accepting our interview, we appreciate your cooperation to our research.

1. First, we ask you about the reason why you would like to go public. We knew that you have a plan to go public within 3~5 years (within 1~2 years, when the time is opportune) in "Nikkei Venture Business Directory). How will your firm be benefited by going public?
2. On the other hand, what are the disadvantages of going public for your firm?
3. Which part(s) of the IPO process is/are difficult for you?
4. Do you think the listing requirements of Japanese junior stock exchanges are still too strict? If so, which part(s) of the requirement is difficult to satisfy?
5. What do you think of the evaluation procedures?
6. Please tell us about your opinion on the current state of the Japanese junior stock exchanges. Do you have any suggestions for these stock exchanges that may make their system better?
7. Which exchange your firm would like to list?

Why does your firm choose these exchanges?
8. Why, do you think, is the Japanese venture capital market underdeveloped?
9. Finally, if you do not mind, we would like to ask about your firm and your background.
 - 9-1. How old are you, and what is your final degree?
 - 9-2. How many different companies have you experienced before starting this business?
 - 9-3. How many different occupations have you experienced before starting this business?
 - 9-4. How many years of experience do you have as a business manager before starting this business?

9-5. How many years of experience do you have in this industry before starting this business?

9-6. Is/Are there (a) financial manager(s) in your firm? If yes, who is s/he?

9-7. What do your forecast for your firm's annual sales revenue 3 years from now?

Thank you very much. This is the end of this interview.

Your answers will be kept **absolutely confidential** and strictly used for this research. No information related to individual companies but only aggregated data will be revealed.

The results of this study will be sent to you once it is completed, probably around the end of this year.

We appreciate your cooperation, thank you very much for your time.

(for firms not going public)

Hello, this is Miwako Nitani at Carleton University, Canada. Could I speak to Mr. ?
This is Miwako Nitani at Carleton University, Canada, who has sent a fax to request a telephone interview. Thank you very much for accepting our interview, we appreciate your cooperation to our research.

1. We knew that you do not have a plan to go public. Why you would not like to go public?
2. Please tell us about your opinion on the Japanese venture capital market. Why, do you think, is it underdeveloped?
3. Finally, if you do not mind, we would like to ask about your firm and your background.

3-1. How old are you, and what is your final degree?

3-2. How many different companies have you experienced before starting this business?

3-3. How many different occupations have you experienced before starting this business?

3-4. How many years of experience do you have as a business manager before starting this business?

3-5. How many years of experience do you have in this industry before starting this business?

3-6. Is/Are there (a) financial manager(s) in your firm? If yes, who is s/he?

3-7. What do your forecast for your firm's annual sales revenue 3 years from now?

Thank you very much. This is the end of this interview.

Your answers will be kept **absolutely confidential** and strictly used for this research. No information related to individual companies but only aggregated data will be revealed. The results of this study will be sent to you once it is completed, probably around the end of this year.

We appreciate your cooperation, thank you very much for your time.

Appendix D: The Letter for a Request for Co-operation (English Translation)**Study on Venture Capital in North America and Japan
Request for Co-operation**

The School of Business at Carleton University, Ottawa, Canada is conducting a study of venture capital in North America and Japan. As part of the project, I am undertaking the research relating to Japan. I am writing to ask for your assistance. The study will explore:

- Japanese SME owners' attitudes towards equity capital;
- Their perception of the Japanese junior stock exchanges (such as MOTHERS, JASDAQ, NASDAQ Japan, etc.).

In order to grasp accurately Japanese SME owners' perceptions and attitudes, we will proceed by way of telephone and mail survey. The success of this study heavily depends on the accuracy of the survey results. Thus, by means of this brief letter I would like to ask your co-operation for the survey. More specifically, I am seeking permission to state that the study is supported by your organization. By doing so, the work will benefit from additional credibility and consequently an increased response rate.

Please see the attached questionnaire and covering letter for our interview request that will be sent to the Japanese SME owners. If you require additional information, please contact Miwako Nitani at one of the following addresses.

In return for your assistance, we will be pleased to send you the final report.

We would deeply appreciate if you could consider and accept our request.

We thank you in advance for your co-operation.

