PitchBook

2023

JAPAN

Private Capital Breakdown

Contents

Note: We have launched a pre-seed report methodology to more accurately and comprehensively capture deals from the earliest phase of venture. Going forward we will sunset "angel" as a specified stage of venture in all of PitchBook's venture-focused reports.

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Click here for PitchBook's report methodologies.

Overview

In Japan, private equity remains a market in search of growth. Succession planning is one of the common use cases for PE within the country. As Japan fights against its aging workforce, many founder-owners are now looking to private equity to develop a continuation of their business as they look toward retirement. This feature of Japanese PE keeps many deals within the lower middle market and middle market in terms of deal sizes, with few large deals to entice large foreign institutions.

The take-private buyout of Toshiba completed in 2023 is one of the largest private equity deals on record in Japan. At nearly $15 billion, the deal has accounted for roughly 65% of private equity deal value during the year. The next-largest deal through Q3 was just $300 million.

The venture capital market in Japan has consistently grown during the past couple of years and stands to benefit from several tailwinds. These include steady government support, a strong innovation culture, the presence of industry-leading, multinational corporations, as well as increased interest from foreign investors seeking to de-risk and reduce their China exposure in light of elevated US-China tensions and a series of ongoing socioeconomic challenges with China.

Non-VC investors play a prominent role in the Japanese venture ecosystem. In addition to government-affiliated investment vehicles putting large swaths of capital to work in the private market, corporations and financial institutions including banks and insurance companies actively participate in the regional VC market. With ample cash reserves, these players can support startups from nascency through exit. In contrast, traditional VC funds in Japan tend to focus on earlier stages of the venture lifecycle due to fund size constraints.

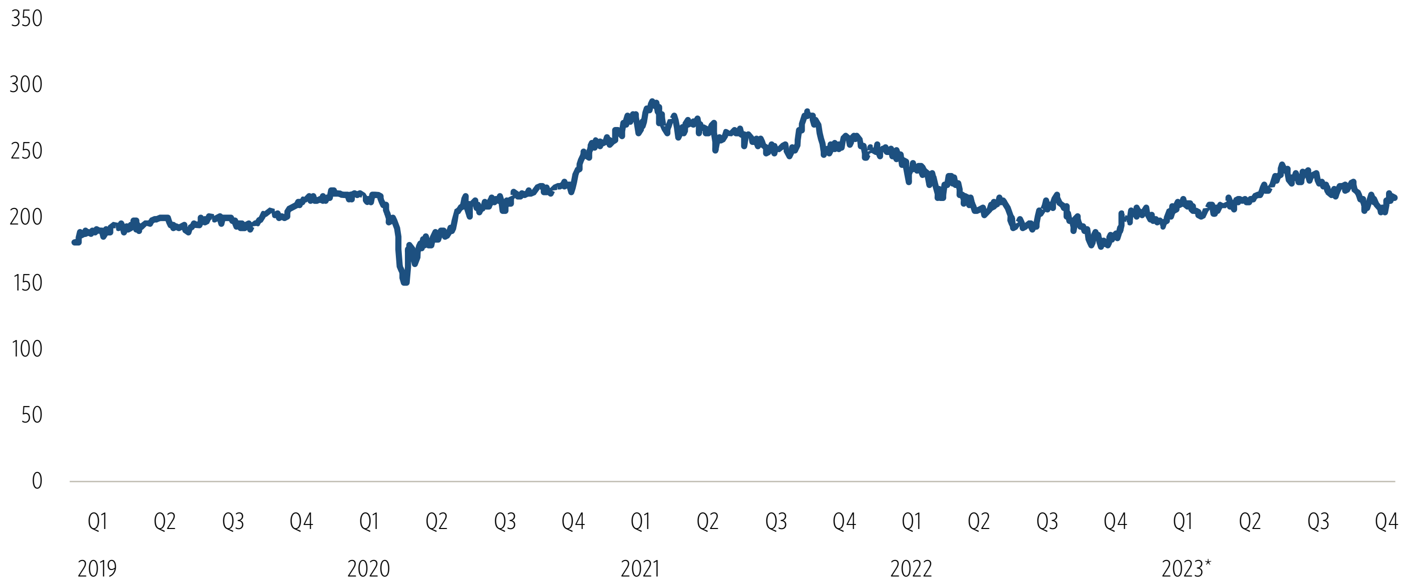
Going public on the Tokyo Stock Exchange has been the mainstream exit channel for Japanese startups. There have been many IPOs in Japan in recent years, albeit with relatively small value. The regional M&A market has been lackluster due to several factors, including Japanese corporations historically being unacquisitive, budgetary and human resources concerns, and the preference of Japanese companies to develop their technology in-house versus applying externally developed technology onto existing frameworks.

The weakening of the yen may provide a boost to private capital fundraising. As the market has grown, foreign investor purchase power has increased in recent years. Global PE managers that previously had exposure to Japan through pan-Asian funds and that are hoping to transact on attractive companies in an inexpensive debt environment may look to raise Japan-specific funds. There is a sense that LPs looking to reallocate funds away from China may also look toward the stability of Japan's markets in a positive light.

A unique feature of the venture ecosystem in Japan is the makeup of the largest and most important LP players. These include government-affiliated investment entities, banks, and corporations. Since around 2017, the VC landscape in Japan has become more competitive, calling for greater GP differentiation. For Japanese GPs hoping to more meaningfully secure foreign LP commitments, the regional market must demonstrate stronger financial return prospects.

Japan market update

Nikkei 225 Average PR USD index



Source: Morningstar • **Geography:** Japan
*As of November 9, 2023

For the past 30 years, Japan's economy has struggled to generate consistent growth. At current prices of around $4.4 trillion, the country's gross domestic product (GDP) is lower than it was three decades ago. However, Japan still boasts the third-largest economy in the world despite showing an annual economic growth rate above 2.0% only during two years since 2000. The 2023 real GDP growth is projected at 1.3%.

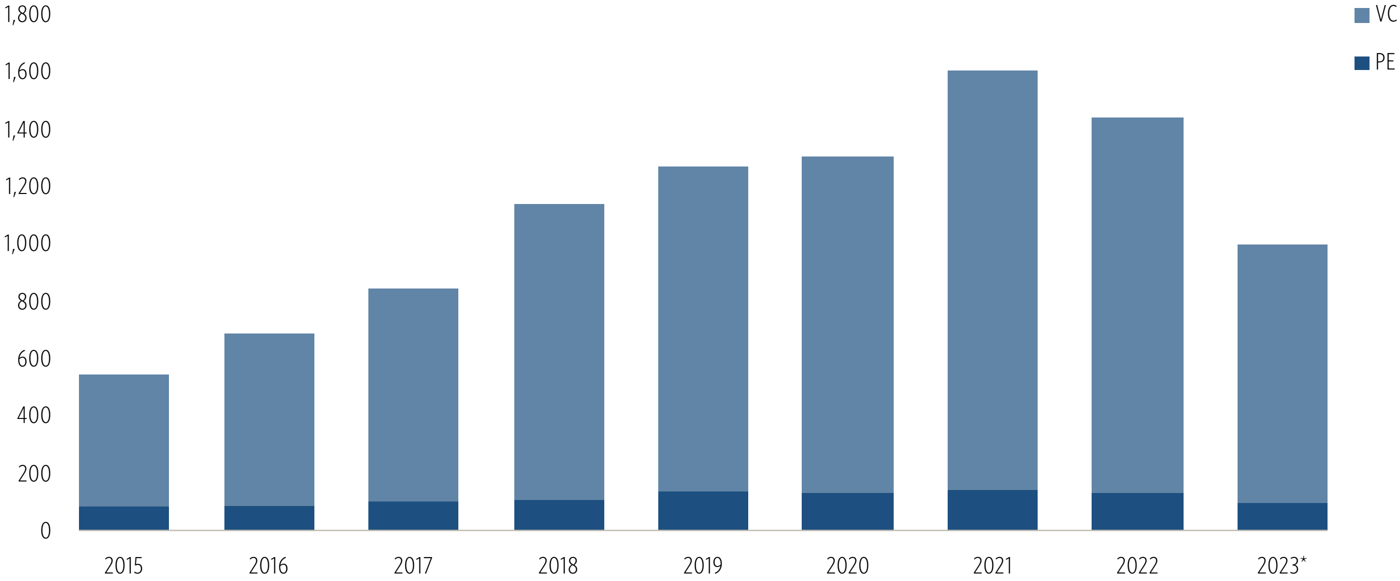
Herein lies the puzzle for PE and VC. Japan is a country at the forefront of technology. It is a central piece of the global supply chain, with major corporate brands used around the world. Yet alongside everything that makes Japan core to the global economy is that stagnant economic growth and a private market that remains much smaller than would be expected. Private equity and venture capital have combined to generate just $130 billion of invested capital in Japan over the past five years. Contrasted with similar economies, Japan's private market sits well below expectations. The country's uniqueness from its counterparts creates challenges to private market growth, as well as distinct opportunities, as the market turns from traditional practices to new-age dynamics.

The rapid aging of the country is set to dramatically shift its future economy. While not a challenge of recent origin, this problem is coming to a head, with many founder-owners and CEOs looking for succession plans. An aging population also puts pressure on continued economic growth through efficiency. Costs associated with aging have aggravated and will continue increasing, despite the Japanese labor force stagnating in recent years. Labor force turnover may be a point for Japan to restart economic growth. An aging corporate growth model has left big corporations with large cash piles and stunted growth. The Japan Exchange Group (JPX), which operates the Tokyo and Osaka stock exchanges, has begun implementation of a policy to pressure companies into growth, listing companies that do not meet the JPX's guidelines for increasing corporate value.

Estimated at $2.3 trillion, Japanese corporations hold enormous amounts of cash on hand.[1] At its core, this figure highlights a difference between the Japanese market and other capitalist economies: Whereas other markets tend to invest such capital back into the company—for example, into M&A or share buybacks—Japanese corporations have been shaped by regulations and tradition, wherein

1: "Basic Figures: Flow of Funds for the Second Quarter of 2023 (Preliminary Report)," Bank of Japan, Research and Statistics Department, September 20, 2023.

Private capital deal count by asset class



Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

large amounts of capital are rarely deployed to organic or inorganic business expansion. Japanese corporations have benefited from corporate tax cuts meant to further investment and, eventually, GDP growth. With the large cash holdings, corporations are an integral piece of the private market, but their participation barely dents their cash on hand, as incentives for using cash for growth in a meaningful way have been lacking.

A major challenge that the country's economy faces is an overload of government debt. Japan's government-debt-to-GDP ratio has surpassed 260%;[2] the United States, as an example, holds a debt-to-GDP ratio of around 130%. Japanese government interest rates have held steady at -0.1% for more than a decade, thereby keeping borrowing costs low, yet that has not translated into economic growth. Minor increases may be on the way; however, large factors caused by the loose monetary policies of the past decade are likely to keep any increase to a minor bump. Japanese banks are intertwined with the Japan private markets—not solely because they are the largest lenders for PE, but also because they have adapted a venture-forward strategy by making direct investments into venture deals and by providing capital as LPs. Negative rates and overall rate caps on loans have driven banks to to seek diversified sources of revenue through nontraditional lending practices and investment activity.

GDP growth of G7 economies*

Country	2022	2023	2024
France	2.6%	0.7%	1.3%
Germany	1.8%	-0.1%	1.1%
UK	4.0%	-0.3%	1.0%
Italy	3.7%	0.7%	0.8%
US	2.1%	1.6%	1.1%
Japan	1.1%	1.3%	1.0%
Canada	3.4%	1.5%	1.5%
G7 average	**2.2%**	**1.5%**	**1.2%**

Source: International Monetary Fund • **Geography:** Global
*As of April 2023

2: "Japan General Government Gross Debt to GDP," Trading Economics, n.d., accessed November 5, 2023.

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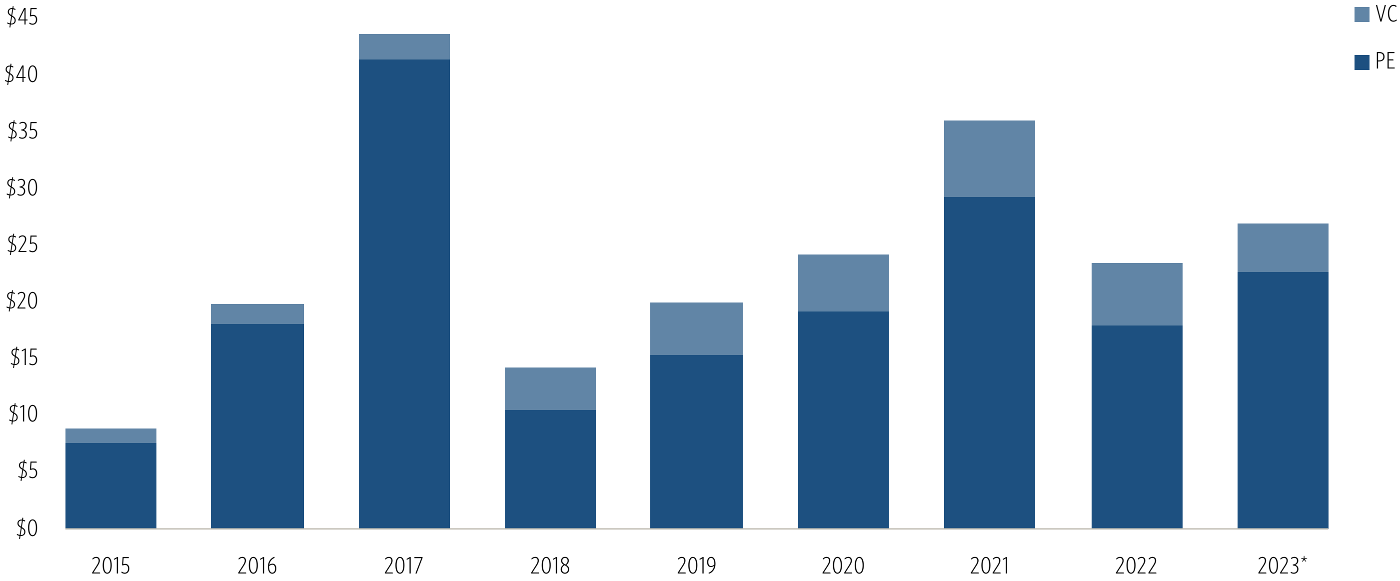
Private capital deal value ($B) by asset class



