Private Equity Market in Japan

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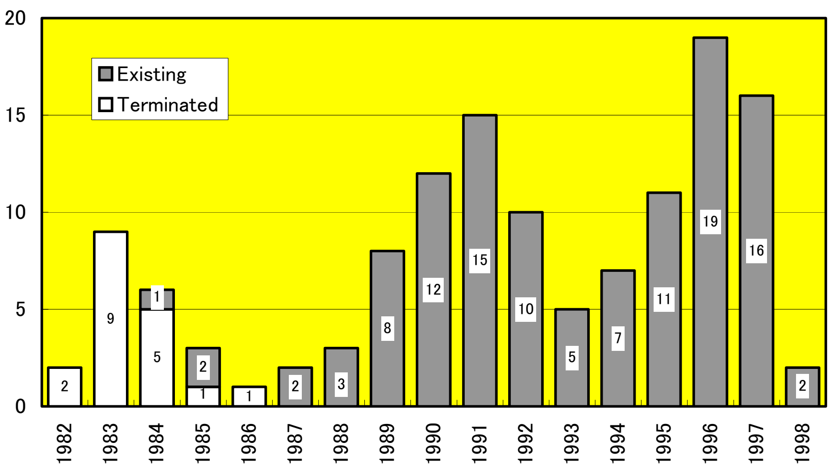
In Japan, there is a heightening of interest in private equity investment such as venture capital and management buyouts (MBO), etc. Expectation is placed on venture capital to alleviate a state of difficulty in raising funds on the part of venture companies. MBOs are seen as being of use in the revitalization of existing companies. However, in order to deploy these functions, it is necessary to meet various conditions.

1. The Need for the Development of a Private Equity Market

The peak of the third venture boom occurred in Japan in 1996. However, from 1997 onwards, the recession intensified and there was an increase in concern about the financial sector. Moreover the credit crunch problem also intensified, and this boom rapidly cooled off. Japan's venture companies and venture capital have come to a major turning point. The number of new venture funds established dropped sharply in 1998, as shown in Figure 1.

Figure 1 Number of New Venture Capital Funds Established



Note: The figures for 1998 are up to September.
Source: "Venture Capital Funds Performance Benchmarks", Ministry of International Trade & Industry (MITI)

However, the need for venture funds has grown still further. According to research carried out by MITI, the rate of establishment of new firms[1] in 1997 dropped by 0.4 points over the previous year to reach the lowest level ever of 3.5%. On the other hand, the rate of exit from the sector rose by 2.2 points over the previous year to a rate of 4.5%. It is the first time since 1975 that the rate of establishment has been below the rate of exit. In 1998, the situation is thought to have worsened. Thus, it is desirable to effect the development of the private equity market as a place to supply funds to the venture firms.

The greatest demand placed on the already mature companies is for a drastic restructuring. To effectively utilize operational resources, a move to sell off divisions has become evident. Buyout is attracting attention as a method of facilitating this kind of restructuring. Another problem facing Japan is the disposal of bad debts and bad assets. Regarding this, expectation is placed on the role of distressed funds.

The areas mentioned above, that is venture funds, buyout funds and distressed funds, are known as private equity funds in Europe and the U.S. These funds are a mechanism to allow investment in equity with less information and liquidity than public equity market. The funds are established by professionals who attract the investors, and they are not a form of the traditional stock and/or bond investment funds. Private equity funds provide a risk and return relationship not found in traditional investment instruments. It is hoped that these funds will also provide a solution to the problem of the Japanese investors who are beset by low performance[2]. In reality, the foundations for the expansion of the private equity market are progressively coming together in Japan as shown hereafter.

2. Movements in the Venture Area

1) Problems besetting Japan's venture companies

The problems directly facing Japan's venture companies and venture capital are not simply limited to the movements reflecting the deterioration of the economy and financial situation such as the economic recession and the credit crunch. There are structural problems surrounding venture companies already existed up to now have emerged under adverse economic and financial situations.

The first problem is the thinness of the foundations of fund raising for venture capital. In the U.S., since the reform of the ERISA in 1979, pension funds have commenced investment in venture capital. This is a vital factor in the expansion of the supply of funds to venture companies. However, the reality is that in Japan the pension funds have not invested in venture capital. That is to say, nearly half of the investors in Japan's venture capital are corporate sector firms, 30% are banks, and the remaining 10% is divided between securities firms and insurance firms. However, in the U.S., over 50% of the investment in venture capital is by the pension funds.

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1 This has been calculated by dividing the number of company established by number of companies nationwide in Japan.

2 Yasuyuki Fuchita, “Reconstruction of Functions of Financial Intermediaries in Japan”, *Capital Research Journal*, Spring 1999

One factor in the background to this is the problems existing in Japan's venture capital system. In Japan, there was no legal framework equivalent to the limited partnership in the U.S. until very recently. We do have an innovative venture investment method which has been developed within Japan's legal frameworks, that is meant to function like the US type limited partnership. Such type of venture capital has progressed and advanced. Even so, many limitations and problems have emerged. A factor that particularly causes institutional investors to hesitate is the possibility of the investors not being covered by complete limited liability.

Also, recently, performance of those Japanese type venture capital has deteriorated. There are some cases where investors point out problems in the operations of some venture capital and a lack of information disclosure to investors.

In addition, it has also been pointed out that it is difficult to make a decision on investment due to the insufficiency of performance data. This is due to the lack of tracking records regarding venture investments.