Sincerely,

Miwako Nitani
School of Business
Carleton University

Appendix E: Profiles of SMEs and Their Principals: Questionnaire and Interview Samples

I. Firm Size

Table E-1: Number of Employees

	Questionnaire Sample (total 88)					Interview Sample (total 62)				
# of Employees	1<4	5<9	10<49	50<99	>100	1<4	5<9	10<49	50<99	>100
# of Firms	21	28	34	2	3	7	15	23	2	15
%	23.9	31.8	38.6	2.3	3.4	11.3	24.2	37.1	3.2	24.2
Cumulative %	23.9	55.7	94.3	96.6	100.0	11.3	35.5	72.6	75.8	100.0

Questionnaire Sample: Mean = 16.56; 5% Trimmed Mean = 12.45; Median = 8.00; SD¹ = 24.46
Interview Sample: Mean = 55.37; 5% Trimmed Mean = 44.44; Median = 15.5; SD = 83.22

¹ Standard Deviation

Table E-2: Capitalization (million yen)

	Questionnaire Sample (total 88)					Interview Sample (total 61)				
Capitalization	3.0	10.0	20.0	100.0	>500.0	3.0	10.0	20.0	100.0	>500.0
	<9.9	<19.9	<99.9	<499.9		<9.9	<19.9	<99.9	<499.9	
# of Firms	25	35	22	4	2	4	9	23	19	6
%	28.4	39.8	25	4.5	2.3	6.6	14.8	37.7	31.1	9.8
Cum %	28.4	68.2	93.2	97.7	100.0	6.6	21.3	59.0	90.2	100.0

Questionnaire Sample: Mean = 152.28; 5% of Trimmed Mean = 19.60; Median = 10.00; SD = 978.89

Interview Sample: Mean = 213.55; 5% of Trimmed Mean = 127.71; Median = 56.50; SD = 510.85

Capitalization

Table E-3: Sales (million yen)

Questionnaire Sample (total 88)							
Sales	<99.9	100.0	200.0	500.0	1,000.0	2,000.0	>5,000.0
	<199.9	<499.9	<999.9	<1,999.9	<4,999.9		
# of Firms	33	18	15	13	3	3	3
%	37.5	20.5	17.0	14.8	3.4	3.4	3.4
Cum %	37.5	58.0	75.0	89.8	93.2	96.6	100.0

Questionnaire Sample: Mean = 656.00; 5% Trimmed Mean = 344.00; Median = 150.25; SD = 1,675.73

Interview Sample (total 61)							
Sales	<99.9	100.0	200.0	500.0	1,000.0	2,000.0	>5,000.0
	<199.9	<499.9	<999.9	<1,999.9	<4,999.9		
# of Firms	15	4	20	5	6	6	5
%	24.6	6.6	32.8	8.20	9.8	9.8	8.20
Cum %	24.6	31.1	63.9	72.1	82.0	91.8	100.0

Interview Sample: Mean = 1,318.99; 5% Trimmed Mean = 935.56; Median = 322.90; SD = 2,394.24

Table E-4: Net Income (million yen)

	Questionnaire Sample (total 60)					Interview Sample (total 61)					
Net Income	<0	0	10.0	30.0	50.0	<0	0	10.0	30.0	50.0	>100.0
		<9.9	<29.9	<49.9	<70.0		<9.9	<29.9	<49.9	<99.9	
# of Firms	10	35	10	3	2	19	18	12	3	4	5
%	16.7	58.3	16.7	5.0	3.3	31.1	29.5	19.7	4.9	6.6	8.2
Cum %	16.7	75.0	91.7	96.7	100.0	31.1	60.7	80.3	85.2	91.8	100.0

Questionnaire Sample: Mean = -10.72; 5% Trimmed Mean = 5.66; Median = 2.70; SD = 131.13

Interview Sample: Mean = -44.53; 5% Trimmed Mean = 15.53; Median = 4.32; SD = 552.53²

² Eight firms did not specify the number of net income, reporting just “negative”. The mean, median and 5% trimmed mean are calculated by assuming these companies’ loss as 1 million yen. When mean, median, and 5% trimmed mean are calculated excluding these firms, the figures are -51.10, 19.20, and 5.00 respectively.