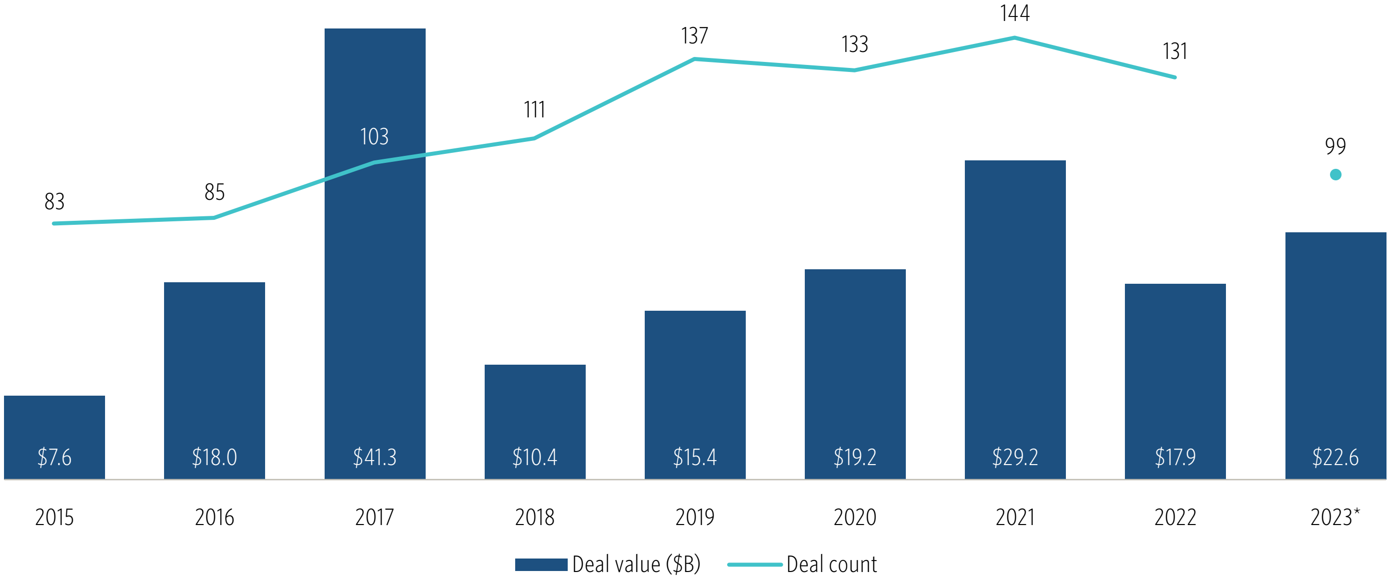
Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

Despite the debt-related problems that the Japanese government has few options to address, government support for private investment has been a major part of former Prime Minister Shinzo Abe's and current Prime Minister Fumio Kishida's policies. For startups specifically, Japan has launched fund startups in specific sectors, created a government cabinet to boost innovation within the country, and pushed the Government Pension Investment Fund to increase outflows to startups. Japan's Society 5.0 vision positions the future society of the country as a mix of human and technological interaction that relieves burdens and pushes the country forward. To achieve this, investment must increase significantly.

Japan's location adds to the intrigue for future growth of the private markets. As the US and other countries look to de-risk away from China amid escalating US-China tensions and as China's economy stumbles, investors looking for exposure to the Asia-Pacific (APAC) region have begun to shift their gaze elsewhere. While Japan has previously been a challenging market to break into, the potential for growth for the world's third-largest economy could push more foreign capital into the market. Venture capital and private equity stand to gain on the changes that Japan seeks to create for its economy.

Dealmaking

PE deal activity



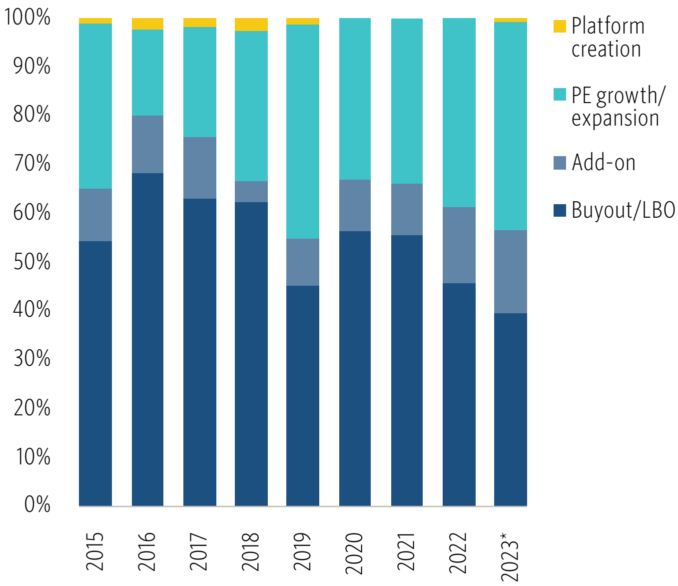
Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

Private equity and venture capital are still emerging as active markets in Japan. Over the past five years, the market has averaged 129 PE deals and roughly $21 billion of PE deal value annually, while venture deals have pushed beyond 1,000 deals annually since 2018 and past $3 billion in deal value since 2018 but no more than $5 billion annually since.

Japan's dealmaking climate has remained relatively stable despite the global market slowdown. This encapsulates much of what the Japan market has come to be known for: stability. Whereas deal activity has slowed in more developed markets, Japan is roughly on pace to match the previous four years in terms of deal count in 2023 for both private equity and venture capital, albeit at a much lower level than in larger markets.

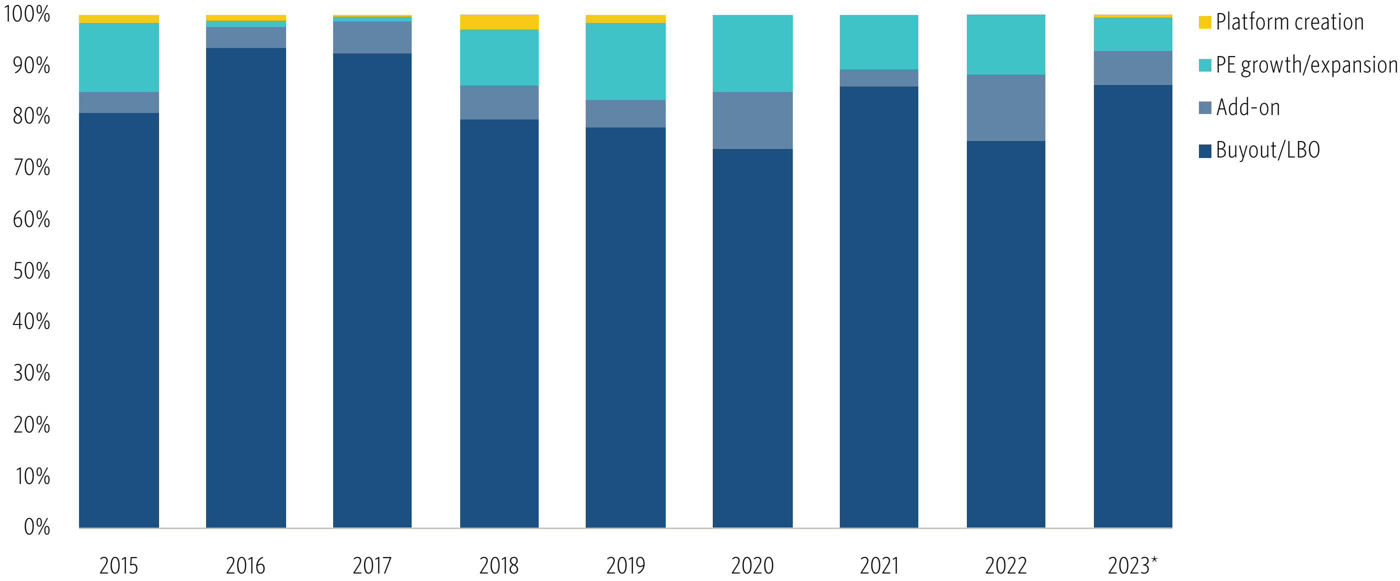
Through Q3, Japan has attracted nearly $27 billion in private capital investment—likely placing 2023 as the year with the second-most capital invested into the country—behind 2017, when eight buyouts were completed on at least $1 billion. The relative strength of the Japanese private capital market amid the global slowdown is likely due to several factors. Not only is the market relatively nascent and high on opportunities for growth, but government boosts and increasing interest from foreign investors have kept dealmaking high.

Share of PE deal count by type



Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

Share of PE deal value by type



Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

Succession planning an opportunity for private equity

Business succession has always been a core private equity play, especially among domestic middle-market managers. Japan is being hit with an increasing aging population coupled with one of the world's lowest birthrates, which has resulted in the average age of business owners in Japan to reach 62 years old, with nearly two-thirds of these businesses without a successor.[3] So prolific is the problem, in fact, that Japanese entrepreneurs have turned to AI solutions or startup avenues to try to address the challenge, as illustrated by the development of companies like M&A Research Institute and Next Generation Technology Group, both established in 2018. Because small and medium-size businesses (SMBs) have such a difficult time with this issue, Japanese middle-market fund managers are met with many opportunities across a variety of sectors.

This market trait keeps most private equity deals on the smaller end of the spectrum. Beyond the $15 billion buyout of Toshiba, the next-largest deal of the year was just $300 million. Alongside the country's aging population, founder-owners, CEOs, and other top executives of companies are aging to the point that more rapid planning must take place. Corporate culture in Japan has long been for workers to remain at the same company for entire careers, moving to different departments while moving up the corporate ladder. The recent shift in this cultural trait can also explain part of the need for succession.

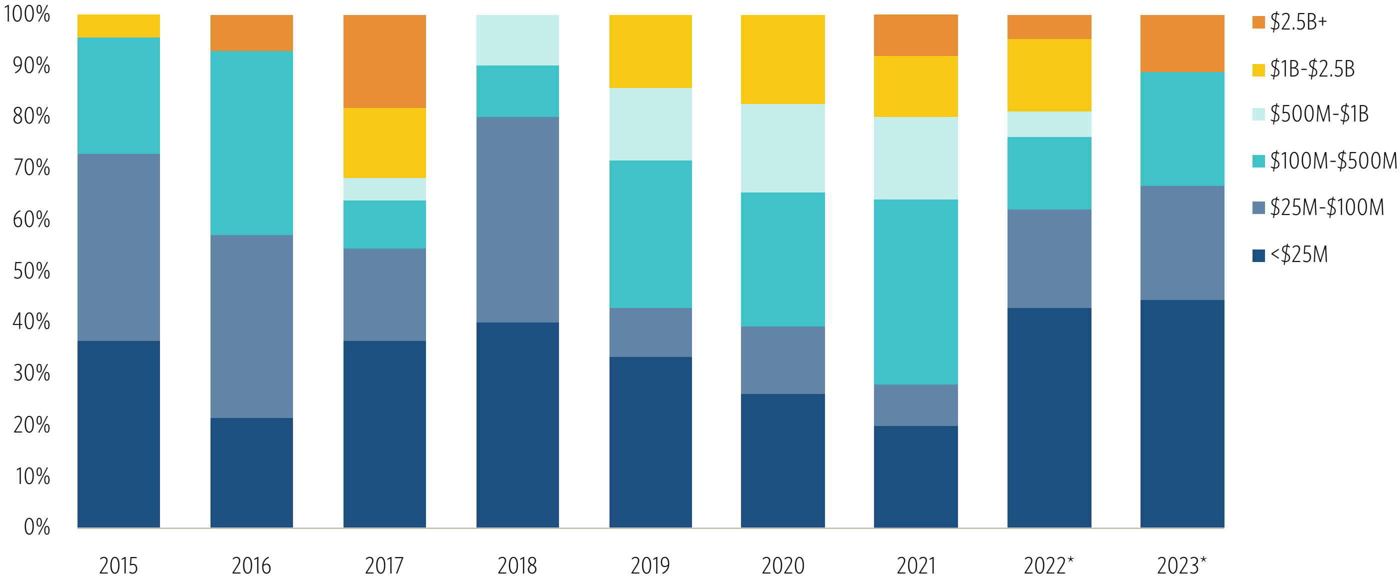
As younger generations opt for positions outside of the family business—in some cases moving toward startup culture—businesses are being left without the standard succession of prior generations.

For private equity firms, this is a favorable opportunity primed for add-ons and possible sector consolidation, but also for future expansion. Many PE firms in the region help SMBs expand across the APAC region, unlocking new markets and areas of growth that are not as easily attainable in more developed private equity markets.

There remain barriers and challenges, however. For one, private equity comprehension is still growing, and potential misunderstandings of the nature of PE and what firms are looking to do can deride deals. Aging founder-owners are often protective of the companies they have built, prioritizing the continuation of operations above the near-term operations of the PE firm postbuyout. Pricing can also be an issue. As the number of intermediaries within the market has grown to supply deal flow to PE firms, prices have increased in recent years. As the market grows, matching entry prices with exit expectations will continue to be an adjustment.

3: "Japan's Business Owners Can't Find Successors. This Man Is Giving His Away," New York Times, Ben Dooley and Hisako Ueno, January 3, 2023.

Share of PE deal count by size bucket



Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

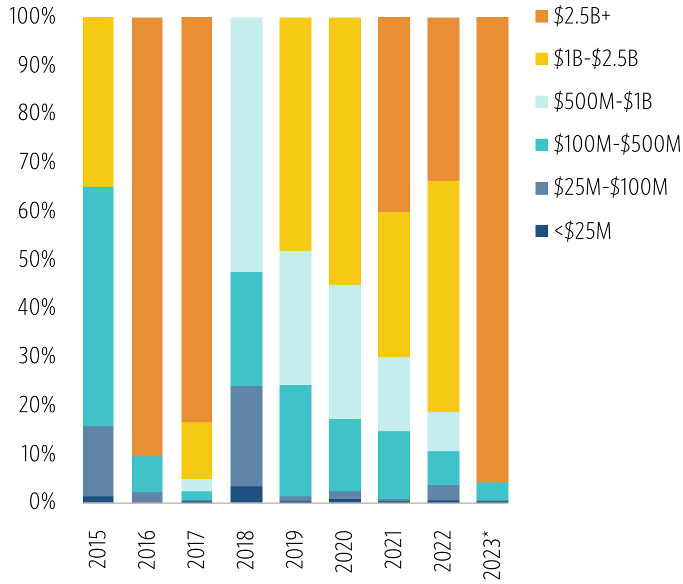
Take-private of Toshiba driving 2023 PE deal value

Private equity is not yet a large financial market in Japan, but the market is ripe for outsized deals. 2023 has already reached beyond that value figure, though a large majority has come from one of the largest deals in Japanese PE history, the near-$15 billion take-private of Toshiba. The deal, which was led by Japan Industrial Partners, will see the large technology company delist from the Tokyo Stock Exchange in December after 70 years as a listed entity.

