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The Rise of Corporate Venture Capital Funds for Middle-sized Companies in Japan as the Strategy of New Business Developments

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Introduction

- Presently Japanese companies need to develop higher **profitable new business consecutively**.
- Already **CVC activities are common for Japanese large companies**. Japanese large companies recognize **the limitation of closed innovation** and have established their CVCs to promote their **open innovation strategy**.
- Recently, **not only large companies** (huge amounts of sales revenue on the listed companies in the first section of TSE), **but also middle sized companies** (definition shown later) have started to establish their CVCs.
- This research will consider the **cases of CVCs for Japanese middle sized companies** as a new era in the history of Japanese CVCs
- I tried to confirm this phenomenon is **consistent with general theories and prior literature**.



What's Corporate Venture Capital?

- A CVC is a **tool for new business developments** and promoting open innovation strategies **as a form of an investment fund**.
- Chesbrough (2002) defines a CVC as **a direct investment from a company to an external venture business**.
- CVCs seek not only **financial returns**, but also **strategic return (synergy and collaboration)** between limited partners and invested companies.
- Sometimes CVCs faced the **balancing problem** of both returns and have to pay **extra premium** for getting strategic return.
- Three major tools of “Open Innovation”:
M&A ↔ CVC ↔ Alliance
Dushnitsky (2011)



Three Types of CVC Operations as Defined by Chesbrough

Chesbrough (2002)

There are **three types of CVC formations** in venture business:

1. Investment in VC funds
2. Entrustment of CVC operations to VC firms
3. CVC operations by its own balance sheet



My Definition of a Middle Sized Company

- Many definitions about **small-mid sized companies** are in research papers or white papers
- **No clear definition of middle sized companies.**



As a consequence, I define **a middle sized company** by **5 points** below.

1. **Sales revenue**: Over \$100M but less than \$2B
2. **Amount of Capital**: Over \$10M USD but less than \$500M
3. **Number of employees**: Over 200 but less than 2000
4. **IPO**: Can be either listed or non-listed in Stock Markets
5. **Founding family**: Founding family still exists in management or as shareholders or not, either is acceptable

Two Cases of CVCs Established by a Middle-Sized Company

	Case 1	Case 2
Trade Name	Toyo Kanetsu KK	TOYOSHIMA & CO., LTD.
Established	1941	1841 (Incorporated 1918)
Headquarters	Tokyo, Japan	Nagoya, Japan
Capital	1.85 Billion USD	30 Million USD
Sales Revenue	417 Million USD	1.8 Billion USD
Ordinary Income	26 Million USD	72 Million USD
Number of Employees	899 Consolidated (225 Individual)	526
Listed Exchange	Tokyo Stock Exchange (First Section)	Non-Listed
Main Business	Manufacturing of large Tanks, Logistics Systems (Toyo Kanetsu Solutions as a 100% subsidiary)	Textile trading, apparel business and large-scale electronic equipment
Type of CVC Activities	Entrust management of CVC to a venture capital firm outside of the company (a special fund for the company only)	Self-management of the CVC inside the group



Management Concerns Faced by Toyo Kanetsu

1. The volatility of the business environment and profitability in the two existing businesses is very large.



2. The change of technological innovation in the logistics system business is rapid. If the technical standards change, the power relationship in the industry changes dynamically (necessity of constant catching-up).

3. Because of no debt by the actual meaning, holding a larger amount of cash the amount of bank loans, therefore, ROE and PBR are low. Cash Rich

4. Lack of human resources (especially planning, development, marketing, etc.) inside the company.



5. Each division is overloaded by the immediate response to customer's needs and it is difficult to develop new business for the future.

=> These concerns led Toyo Kanetsu to establish their CVC!

Innovator's Dilemma and Open Innovation Strategy for Toyo Kanetsu

To indicate some of the problems in developing new business for Toyo Kanetsu, there are the following list:

- No existence of R&D Center
- Passive stance of human resources
- The limitation of closed innovation
- Too strong a concentration to their existing business domain



→ **Innovator's Dilemma** Christensen (2001)

→ The Necessity of **Open Innovation Strategy** Chesbrough (2003)

=> Therefore, **they established a CVC!!**

Difficulties of CVCs Established by Middle Sized Companies

Exploring the Future



TOYO KANETSU × TC CONSULTING
TKCV
PARTNERSHIP

In comparison with CVCs established by large companies:

1. **Fund size** for middle sized companies is relatively smaller
=> **Less power / less brand / less ability for big deals**
 2. **Number of business domains of middle sized companies is smaller** than ones of large companies.
=> **the possibility of matching by CVC investments must be low.**
 3. Sales revenue and earnings of middle sized companies are relatively smaller, so **the buffer for investment is also smaller.**
=> **It will be very difficult to execute “exploration”, and it will most likely execute “exploitation” for chasing short term profit.(Competency Trap)**
- => Actually, CVCs established by middle sized companies have some weak points** against ones established by large companies.

Conclusions

1. CVC activities by Japanese middle sized companies are **consistent with well known theories** like open innovation and Innovator's Dilemma, and so on.

(I have not found the difference between the contents shown in previous CVC research and the actual situation of CVCs of Japanese middle sized companies yet. That is a future work.)

2. This phenomenon that Japanese middle sized companies trend to establish their CVCs is **following up to large companies**, but it is **one epoch and a new era in the history of Japanese CVCs**.
3. **From the view of simulating the Japanese economy**, the capital flows from the middle sized companies with large amounts of retained earnings(Cash-rich) **is very effective**.

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