2. Firm Characteristics

Table E-5: Establishment

	Questionnaire Sample (total 88)				Interview Sample (total 62)									
Year	Before 1994	1994	1998	After 1998	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
# of firms	8	35	44	1	7	3	5	6	8	9	6	10	3	5
%	9.1	39.8	50.0	1.1	11.3	4.8	8.1	9.7	12.9	14.5	9.7	16.1	4.8	8.1

Table E-6: Sector

	Questionnaire Sample (total 82)			Interview Sample (total 62)		
Sector	Manu- facturing	Service	Housing & Constructions	Manu- facturing	Service	Housing & Constructions
# of firms	30	42	10	27	33	2
%	36.6	51.2	12.2	43.5	53.2	3.2

* Manufacturing includes food, textiles & fibers, lumber & paper, chemical & medical supplies, steel & metal, machinery, electricity & electronics, transportation machinery, precision machines, publishing & printing, and others. Service includes information, software, retail & wholesale, food & beverage, and other services.

Table E-7: Number of Officers

	Questionnaire Sample (total 85)						Interview Sample (total 62)					
# of Officers	1	2	3	4	5	>6	1	2	3	4	5	>6
# of Firms	17	29	26	4	4	5	3	5	26	12	5	11
%	20.0	34.1	30.6	4.7	4.7	5.9	4.8	8.1	41.9	19.4	8.1	17.7
Cum %	20.0	54.1	84.7	89.4	94.1	100.0	4.8	12.9	54.8	74.2	82.3	100.0

Questionnaire Sample: Mean = 2.74; Median = 2; SD = 1.87

Interview Sample: Mean = 3.91; Median = 3.00; SD = 1.90

Table E-8: Percentage of Management Ownership

	Questionnaire Sample (total 83)			Interview sample (total 60)		
% of Management Ownership	0<50	51<79	80<100 (100)	0<50	51<79	80<100 (100)
# of Firms	24	8	51 (37)	18	17	25 (13)
%	28.9	9.6	61.4 (44.6)	30.0	28.3	41.7 (21.7)
Cum %	28.9	38.6	100.0	30.0	58.3	100.0

Questionnaire sample: Mean = 67.00; Median = 90.00; SD = 40.88

Interview Sample : Mean = 64.21; Median = 69.50; SD = 31.29

Table E-9: Owners

	Questionnaire Sample (total 39)				Interview sample (total 48)			
Owners	Parent Company	Other Company	VC	Others	Parent Company	Other Company	VC	Others
# of Firms	20	5	2	12	5	22	24	7
%	51.3	12.8	5.1	30.8	10.4	45.8	50.0	14.6

* More than one response is allowed, firms 100% owned by management are excluded

* "Other Company" includes owner's ex-company and business partner.

Table E-10: Financial Managers

	Questionnaire Sample (total 85)		Interview sample (total 62)	
With/ Without Financial Manager	With	Without	With	Without
# of Firms	28	57	51	11
%	32.9	67.1	82.3	17.7

Table E-11: Profile of Financial Manager

	Questionnaire Sample (total 28)			Interview sample (total 51)		
Financial Manager	Owner	Employee	Outside accounting firm	Owner	Employee	Outside accounting firm
# of Firms	20	4	4	31	17	4
%	71.4	14.3	14.3	59.62	32.69	7.69

* More than one response is allowed, firms 100% owned by management are excluded

Table E-12: Expected Growth Rate (percentage)

	Questionnaire Sample (total 78)					Interview Sample (total 52)				
Growth Rate	<0	0	10.0	50.0	>100.0	<0	0	10.0	50.0	>100.0
# of Firms	9	12	30	15	12	2	0	16	21	13
%	11.5	15.4	38.5	19.2	15.4	3.8	0	30.8	40.4	25.0
Cum %	11.5	26.9	65.4	84.6	100.0	3.8	3.8	34.6	75.0	100.0

Questionnaire Sample: Mean = 66.84; 5% Trimmed Mean = 43.47; Median = 34.90; SD = 165.94

Interview Sample: Mean = 78.96; 5% Trimmed Mean = 71.90; Median = 61.50; SD = 69.01