The deal highlights the opportunities for private equity among the large corporations within the country—many of which have stalled growth over the past decade. Toshiba's revenues had steadily declined over the past decade, with quarterly revenues declining around 65% during that time.

Though in itself not a corporate carveout, the Toshiba deal portends further activity through such deals, as corporate governance reforms within the country shape the future corporate ecosystem in Japan. Until 2022, carveouts had accounted for more than 10% of PE deal count nearly every year since 2015. As Japan looks to boost corporate growth, even through nontraditional methods such as a stock index that tracks corporations committed to making money for shareholders, Japanese corporations may be enticed to part with underperforming business units.

Share of PE deal value by size bucket

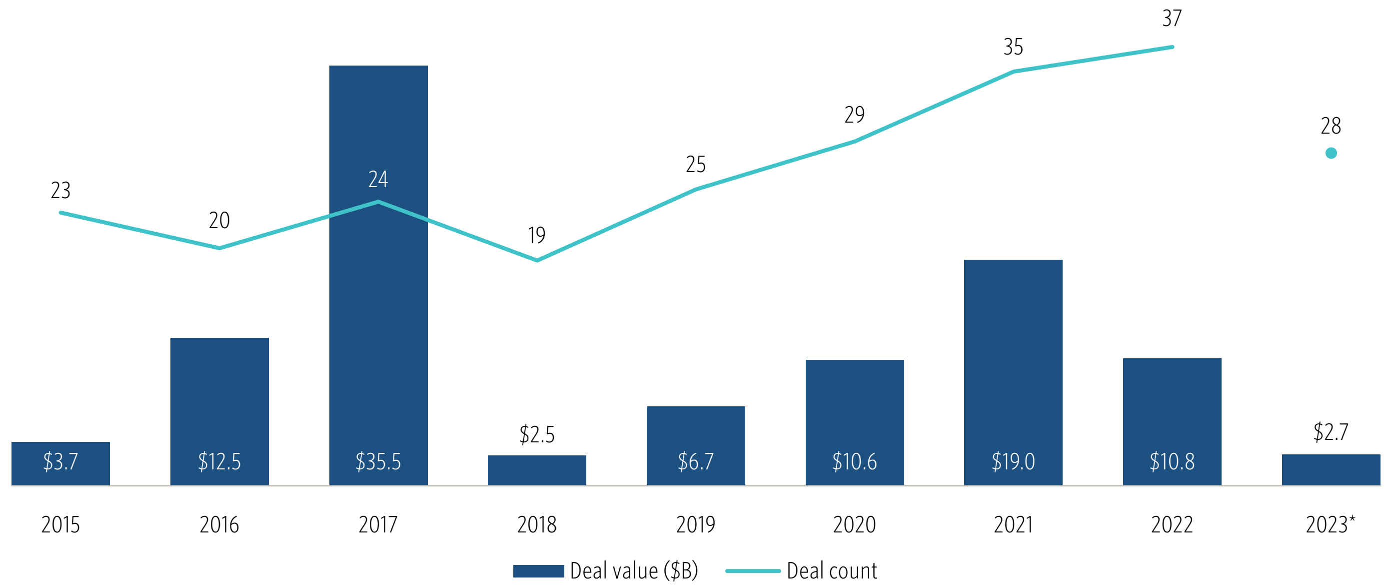


Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

Japan's low borrowing costs

In an effort to spur economic activity, the Bank of Japan (BoJ) introduced negative interest rates in 2016, moving short-term interest rates from 0.0% to -0.1%, where they remain today. In early October 2023, market participants largely expected that Japan's era of negative interest rates would soon come to an end on the heels of a BoJ meeting in which board members remarked that Japan was incredibly

PE deal activity with foreign investor participation



Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

close to reaching its sustained 2% inflation target.[4] While there has been recent speculation regarding the potential for the BoJ to reverse negative interest rates before the end of 2023, there is no consensus around timing, particularly given the conservative and slow-moving nature of Japanese monetary policy, with some expecting the decision to finalize in 2024. However, in late October, it was reported that consumer price inflation excluding fresh food prices (a fundamental indicator in monitoring inflation in Japan) dipped from 3.1% in August to 2.8% in September,[5] bringing into question whether this slight decline will give BoJ a pause in pushing forward any significant changes to monetary policy.

Despite this uncertainty, private equity players in Japan remain largely unconcerned about the possibility that rates may rise in the near term, as many believe that even if rates do get raised, these increases will be minimal and without a material effect on leverage buyout (LBO) finance pricing. It is not uncommon for sponsors—particularly those in the middle market—to encounter credit spreads between 250 basis points and 350 basis points, which is a far cry from the pricing levels seen in North America or Europe. In addition to low interest rates, low LBO pricing persists likely due to the fact that, unlike North America or Europe, which have seen the rise of private credit firms as main sources of lending platforms as banks and traditional lenders struggle to provide debt financing, Japan's commercial banks are still the largest lenders toward domestic private equity players, thereby helping to maintain reasonable credit spreads.

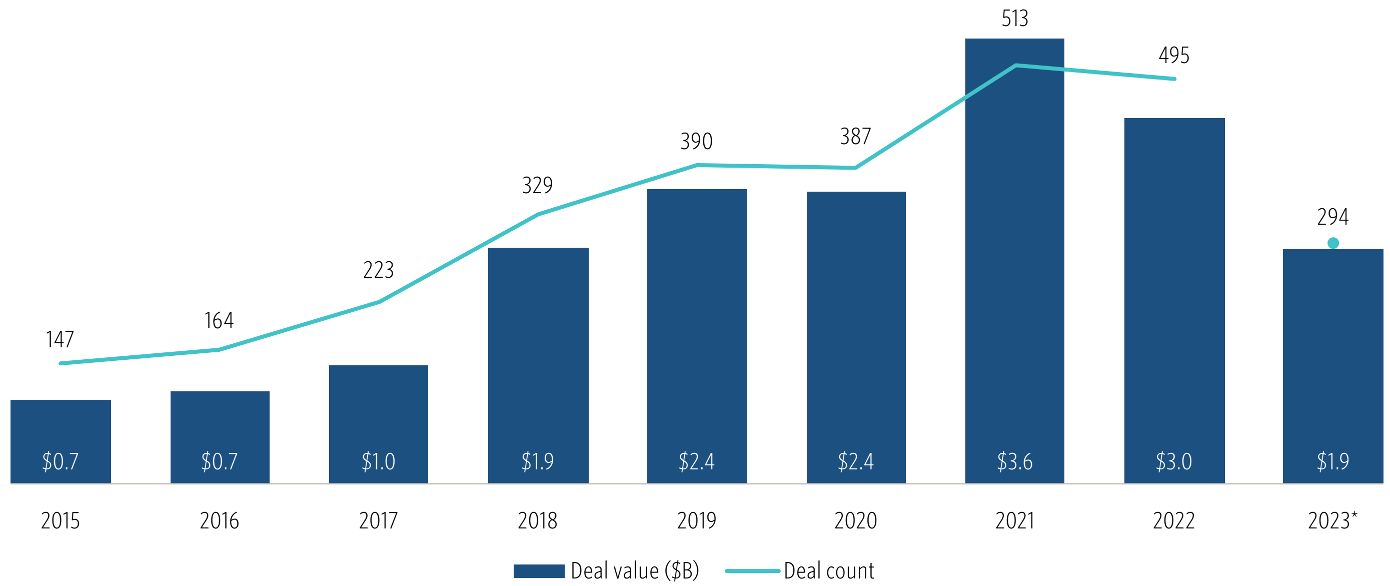
Foreign GPs interested in Japan PE and VC

Another development in the Japanese private capital market has been the recent influx of foreign GP entrants. In 2022, PE firms such as Northleaf Capital and the newly merged BPEA EQT announced the opening of their Tokyo offices. Investcorp followed suit in early 2023. These firms join the handful of global private equity firms that have had a presence in Japan via their exposures to the region through various pan-Asian funds, such as Bain Capital—which closed its first Japan-specific middle-market fund in 2021 on around $1 billion—or the few GPs that have had dedicated Japan strategies for several years, including Carlyle. Additionally, some global private equity firms are partnering with Japanese players in joint ventures to target private wealth, as demonstrated by KKR's recent partnership with SBI Holdings.

While the emergence of foreign entrants might beget expectations of a potentially overcrowded market, some Japanese market participants believe these newer GPs, due to the size of their platforms, will be competing mainly amongst themselves for the fewer larger deals that emerge. A 2017 white paper from Japan's Ministry of Economy, Trade, and Industry noted that there were approximately 11,000 large enterprises in Japan, representing around 0.3% of Japan's company ecosystem.[6] Though not always the case, larger deals tend to involve carveouts of established domestic conglomerates that are trying to reduce their exposure to noncore businesses or take-private deals.

4: "BOJ Board Members See Price Goal Progress, Need to Plan Exit," Bloomberg, Toru Fujioka, October 1, 2023.
5: "Japan Inflation Slows Below 3% in Line With BOJ Price View," Bloomberg, Erica Yokoyama and Yoshiaki Nohara, October 19, 2023.
6: "2017 White Paper on Small and Medium Enterprises in Japan," The Small and Medium Enterprise Agency, April 2017.

VC deal activity with foreign investor participation



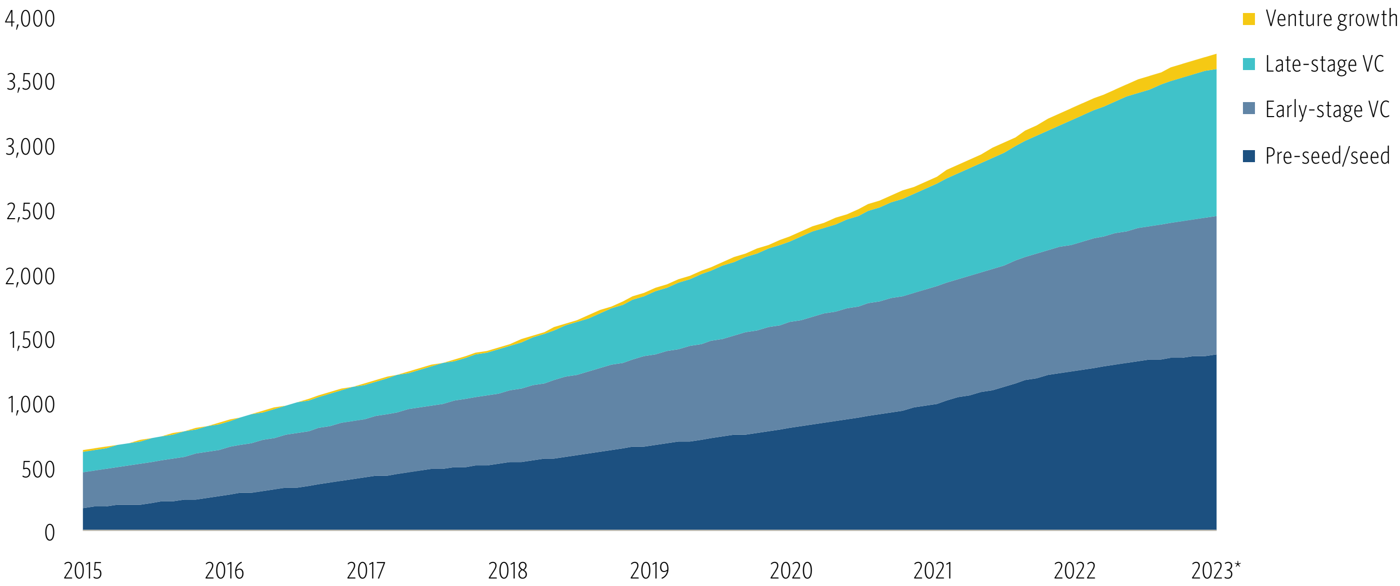
Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

Because of the relatively larger deals that foreign investors participate in, foreign investment has consistently accounted for a large proportion of total private equity deal value in Japan. During 2020 through 2022, foreign investors participated in an annual average of more than 60% of deal value, despite participating in fewer than 25% of deals. Though Toshiba's $15 billion buyout was not a foreign-investor-led deal, that area of the market is likely to attract the most foreign capital.

Japan's VC market is also attracting foreign capital. However, beyond challenges brought by the ongoing global market volatility, several potential hurdles exist for foreign investors to contribute meaningful capital to the VC market in Japan within a short period of time. To start with, the startup ecosystem in Japan is small when compared with more developed venture ecosystems such as the US and China, which inherently limits the volume of highly investable deals. In addition, Japanese startups tend to have much lower return profiles than their US and European counterparts, which in turn leads to low valuations, thereby limiting foreign investor appetite. Japanese startups also tend to go public on the domestic stock exchange before reaching the same level of maturity as US startups, with domestic VC firms' shortage of capital availability to support late-stage startups being one of the contributing factors. The trend of going public early also dampens return potential from an investor perspective.

Despite these hurdles, the startup ecosystem in Japan has been expanding consistently over the past couple of years and stands to benefit from macroeconomic tailwinds—most prominently against the backdrop of volatility stemming from increased complexity in geopolitics in neighboring countries. With escalating US-China tensions, as discussed in our recent Examining US Investments in China analyst note, US investors that have historically participated in the Chinese VC and PE markets have become more cautious. Many US investors have adopted a "wait and see" approach while reevaluating their China strategy and exposure. Many Japan-based GPs have received an increased number of inquiries from foreign investors seeking to diversify away from China amid the ongoing geopolitical volatility and are taking a closer look at Japan as an alternative market to reallocate the capital historically reserved for China. In contrast to China, which went through multiple swift changes including the abrupt end of its Zero-COVID Policy and its crackdown on the tech industry, along with increased scrutiny from the US government on deals made in China's high-tech sectors that tested and weakened nondomestic investor confidence, Japan is characterized by a high level of stability and consistency and is likely to benefit from foreign investors, especially ones based in the US.

Smoothed VC company count by stage

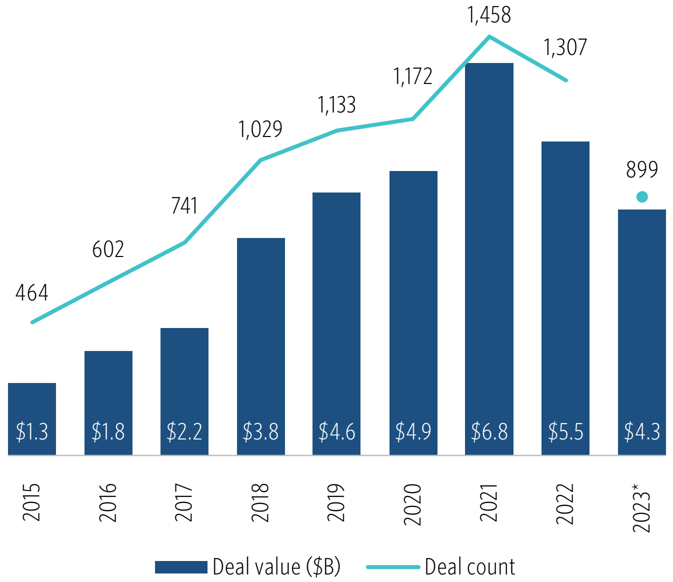


Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

VC in Japan: Steady growth but still in early stage of development

The VC market in Japan has consistently expanded during the past couple of years. As of September 30, 2023, Japan's VC-backed company universe has expanded to 3,780 companies, suggesting a near-6x increase from 2015. Despite a slip in VC deal value and count between 2021 and 2022, annualized deal value for 2023 is on track to eclipse the pre-pandemic levels. For context, a slowdown in the venture universe has been observed across many global regions, and Japan was no exception. Through the first three quarters of 2023, $4.3 billion was deployed to VC in Japan across 899 deals. Should this dealmaking pace continue, the 2023 yearly deal count is expected to exceed the 2020 annual figure, reflecting a healthy momentum of the domestic venture ecosystem.

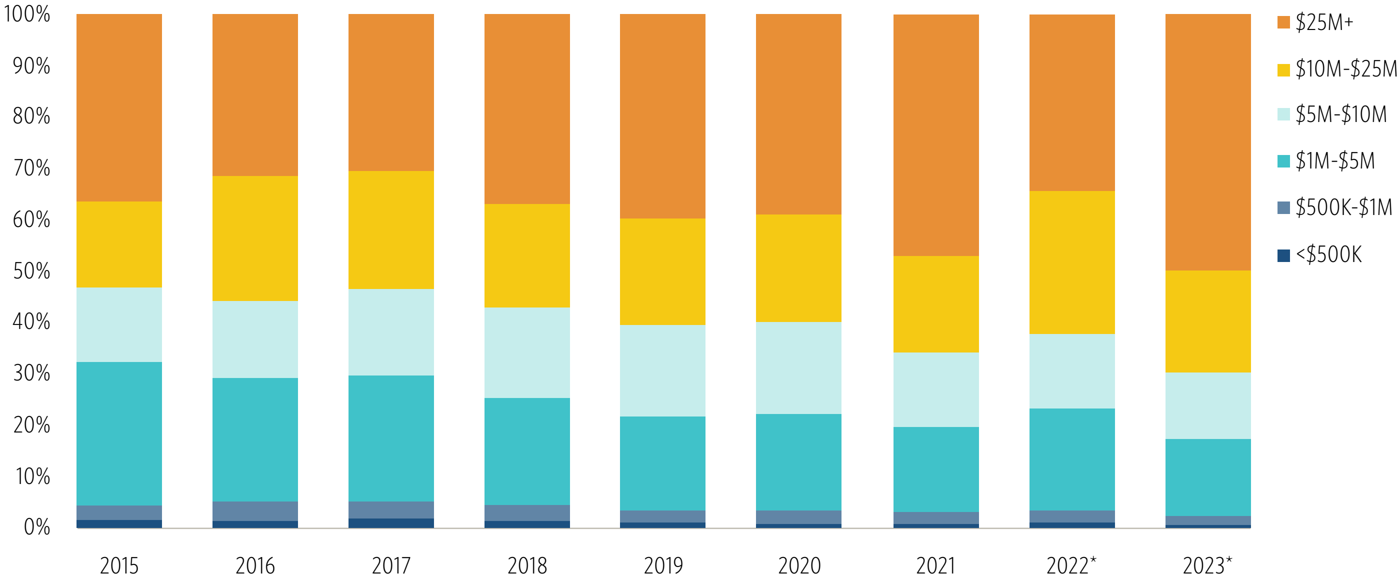
VC deal activity



Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

The VC market in Japan has benefited from several tailwinds, ranging from steady government support to a culture of innovation, as well as the presence of industry-leading, multinational corporations, but this emerging market remains in an early stage of development with large hurdles to overcome. In addition to challenges brought by aging demographics, many large, established corporations have slowed their pace of growth, and with VC being a relatively recent concept in Japan, there is a lack of serial entrepreneurs and experienced VCs. From a company perspective, most founders are in their mid-20s to mid-30s. Japan's traditional career trajectory has taken employees from start to finish with the same corporation, thus limiting the number of seasoned professionals starting their own businesses. Though being young is not a negative, from a risk standpoint, serial founders with deeper market insights and a wider industry network tend to be better positioned than their novice counterparts to lead a business from inception to a successful exit. In addition, there is a shortage of domestic VC investors with an established track record and investment acumen. A lack of talent from the investor side could diminish the number of successful outcomes for those industries. Because of this, the market has relied upon corporate venture capital (CVC) and banks to provide more of the risk capital needed than is seen in other developed VC ecosystems.

Share VC deal value by size bucket



Source: PitchBook • **Geography:** Japan
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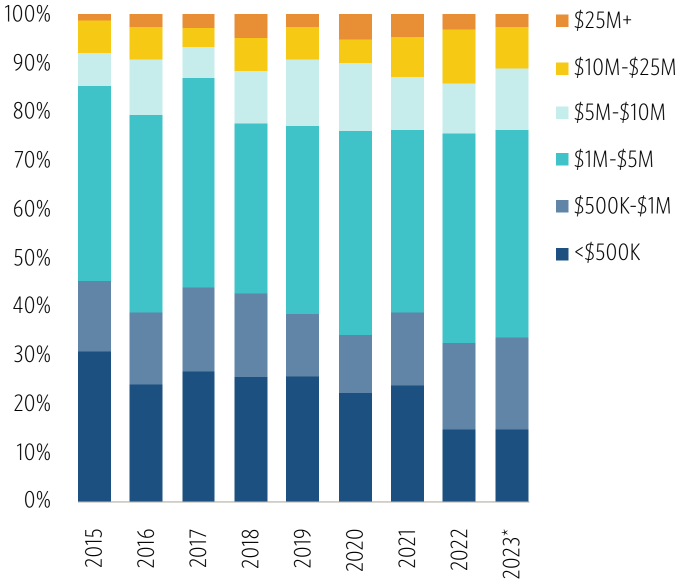
Because the domestic market still has a long way to go before reaching maturity, Japanese VC investors have been actively participating in overseas investments, especially in the US, Israel, and Europe, where deals provide more favorable risk/return profiles and larger market sizes. However, lately, both LPs and GPs in Japan indicated that they have started to see a gradual trend of investors looking more closely at the domestic market, where the quality and quantity of startups have both improved. Some VC funds with certain types of LPs—particularly government-affiliated agencies and financial institutions like banks—are also motivated to invest more inwardly when their LP base is inclined to see more domestic investments.

There is a general push to connect Japanese startups and VCs with overseas companies and investors to promote the exchange of information and to globalize the Japanese VC community. The Japan-Seattle AI Innovation Meetup, which is a series of business matchmaking events between startups based in Washington state in the US and large corporations in Japan that launched in 2016, is an example of how large corporations in Japan can learn about innovative startups in the US as potential investment targets. Recent initiatives for Japanese VCs to host forums overseas—such as UTokyo IPC, an investment company owned by the University of Tokyo, organizing a conference in Boston in May this year to connect Japan and Boston—also indicate the drive from within the Japanese investor community to connect with their global counterparts.[7]

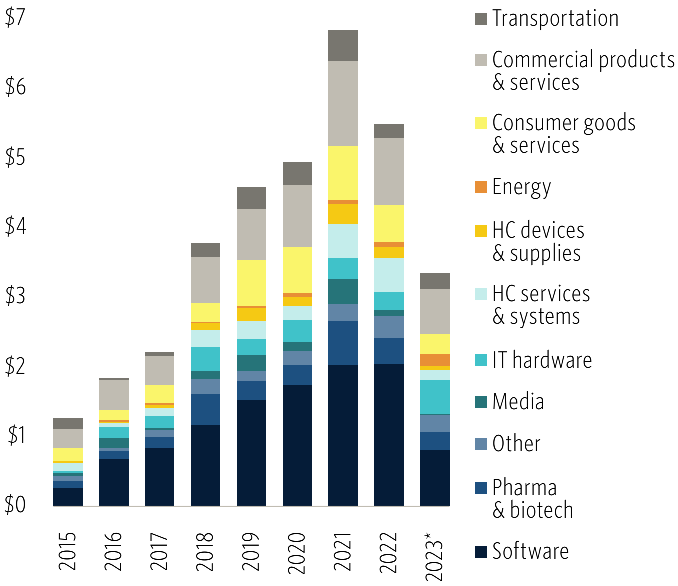
Share of VC deal count by size bucket



Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

7: "Introduction to UTokyo IPC," Venture Café, May 2, 2023.

VC deal value ($B) by sector



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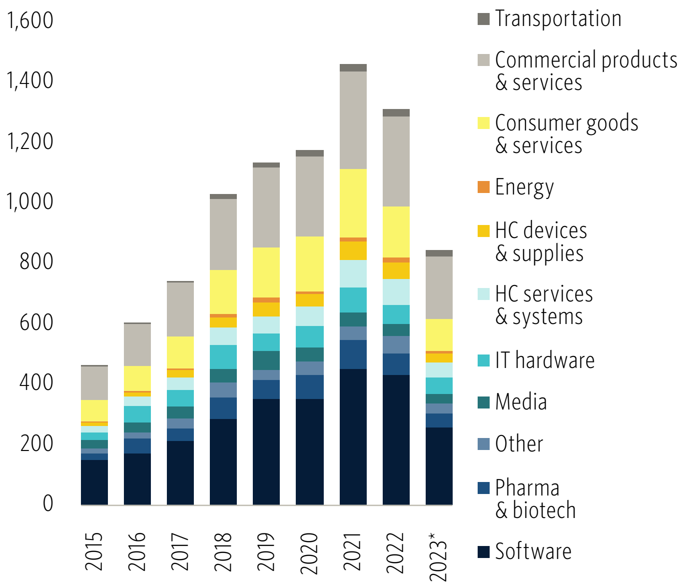
VC deal count by sector



Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

Government support for startups

A major tailwind for Japan's VC ecosystem development can be found in government support for the domestic startup landscape. This support takes many forms, including articulating long-term visions, tax policies, subsidies, setting up government-affiliated investment entities to inject capital into the private market, working with top research universities as intermediaries to launch venture initiatives, nudging financial institutions like banks to provide support to startups, and more. The Japanese government has a long history of supporting startups, but former Prime Minister Abe, who came to power in 2012, was often credited for pioneering startup development support, as he was the first to crystalize and advocate the idea. Abe put forward the idea of enhancing business competitiveness by strengthening existing corporations as well as cultivating a startup-friendly environment that nurtures and facilitates growth of SMBs. Subsequently, current Prime Minister Kishida took over the baton to carry on this mission. In June 2022, the Kishida administration revealed its plan for "a New Form of Capitalism"—two of the four pillars of which aim to facilitate startup development and target STEM-related investments.[8]

Along with the rhetoric around promoting startup development, the Japanese government injected capital to support the ecosystem via a range of initiatives. First, in addition to acting as LPs, government-affiliated investment entities such as the Japan Investment Corporation (JIC) have subsidiary VC funds that make direct investments into startups that are aligned with the long-term visions outlined by the government.[9] Second, state-sponsored investment arms have contributed capital to university-affiliated venture programs to foster innovation coming out of top higher educational institutions. Third, government policy measures such as tax deductions incentivize corporations to invest in small businesses. These policies are not always formal, however. For example, large Japanese banks were reportedly asked by the government to support startups by providing loans.

A general sectoral trend in Japan that focuses on deep tech links back to government support. Deep tech companies are eligible to apply for government subsidy, and domestic banks can offer an additional layer of support to deep tech startups by providing them with working capital in the form of loans until the government grant gets released at the end of each fiscal year. The mentality behind this subsidy initiative is to support deep tech founders—many of whom come from academia and have strong technical skills and domain expertise but may not have had much exposure to entrepreneurship.

8: "Investing in People for a New Form of Capitalism," The Government of Japan, July 28, 2022.
9: "Investment Criteria," Japan Investment Corporation, n.d., accessed on November 5, 2023.

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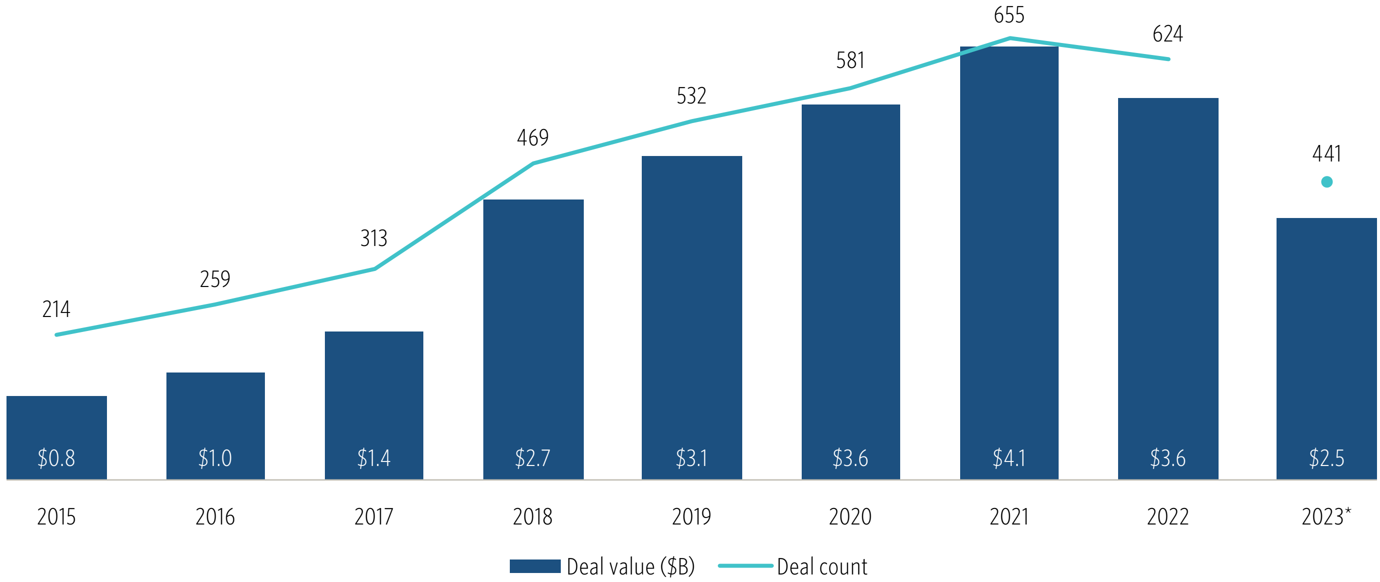
SPOTLIGHT