3. Profiles of Owners/CEOs

Table E-13: Gender

	Questionnaire Sample (total 88)		Interview sample (total 62)	
Gender	Male	Female	Male	Female
# of Firms	86	2	60	2
%	97.7	2.3	96.8	3.2

Table E-14: Age

	Questionnaire Sample (total 88)					Interview sample (total 62)				
Age	25<34	35<44	45<54	55<64	>65	25<34	35<44	45<54	55<64	>65
# of Firms	2	15	38	27	6	6	12	20	19	5
%	2.3	17.0	43.2	30.7	6.8	9.7	19.4	32.3	30.7	8.1
Cum %	2.3	19.7	62.5	93.2	100.0	9.7	29.0	61.3	91.9	100.0

Questionnaire sample: Mean = 51.8; Median = 49.5; SD = 83.46

Interview Sample: Mean = 49.8; Median = 49.5; SD = 10.84

Table E-15: Degree

	Questionnaire Sample (total 86)				Interview sample (total 60)			
Degree	High School	Technical Collage	Uni- versity	Post Graduate	High School	Technical Collage	Uni- versity	Post Graduate
# of Firms	18	6	58	4	15	3	40	2
%	20.9	7.0	67.4	4.7	25.0	5.0	66.7	3.3
Cum %	20.9	27.9	95.3	100.0	25.0	30.0	96.7	100.0

Table E-16: Number of Company the Owner/CEO Experienced (excluding the current company)

	Questionnaire Sample (total 83)					Interview Sample (total 61)				
# of Company	0	1	2	3<5	>6	0	1	2	3<5	>6
# of Firms	12	22	24	23	2	2	15	27	11	6
%	14.5	26.5	28.9	27.7	2.4	3.3	24.6	44.3	18.0	9.8
Cum %	14.5	41.0	69.9	97.6	100.0	3.3	27.9	72.2	90.2	100.0

Questionnaire Sample: Mean = 2.0; Median = 2.0; SD = 1.53

Interview Sample: Mean = 2.4; Median = 2.0; SD = 1.75

Table E-17: Number of Occupation the Owner/CEO Experienced (excluding the current occupation)

	Questionnaire Sample (total 74)					Interview Sample (total 61)				
# of Occupation	0	1	2	3<5	>6	0	1	2	3<5	>6
# of Firms	12	20	21	18	3	2	26	18	10	5
%	16.2	27.0	28.4	24.3	4.1	3.3	42.6	31.2	16.4	8.2
Cum %	16.2	43.2	71.6	95.9	100.0	3.3	45.9	75.4	91.8	100.0

Questionnaire Sample: Mean = 2.0; Median = 2.0; SD = 1.69

Interview Sample: Mean = 2.1; Median = 2.0; SD = 1.72

Table E-18: Number of Years of the Owner's /CEO's Experience in Management (before the current company)

	Questionnaire Sample (total 77)					Interview Sample (total 61)				
# of Years in Management	0	1<2	3<4	5<9	>10	0	1<2	3<4	5<9	>10
# of Firms	17	4	4	16	36	21	5	11	8	16
%	22.1	5.2	5.2	20.8	46.8	34.4	8.2	18.0	13.1	26.2
Cum %	22.1	27.3	32.5	53.2	100.0	34.4	42.6	60.6	73.7	100.0

Questionnaire Sample: Mean = 8.9; Median = 8.00; SD = 7.97

Interview Sample: Mean = 6.3; Median = 3.0; SD = 8.13

Table E-19: Number of Years of the Owner's /CEO's Experience in Industry to which his/her current firm belongs (before the current company)

	Questionnaire Sample (total 81)					Interview Sample (total 61)				
# of Years in Industry	0	1<2	3<4	5<9	>10	0	1<2	3<4	5<9	>10
# of Firms	16	5	2	13	45	17	2	5	5	32
%	19.8	6.2	2.5	16.0	55.6	27.9	3.3	8.2	8.2	52.5
Cum %	19.8	25.9	28.4	44.4	100.0	27.9	31.2	39.3	47.5	100.0

Questionnaire Sample: Mean = 14.1; Median = 10.00; SD = 12.60

Interview Sample: Mean = 12.9; Median = 10.0; SD = 13.43