Corporate venture capital

VC deal activity with Japanese CVC participation



Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

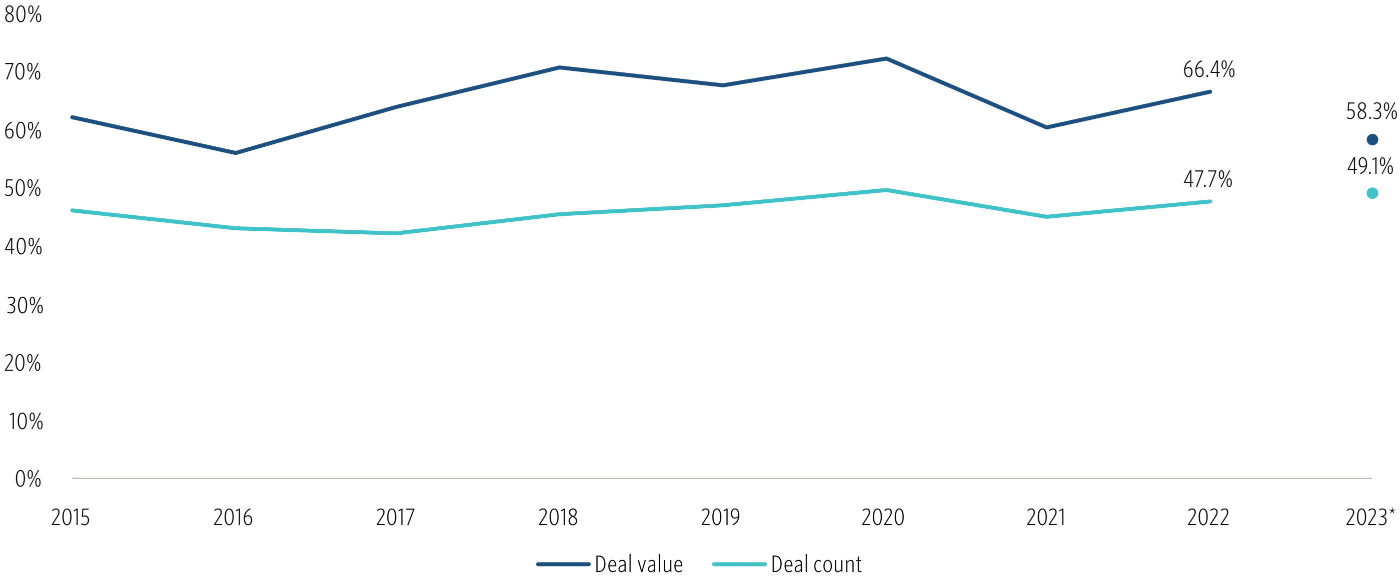
A unique feature of the Japanese VC ecosystem is the important role that non-VC investors play. Traditional VC firms in Japan tend to have relatively smaller fund sizes and focus more on earlier stages of venture due to their limited ability to put significant amounts of capital to work. In contrast, government-affiliated investment vehicles, CVCs, and financial institutions such as banks and insurance companies serve an essential function in the domestic VC market with their ability to deploy capital to startups for financial or strategic objectives. As a result, non-VC investors tend to cover the entire venture lifecycle, supporting startups from their nascency to maturity toward an eventual exit. In contrast, a large proportion of traditional VC funds in Japan focus on earlier stages of venture.

Large corporations such as manufacturers and trading companies wield abundant capital from having large balance sheets and seek to invest in innovative startups that could potentially bring strategic value to their existing business. In recent years, Japanese corporations have been keenly interested in startup investments. Between September 2021 and September 2023, 1,124 corporation-affiliated entities, including corporations and CVCs, participated in at least one global VC deal, significantly outweighing the count of 625 VC firms in the country during the same period.

In contrast to the many traditional VC firms in Japan focusing on earlier stages of the venture lifecycle due to AUM constraints, Japanese corporations sit on ample cash reserves. Corporations in the country developed a habit of hoarding cash when going through earlier financial downturns, when sources of capital were difficult to attain. These corporations are now capable of investing across different stages of venture. According to the Q2 2023 Flow of Funds Preliminary Report published by the Bank of Japan, as of June 2023, private nonfinancial corporations in Japan collectively have approximately 344 trillion yen ($2.3 trillion) of cash and cash equivalents.[10] As a point of reference, Japan's 2023 GDP stands at $4.2 trillion,[11] which means that Japanese corporations hold cash reserves that are north of half of the country's GDP.

10: "Basic Figures: Flow of Funds for the Second Quarter of 2023 (Preliminary Report)," Bank of Japan, Research and Statistics Department, September 20, 2023.
11: "GPD, Current Prices: Japan," International Monetary Fund, 2023, accessed November 2, 2023.

VC deal activity with Japanese CVC participation as a share of all VC deals



Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

Top VC investor types by count since 2015*

Investor type	Investor count
Corporation	990
VC	625
Angel (individual)	427
CVC	134
Other	64
Holding company	48
PE/buyout	40
Accelerator/incubator	38
VC-backed company	36
Asset manager	26
Investment bank	19
Growth/expansion	15
PE-backed company	15
Impact investing	14
Real estate	12

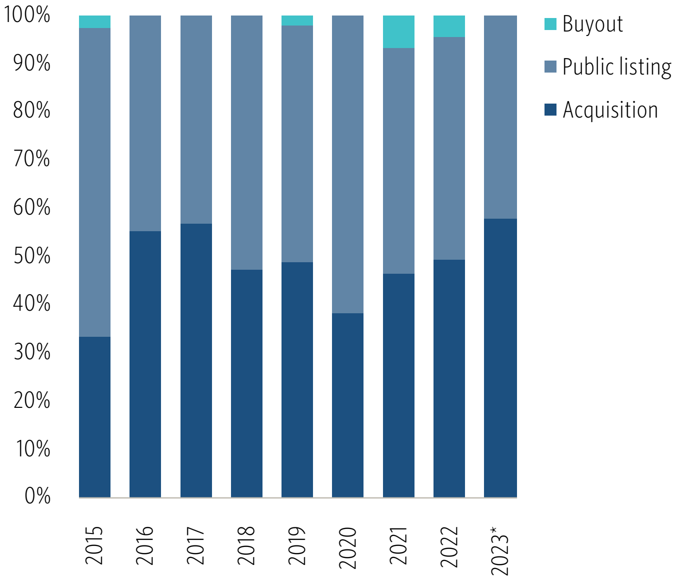
Source: PitchBook • **Geography:** Japan
*As of September 30, 2023
Note: Data includes only active Investors that participated in a global VC deal in the last two years (since September 30, 2021).

With record cash reserves, corporations are well positioned to deploy capital to the regional startup ecosystem. Many CVCs in Japan are interested in making more overseas investments, especially in more developed venture ecosystems that have historically generated attractive return profiles. However, Japan-domiciled funds are legally required to invest at least 50% of their fund size to the domestic market.[12, 13] Additionally, corporations, along with other types of active private market participants, are incentivized to invest in the domestic market, where there are no language or cultural barriers, while contributing to the long-term success of the regional ecosystem.

Through the first three quarters of 2023, CVCs were involved in 60.8% of all Japanese venture deals. During the same period, deals with CVC participation accounted for a record 85.3% by deal value as a proportion of all VC deals in Japan. Our Q1 2023 analyst note, The State of CVCs in Japan, discusses why corporations are essential to the regional venture ecosystem, as well as how Japanese corporations are well positioned to continue actively participating in venture, thereby cementing their leading position. In this "Spotlight" section, we refresh data on Japanese CVCs and extend upon earlier discussions.

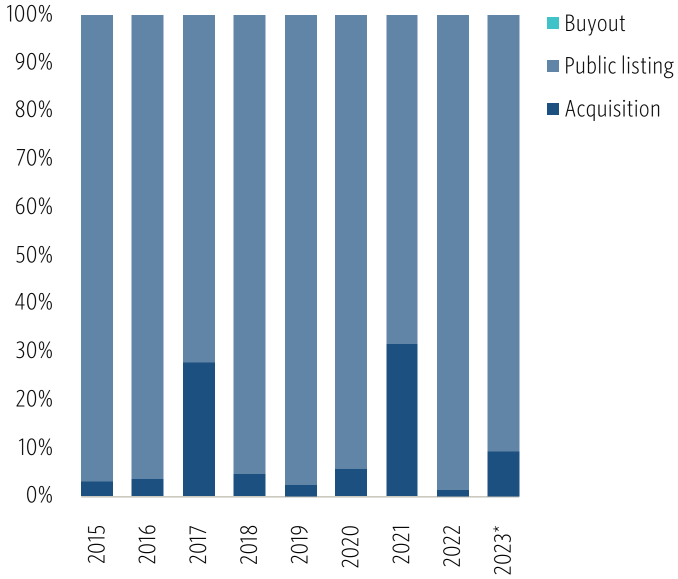
12: "Special Provisions for Foreign Investment Regulations by Funds," Ministry of Economy, Trade, and Industry, n.d., accessed November 5, 2023.
13: "Regarding the Investment Plan to Promote the Use of External Managerial Resources Under the Industrial Competitiveness Enhancement Act," Ministry of Economy, Trade, and Industry (METI), July 2021.

Share of VC exit count by type with Japanese CVC participation



Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

Share of VC exit value by type with Japanese CVC participation



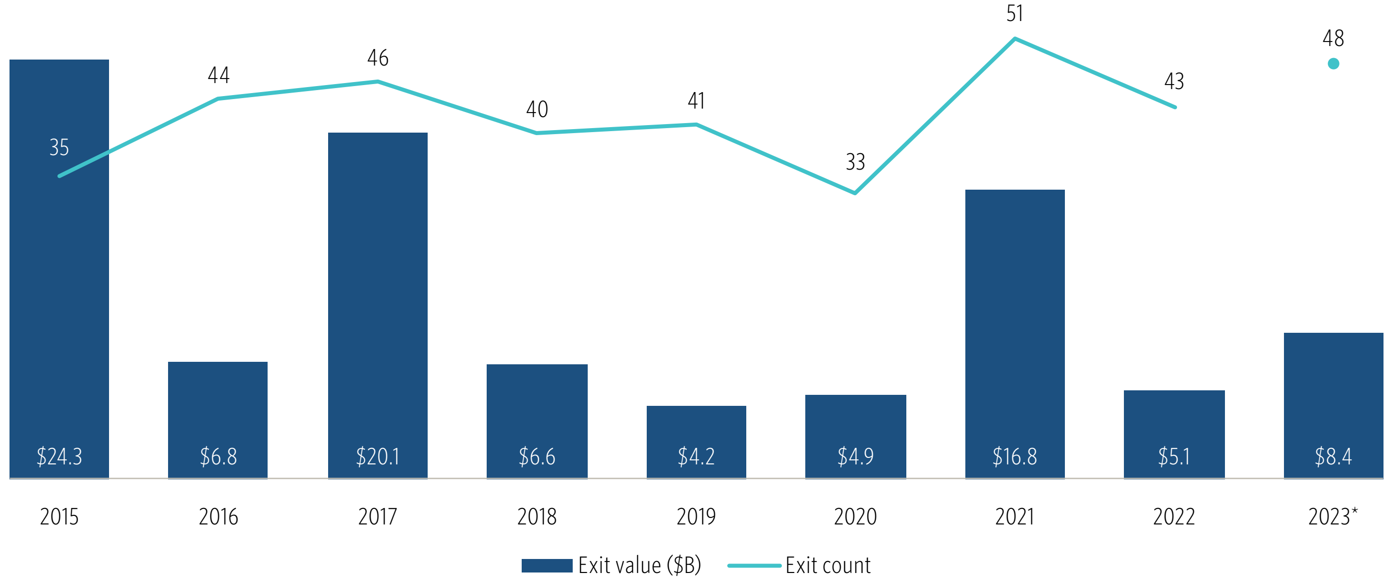
Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

CVCs in Japan come in different shapes and sizes. Some corporations set up independent investment arms managed by former employees of the parent company. The efficacy of this approach is contingent upon the level of investment expertise and existing sourcing networks held by CVC team members. An increasingly popular approach has been to seek external assistance by outsourcing CVC operations or partnering with independent VC firms. For example, Global Brain, an independent VC firm, manages CVC funds for many leading Japanese corporations and banks.

Three pieces of criticism revolve around CVC investment activities in Japan. First, despite CVCs actively making investments, corporations are not doing enough acquisitions. Minority investments are likely insufficient for corporations to take full advantage of innovative technology or ideas outside of the organization. Corporations write small checks into startups for a multitude of purposes. While some could be evaluating an eventual acquisition upon making an initial minority investment, others may be incentivized to participate in a round to observe and learn of the type of innovation happening on the ground. Second, in select industry sectors, deals with CVC participation tend to have inflated valuations. From an exit perspective, when those startups are ready to go public, valuations of such privately held companies could make it difficult for the public market to match. Third, in select sectors such as biotech and deep tech, CVCs typically do not make follow-on investments, nor do their parent organizations tend to acquire portfolio startups.

Exits

PE exit activity



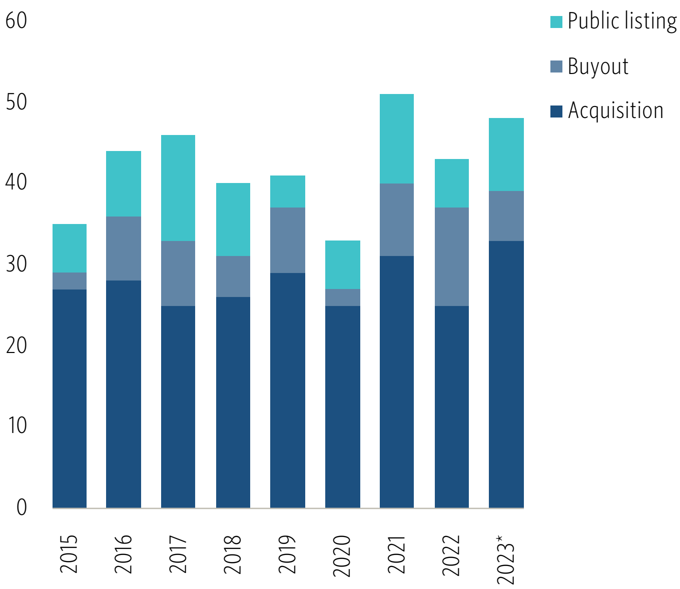
Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

Exit stability defines Japan private equity

The M&A market in Japan has been a strength in 2023. Through Q3, a record number of PE-backed companies had already exited via acquisition, either to another PE shop or to a corporate acquirer. A weakening yen could be seen as attractive to foreign buyers but has yet to translate into a significant increase in such activity. Many of the acquisitions were relatively small, which can be seen as a knock on the Japan PE market. Entry multiples are important within the Japan market as the ceiling exit size is relatively lower than elsewhere.

Similar to dealmaking, the PE exit market has remained remarkably steady over the past couple years. 2023 is set to reach a new high in terms of PE exit count, with Q3 being one of the most active quarters on record, with 19 completed exits. The steady exit activity has led to an investment-to-exit ratio of just over 2.0x in 2023—the lowest figure since 2015. A strong exit market in a weakened global economy highlights the uniqueness of Japanese PE. Whereas the US is pacing for a significant decline in exit count and value from the highs of 2021, Japan will see a record exit count this year. Despite acquisitions continuing as the most common exit route for PE-backed companies, IPOs remain the most lucrative in terms of company valuation. Of the 10 largest PE-backed exits in 2023, IPOs account for eight. The Nikkei 225 is at its highest level in more than 30 years, with a year-to-date return of more than 25%.[14]

PE exit count by type



Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

14: "Nikkei Stock Average, Nikkei 225," FRED, November 7, 2023.

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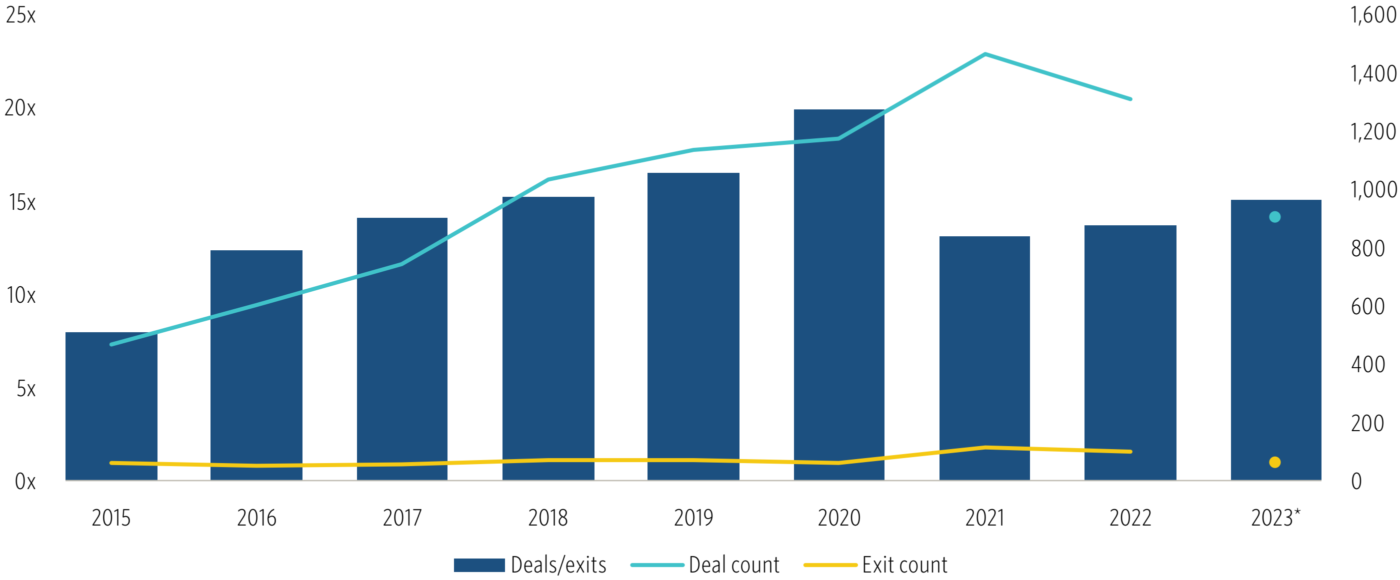
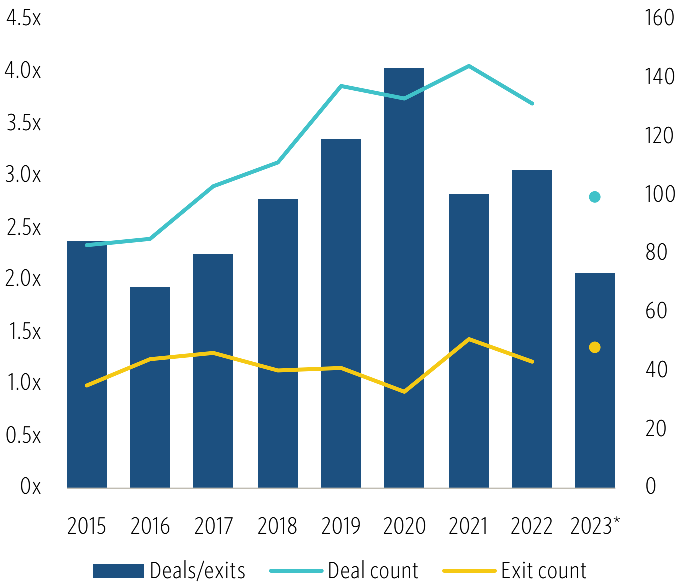
VC deal and exit counts



Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

PE deal and exit counts



Source: PitchBook • **Geography:** Japan
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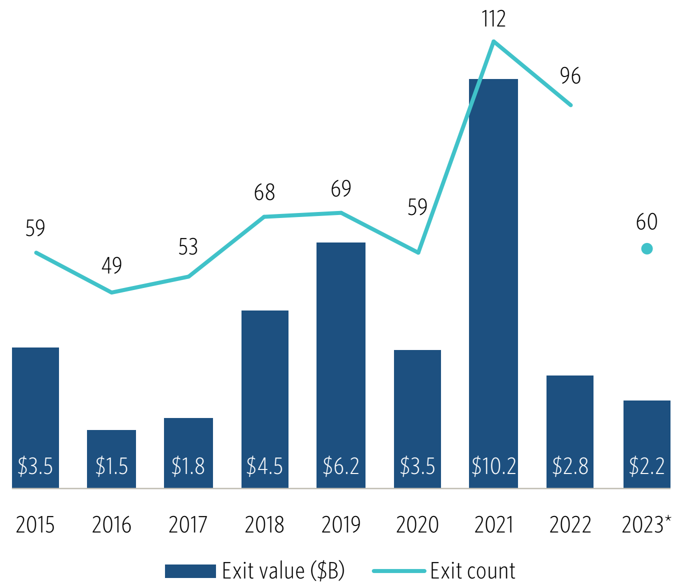
VC exit activity



Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

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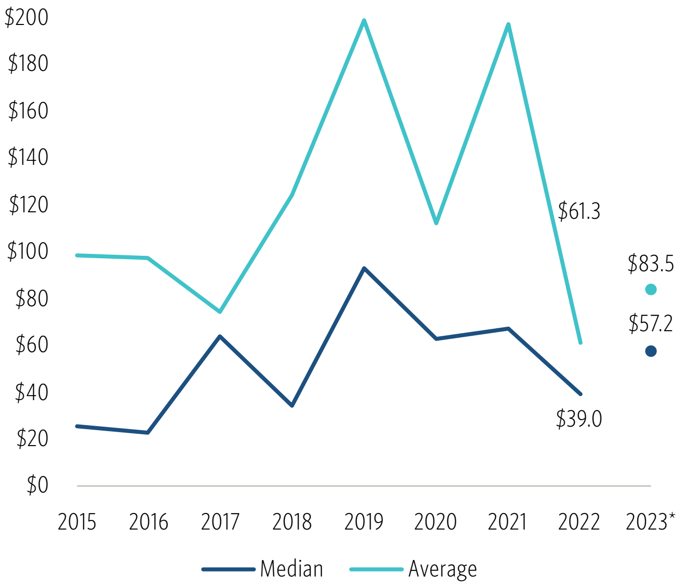
Top 10 exits by size in 2023 YTD*

Company	Close date (2023)	Exit value ($M)	Deal type	Industry
AnyMind Group	March 29	$419.1	IPO	Software
Cover Corporation	March 27	$333.2	IPO	Software
MonstarLab Holdings	March 28	$170.3	IPO	Software
Netstars	September 26	$157.3	IPO	Software
Pixie Dust Technologies	August 1	$117.3	IPO	IT services
Avilen	September 27	$113.6	IPO	IT services
Kanmu	March 30	$105.1	M&A	Software
Ispace	April 12	$103.6	IPO	Commercial products
ABEJA	June 13	$86.0	IPO	Software
OriCiro Genomics	January 4	$85.0	M&A	Pharma & biotech

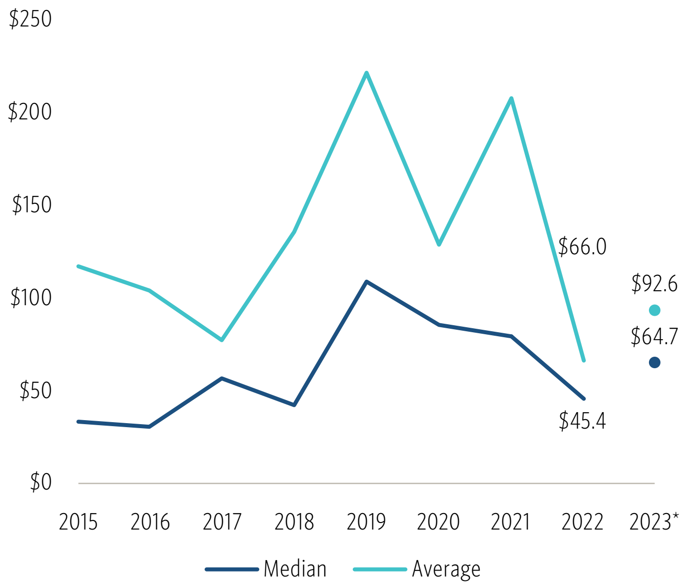
Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

Median and average VC exit value ($M)



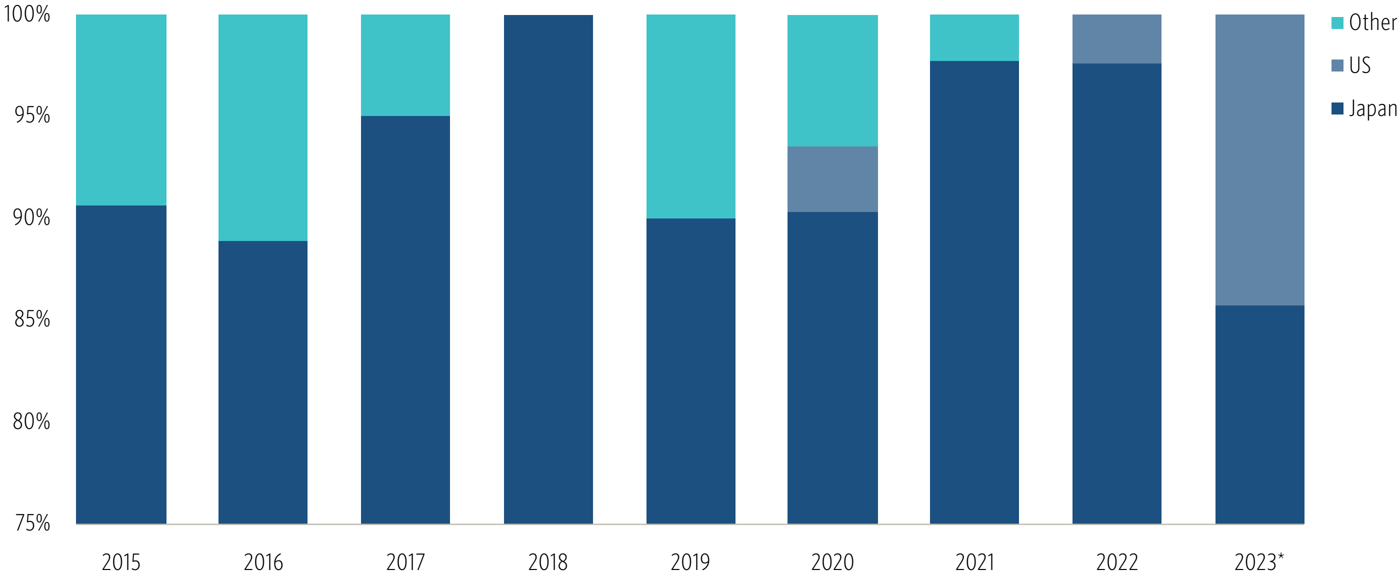
Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

Median and average VC post-money valuation ($M)



Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

Share of VC IPO count by exchange region



Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

A large number of IPOs at relatively small value for VC-backed companies

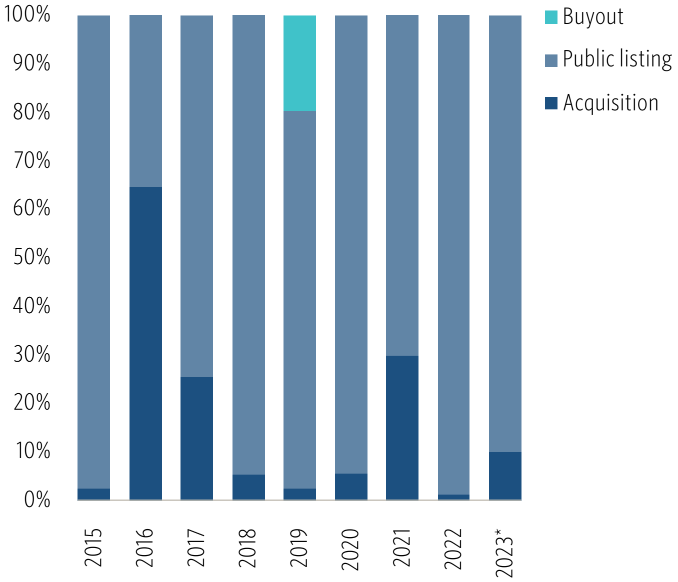
Historically, the mainstream exit channel for startups based in Japan was to go public via the TSE. From a cultural perspective, IPOs are considered the pinnacle of success. Founders strive for the ultimate goal of taking their startups to a public debut and take pride in achieving this goal typically associated with socioeconomic prestige. From a logistics standpoint, going public in Japan is a relatively easy, straightforward process compared to going through the same process in the US, and this is due primarily to government support. Since around 2000, the Japanese government sought to broaden ways in which startups could access funding by encouraging them to list publicly. However, some have voiced the concern that even though the original purpose was for startups to continue growing with funding from retail investors, there have been too many small IPOs.

In April 2022, the TSE went through a restructuring. The market now has three segments: Prime, Standard, and Growth.[15] The third tier, Growth, which replaces the "Mothers" market following the revamp, has the lowest listing criteria among all three segments and is where Japanese startups aim to go public due to their limited size. Despite the recent move, anecdotally speaking, market participants have not seen material shifts in listing activity and startup qualification following TSE's revamp.

Additionally, the IPO market has been plagued by macro headwinds. The ultralow interest rate environment and the rising inflation in Japan have added pressure to corporate pricing and consumer demand. Further, the domestic IPO market is not performing well at the moment. Given how interconnected Japan's economy is to that of the US—Japanese public market trends tend to follow the US, just like many of Japan's global counterparts—concerns around IPO performance in the foreseeable future have been circulating, as the US public market has not seen a full rebound yet.

15: "Overview of Market Restructuring," Japan Exchange Group, September 19, 2023.

Share of VC exit value by type



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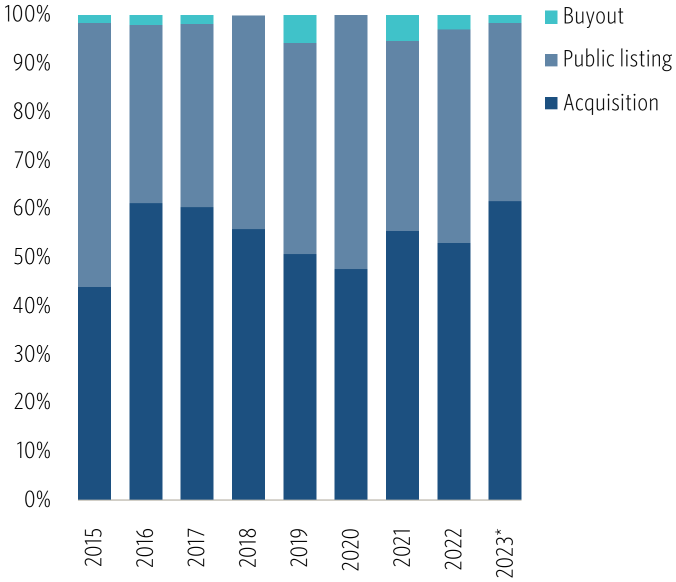
Share of VC exit count by type



Source: PitchBook • **Geography:** Japan
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A shortage of M&A deals: Why are corporations not making more acquisitions?

Among all major exit strategies for Japanese startups, M&A activity has been lackluster in recent years. The sluggish pace of corporations acquiring startups stands in stark contrast to their growing interest in participating in minority stake investments in innovative, budding companies. Why are Japanese corporations uninterested in acquiring startups at a higher velocity? Several factors explain the ongoing depressed M&A trend.

Historically, Japanese corporations have not been acquisitive. With IPOs being the largest and most common exit strategy among Japanese startups, M&A has never taken been the main avenue toward exits. As a result, there is a lack of outsized acquisitions that serve as leading examples within the VC industry.

In terms of M&A activity, budget is a priority for corporations. For startups that are contemplating going public or being acquired, a $50 million valuation is generally a cutoff point because corporations tend to only tuck in smaller-scale startups that have yet to reach that market cap threshold. For corporations that are open to acquisitions, a budget is typically set aside for a specific accounting period such as a fiscal year. While corporations prefer to use the preallocated budget within the designated period, acquisition opportunities come up spontaneously and may not fit the predetermined schedule. Under such circumstances, decision-making could take a long time on the corporation's side, potentially undermining the possibility of a successful acquisition.

Many Japanese companies prefer to develop their own technology in-house, which translates into prioritizing internal research & development (R&D) efforts as opposed to taking an externally developed technology and directly applying it to their existing framework. While corporations are cognizant of this pattern and have been actively seeking changes from the inside by embracing open innovation and looking to foster partnerships with innovative startups, it could take a long time before we see material changes to the status quo.

By definition, venture is a journey wherein founders build groundbreaking technology or try to deliver a new service in a resource-constrained fashion. This means that technology developed by an early-stage startup might not be fully functional or polished in a way that could immediately be adopted by and integrated into the tech stack of a large corporation.

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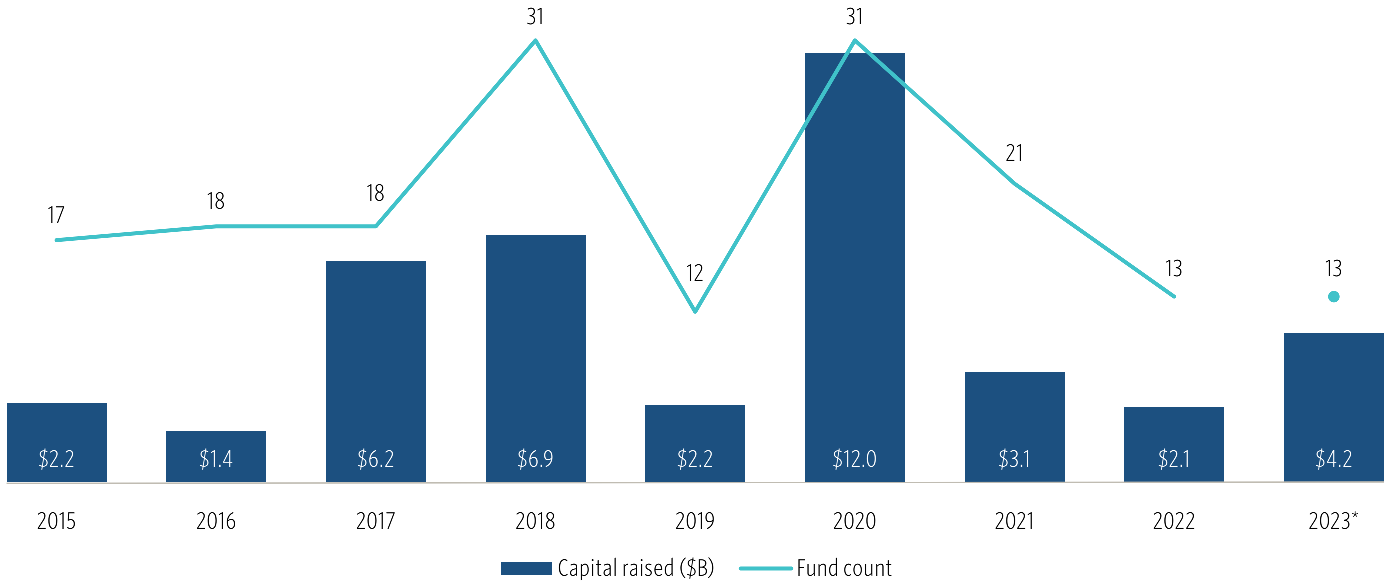
Fundraising

PE fundraising activity



Source: PitchBook • **Geography:** Japan
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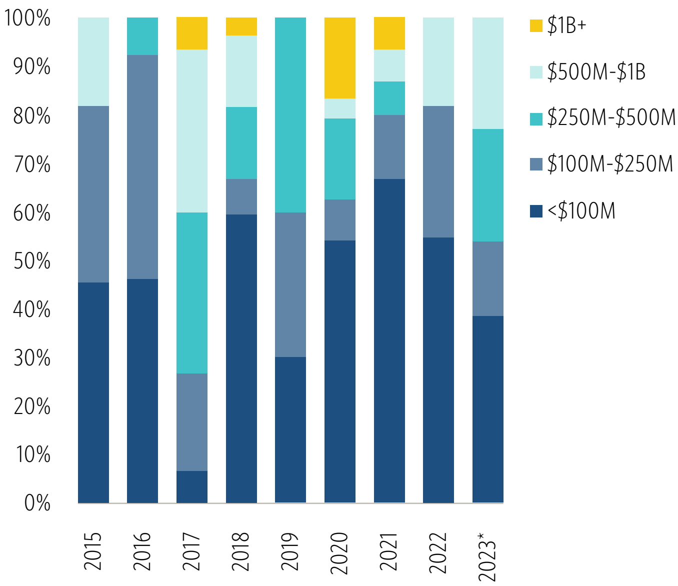
Share of PE fund count by size bucket



Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

Private equity fundraising showing increasing demand

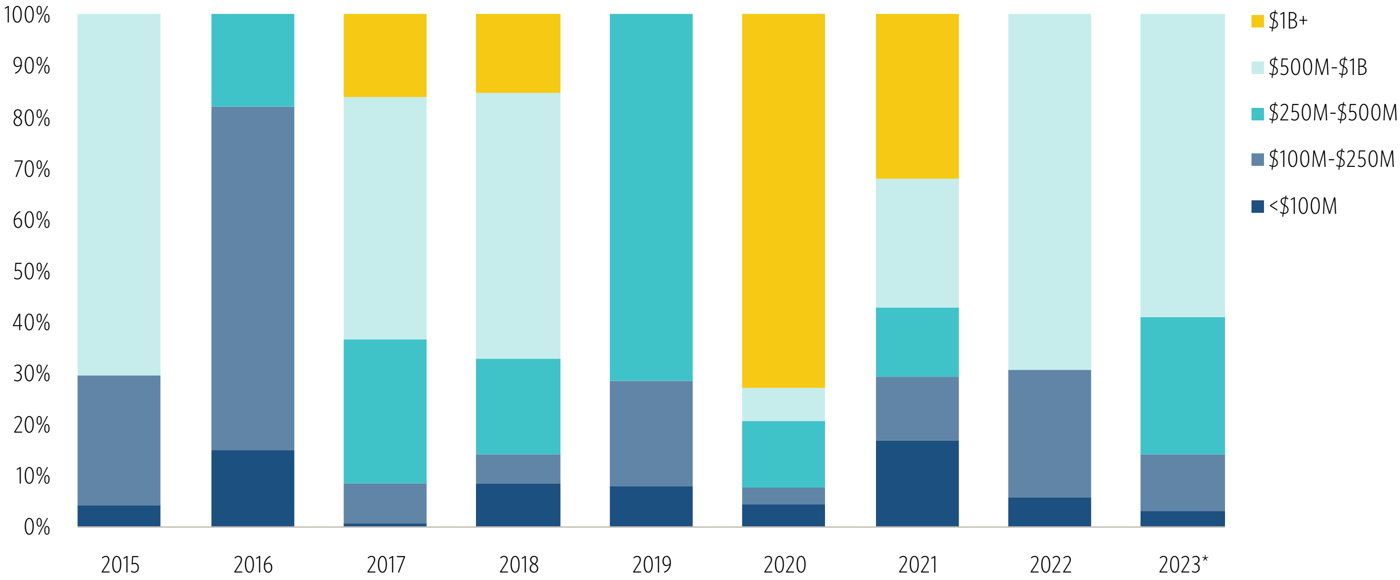
As of Q3, 13 PE funds have closed on a total of $4.2 billion. The largest fund raised thus far in 2023 is Advantage Partners VII, which closed on $978.5 million and will target opportunities in Japan's middle market, followed closely by the $950.0 million close of Carlyle Asia Partners Growth II, which will seek portfolio companies in tech, healthcare, and business services across the APAC region. The remaining 11 funds fall within a range between $3.5 million and $544.0 million, illustrating the wide size dispersion among Japan-focused funds.

A perfect storm of factors is reviving demand for Japanese private equity, particularly from foreign asset allocators: First, the weak yen means that foreign money has more buying power and foreign investors can use currency arbitrage to their advantage. In addition, low interest rates mean LBO financing for deals in Japan is still relatively inexpensive and thus the return potential is attractive. Finally, foreign investors are fleeing Chinese investments as geopolitical tensions rise and the Chinese real estate market—one of the bedrocks for China's explosive economic growth—is struggling.

Though $12.0 billion represented a fundraising peak in Japan, these numbers are a tiny fraction of fundraising in the US and Europe, which as of Q3 2023 have raised $242.0 billion and €86.0 billion, respectively, so far this year.[16] However, it is important to keep in mind that the definitions of small-cap, middle-market, and large-cap funds in Japan

16: For more discussion of the US and European fundraising environments, see our Q3 2023 European PE Breakdown and Q3 2023 US PE Breakdown.

Share of PE capital raised by size bucket



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have not followed those of other markets. Taking the US as an example, funds within the $1 billion to $5 billion range are considered mid-cap funds, while large-cap funds are defined as those over $5 billion. On the other hand, Japanese mid-cap funds are thought of as those between $500 million to $600 million, while large-cap funds are those that surpass $1 billion.

In the same vein, unlike the US and Europe, Japanese private equity has not undergone the megafund phenomenon. In the entire history of Japanese private equity, not a single fund has surpassed the $5 billion mark. The largest fund to close to date was a 2020 buyout fund of $3.8 billion raised by the private equity division of Japan Investment Corporation (JIC). In 2020, JIC launched JIC Capital, its private equity strategy, to target growth equity and buyout opportunities across a wide range of sectors. This particular fund can thus be categorized as an outlier as it is relatively large compared to other players in the market due to its government-backed nature. In addition, JIC Capital operates differently to other pure-play Japanese private equity funds: Rather than acquiring portfolio companies directly, JIC Capital intends to invest alongside other private equity firms and institutional investors.

Though fundraising in Japan has been relatively slow, there are tailwinds that suggest this may change. Global managers that previously had exposure to Japan through their pan-Asian funds and that are hoping to transact on attractive companies in an inexpensive debt environment will likely raise Japan-specific funds. These JPY-denominated funds will lessen the burden on Japanese LPs whose commitments to USD-denominated funds have suffered as the yen has weakened. Additionally, while most Japan-based fund managers generally undergo moderate and incremental step-ups in fund sizes, others are beginning to target larger fund sizes within the $1 billion to $5 billion range. Many of the funds that closed in 2020 will also likely come back to market within the next few years, which could translate to a busy fundraising environment.

The major LPs for Japanese venture capital

A feature of the venture ecosystem in Japan is the composition of large regional active players that are able to deploy large amounts of capital that lead to meaningful impacts on the market. Unlike in the US, where the largest institutional investors consist of federal and state pension funds and university endowments, major players in the Japanese LP landscape consist primarily of three groups: Japanese-government-affiliated investment entities, banks, and large corporations such as trading companies and manufacturers.

The government of Japan has had a long history of promoting domestic business competitiveness through startup investment. Since around 2000, the Japanese government has set up investment vehicles to pump capital into the startup ecosystem. Multiple investment arms were set up as different entities because they are governed by individual laws that confine their lifespan to a specific number of years, but in essence those entities served the same function of contributing to the success of startup development. For example, Innovation Network Corporation of Japan (INCJ), which was established in 2009, changed its name to JIC in 2018, when INCJ, Ltd. was simultaneously set up as a JIC

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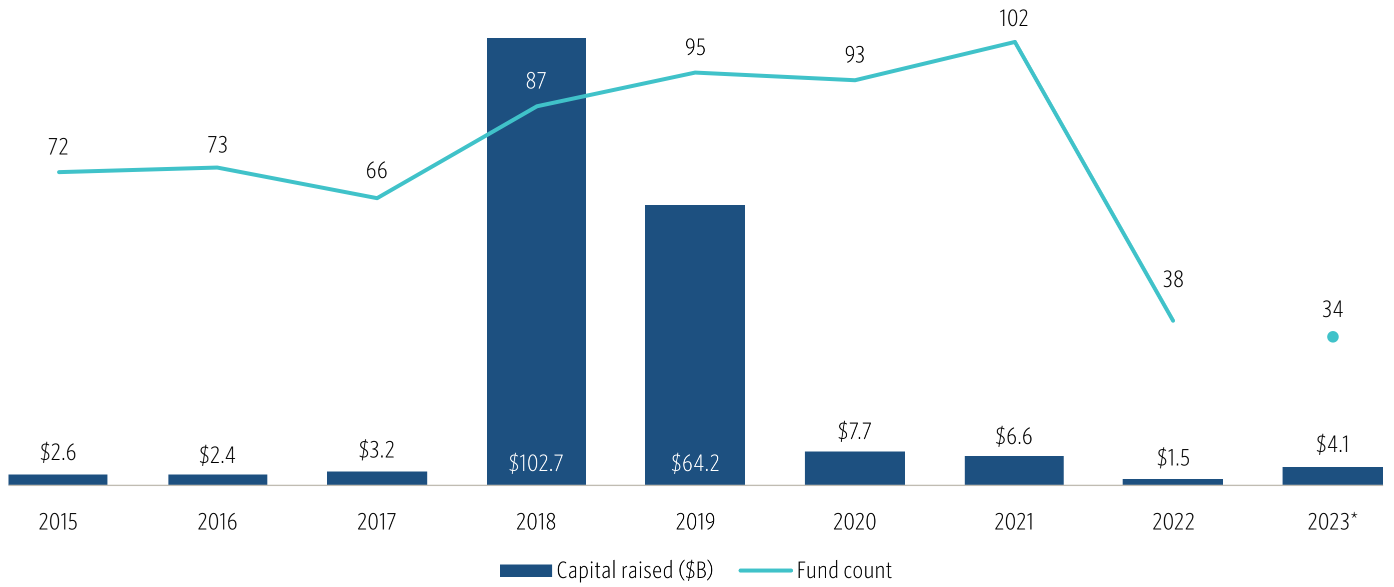
VC fundraising activity



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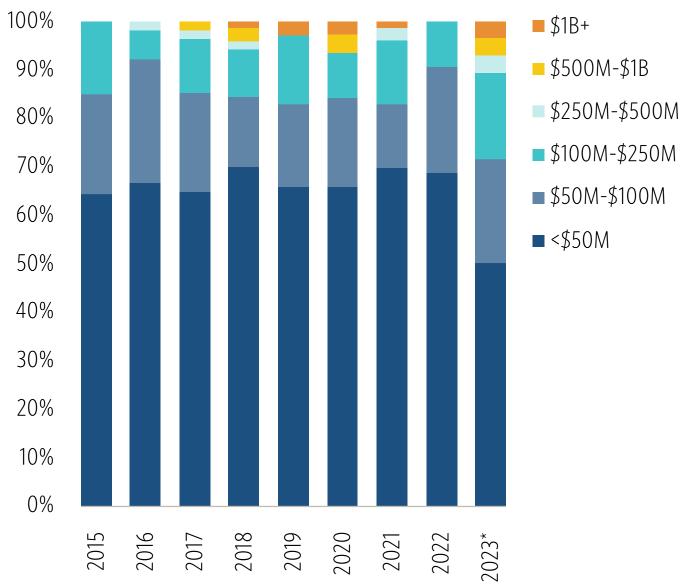
subsidiary.[17] 96% owned by the government and backed by several Japanese enterprises, JIC acts as both GP and LP. For the latter role, the organization commits to both domestic and overseas venture funds.[18] When deploying capital to VCs abroad, JIC aims to help Japanese startups expand overseas to broaden their total addressable market.

Mapping macro climate to fundraising trends from recent years

Japanese VC dry powder currently sits at a historically elevated level. With ample cash from funds available for investing, the domestic venture ecosystem is well positioned to take advantage of tailwinds to further expand. A close look at the macro picture of Japan helps explain the fundraising landscape from the past decade. The 2007 to 2008 global financial crisis (GFC), commonly referred to as "Lehman shocks" in the Japanese context, heavily influenced in the market in Japan, and the impact on the perception of risky investments lingered for several years. Starting around 2013, venture funds in Japan started hiring again, and VC reemerged as an asset class wielding the power to foster innovation. About four to five years later, people who gathered experience working in VC and built investment track records started to fundraise their own funds as emerging managers. The market subsequently experienced a major downturn in 2020 with the onset of COVID-19.

Share of VC fund count by size bucket



Source: PitchBook • Geography: Japan
*As of September 30, 2023

With the trend of new funds getting raised since 2017 and 2018, the VC landscape became more competitive, leading to a greater need for GP differentiation. Founders had more opportunities to pick and choose managers they wanted to work with to grow and scale their businesses. With capital supply becoming table stakes, venture fund managers needed to leverage their expertise to differentiate themselves from the crowd when trying to work with the best founders and to provide additional value to portfolio companies.

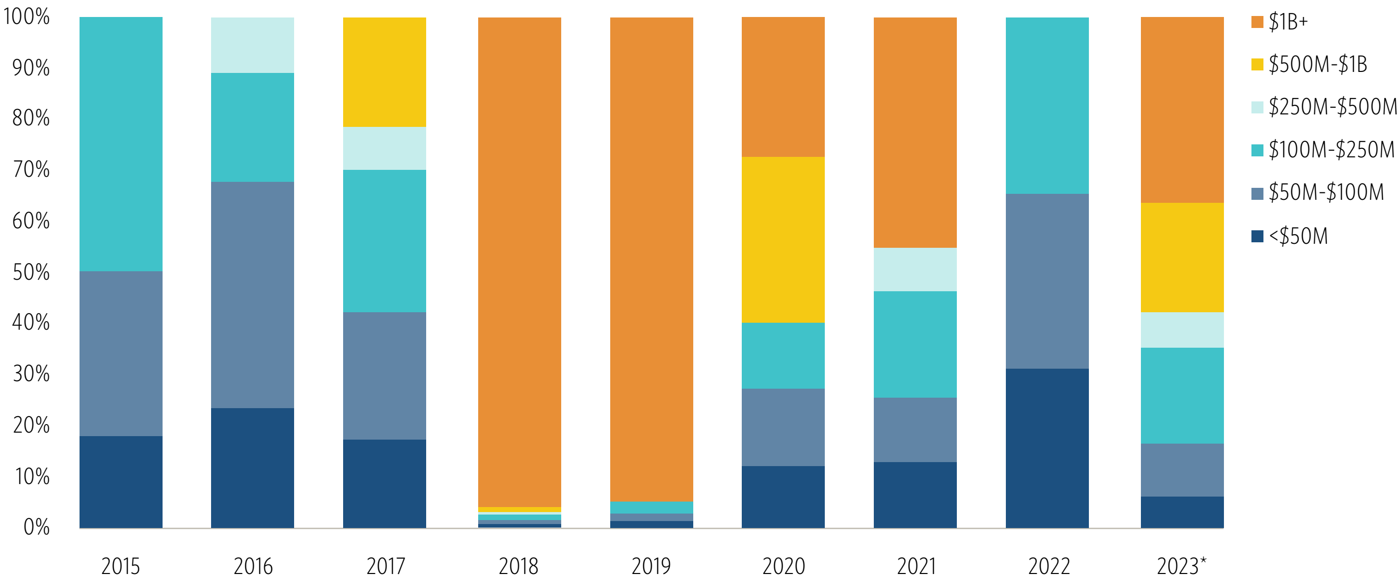
17: "FAQ," Japan Investment Corporation, n.d., accessed November 5, 2023.
18: "JIC Portfolio," Japan Investment Corporation, n.d., accessed November 5, 2023.

Top 15 VC funds by size in 2023*

Fund	Close date (2023)	Capital raised ($M)	Fund type	Fund status
JAFCO SV7	October 2	$662.2	VC	Closed
JICVGI Opportunity Fund No. 1	July 31	$283.4	VC	Closed
SMBC-GB Growth Fund	July 11	$210.3	VC	Closed
SMBC Asia Rising Fund	May 8	$201.3	Early-stage VC	Closed
MUFG Innovation Partners No. 3	September 11	$136.8	VC	Closed
Genesia Venture Fund III	March 31	$110.0	Early-stage VC	Closed
MUFG Innovation Partners Garuda No. 1	February 1	$100.0	VC	Closed
Deepcore Tokyo Fund II	May 31	$85.3	Early-stage VC	Closed
KUSABI No. 1 Investment	February 7	$77.0	VC	Closed
Norinchukin Capital Strategy Co-Creation No. 1 Fund	May 1	$74.9	Early-stage VC	Closed
Angel Bridge Unicorn Fund No. 2	July 19	$70.3	Early-stage VC	Closed
Mixi Global Investments	August 10	$50.0	Early-stage VC	Closed
ICJ No. 2 Fund	October 13	$44.4	Early-stage VC	Closed
Meiji Yasuda Future Innovation Fund	February 1	$38.4	Early-stage VC	Closed
House Foods Group-SBI Innovation Fund II	January 13	$37.6	VC	Closed

Source: PitchBook • **Geography:** Japan
*As of September 30, 2023

Share of VC capital raised by size bucket



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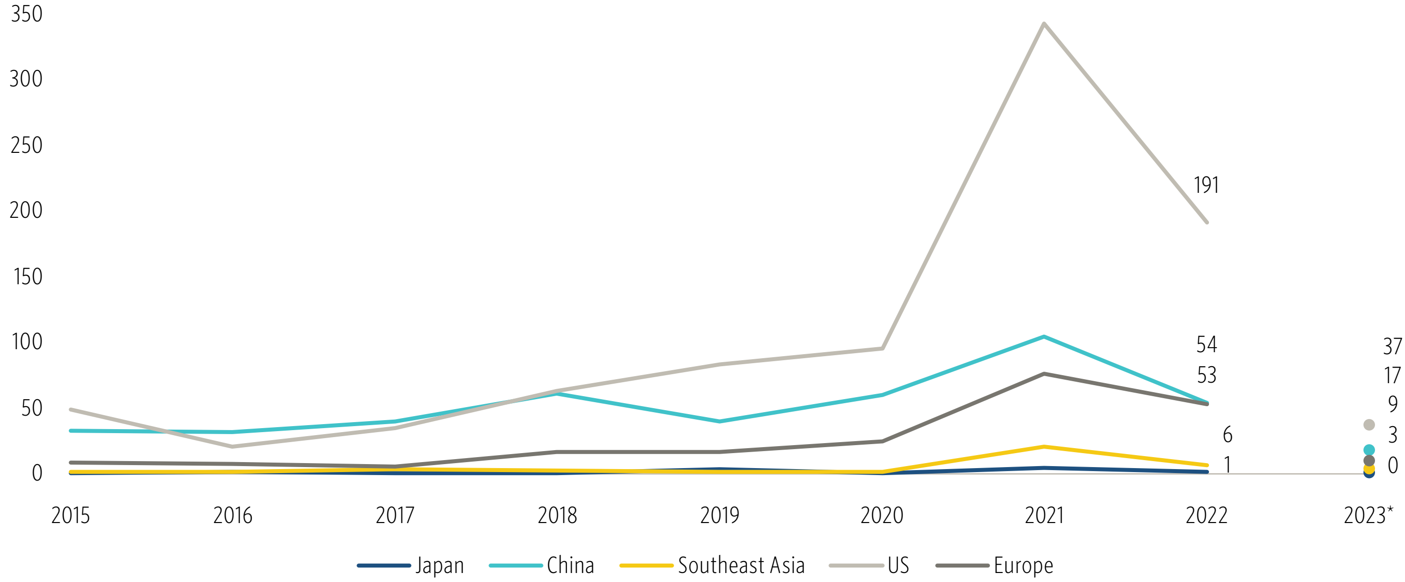
New unicorn count by region



Source: PitchBook • **Geography:** Global
*As of September 30, 2023

Ongoing fundraising challenges

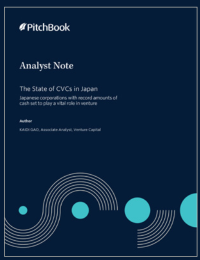
To generate more interest and secure commitments from both domestic and overseas LPs, VCs in Japan need to demonstrate a track record of lucrative financial returns, which have not materialized yet. The number of unicorns, or startups valued at $1 billion or more, is commonly used to measure how vibrant a regional venture ecosystem is. Between 2015 and 2023 YTD, Japan had merely nine new unicorns—significantly dwarfed by the 441 unicorns minted in China and 38 produced in Southeast Asia during the same period. One could argue that the tendency for startups to IPO as soon as they are capable of being listed—and thus missing the opportunity to further grow their valuations—is a leading cause for the lack of unicorns in the country, thereby devaluing the true strength of Japan's VC market.

Company valuations getting compressed adds to the list of fundraising headwinds. Anecdotally, the size of venture funds in Japan that specialize in early-stage investments—in particular Series A and B—has grown over the past few years. However, exit returns failed to match the pace of expansion. In order to consistently deliver fund returns, GPs in Japan resorted to negotiating for lower company valuations.

Uncertainties from a macro standpoint present another layer of challenges. Until mid-2022, the domestic stock market in Japan performed well. Many GPs took advantage of this time window and successfully raised larger funds. With the 2021 capital exuberance in the rearview mirror and people realizing that we might not see another market of extreme capital abundance anytime soon, it has become much more challenging to secure large commitments from LPs, which in turn leads to concerns of diminished dry powder available to be deployed to startups in the near term.

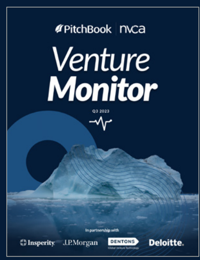
Additional research

Private markets



Q1 2023 Analyst Note: The State of CVCs in Japan

Download the report here



Q3 2023 PitchBook-NVCA Venture Monitor

Download the report here

Q1 2023 Global Fund Performance Report (with preliminary Q2 2023 data)

Download the report here

H1 2023 Greater China Venture Report

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