Another problem surrounding Japan's venture companies is the nature of the exit market. This is a market in which partners realize cash inflows through invested venture firms' IPOs or purchases by other firms. In the U.S., NASDAQ is an exit market that offers an extremely high degree of liquidity. Also purchases of venture firms by other firms are very much common in the US. In addition, there is also a secondary market for limited partnerships, to a certain extent. According to one US venture capital, the ratio of IPOs and acquisition of the firm they are investing in is 2 to 8. In venture companies in the biotechnology sector, there are almost no cases of the company being offered publicly. Rather they are sold to big corporations enabling investors to reap the fruits of investment quickly.

However, in Japan the OTC market acts as an exit market but the liquidity is low. In addition, it is also pointed out that it takes a considerable period of time to IPO. Other exit markets, such as acquisition by other firms, are inactive.

2) Recent changes

In response to the situation described above, recently various measures have begun to be taken. In November 1998, Limited Partnership Act for Venture Capital Investment was enforced. This ensures that investors are covered by limited liability. A disclosure mechanism was also provided. In the OTC market, measures have been taken including the introduction of a new segment in OTC market (July 1996) in which the registration standards are more relaxed than normal and the introduction of a market maker system (December 1998). From July 1997, brokerage and dealing business of non- listed or non-registered stock by securities firms were deregulated. Thanks to this, the non-listed, non-registered stock of venture firms has been given a certain degree of liquidity. In Japan, such shares are often called "private equity." However, as we have previously mentioned, in Europe and the U.S., investment through venture capital is the norm.

There used to be a problem felt in terms of a sharp fall in stock prices of OTC stocks immediately after public offering, and a book building method was introduced for the setting of IPO prices (September 1997).[3] Angel or wealthy investors interested in nurturing venture firms is an important source of funds for venture companies, and a special tax exemption system has been introduced to alleviate individual investors' loss from investments in venture firms (May 1997).

Interest has also heightened in the area of private equity investment by institutional investors. The report, "Fund Asset Management in an Age of Deregulation" released by the Committee on Investment by Pension Funds of the Pension Fund Association in November 1998, states that new types of financial products and services will emerge in line with advances in the major reforms going on the financial sector. The advances expected in the range of products offered should be welcomed in as much as it expands the range of selections available to meet the needs of fund managers. One new sector mentioned was venture investment.

In addition, in December 1998, the Ministry of Trade and Industry (MITI) compiled data on the performance of Japan's venture capital funds. This data will be compiled and released every year. It is hoped that it will facilitate the evaluations and decisions made by institutional investors in the area of venture capital investment.

3) The Basic Differences between Japanese and U.S. Venture Capital

However, in the environment surrounding venture company finance there are still basic differences between Japan and the U.S. In the U.S., a major commitment is made to the operations of the firm invested in. By providing the firm with various managerial supports such as a managerial strategy in general, or specific advice concerning personnel, marketing and technology, this enhances the value of the firm invested in. However in Japan, this function of the investor is weak. Japan's venture capital shows a tendency to invest small amounts over a broad spectrum in diverse companies.

Reflecting this characteristic, Japan's venture funds often tend to invest in companies at a later stage. This means that the proportion of investment in companies which have been established for ten years or more stands at nearly 60% while investment in companies established for less than five years is only 17%. However, in the U.S., about 18% of funds are supplied at the time of establishment, and in the case of firms established for less than five years, 66% of funds has been invested.

The problem does not lie in the difference in figures alone. Based on the needs of the owners of Japan's venture companies and the structures of the financial and labor markets, Japan's venture capital has performed a vital role that is not seen in the U.S. For example, many of the owners of Japan's venture companies take the stance that if the venture capital imposes the condition that if the company's performance is not good, the owner will be fired from the management team, then they do not want to deal with the funds. They would rather seek the funds elsewhere or seek other venture capital firms which do not impose such unacceptable conditions.

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3 See "Reform Movements in the OTC Market of Japan" by Sadakazu Osaki, *Capital Research Journal*, Summer 1999

However in the U.S., it is considered to be normal for the venture capital to impose the condition that if performance is poor, the management will be replaced. In the U.S., it is considered to be a step towards success for a venture company to be able to do business with a famous venture capital. In fact, famous venture capital companies receive many hundreds or thousands of applications for investment every year from venture companies but only a few companies are able to receive funds and advice from the venture capital. In order to succeed, it is the wisest course for the founder of the venture company to accept the guidance of the venture capital firm which is a professional in terms of increasing the value of companies.

However, in Japan numerous venture capital firms compete with each other to invest in venture companies, and during the venture boom it was common to see several venture capital firms fighting with each other for the privilege of investing funds in one venture company. In order to expand their operations, venture capital firms found that it was difficult to impose demanding conditions.

Even if the venture firms were to accept conditions regarding management methods, the problem emerged as to if it would be possible to find a suitable person from outside to act as the CEO. This is because Japan does not have a well-developed executive manpower market. In the case of the U.S., the management team requires 15 to 30% of the ownership of the venture company. This is considered to be an incentive to spur on the management team. In the case of companies in which the owner has an obsession with maintaining control or wants to hand the company down to his/her children, it is not unusual for the venture capital companies not to be interested in doing business right from the start.

In reality, only 1 to 2% of the small and medium size firms are receiving financing from the venture capital firms. Thus, only a handful of extremely able small and medium size firms with good growth potential are able to have relationships with venture capital companies. In Japan, many venture capital firms are affiliated with financial institutions, and many of their proposals for investments are handed down to these firms from the parent company. In such cases, they may be required to make a decision on whether to invest very quickly. Thus, there is a problem of these firms not being able to exercise due diligence. In this case, the venture capital firms are required to play along with the parent company and they don't expect to have a major say in the management of the venture company, since the parent company want to other affiliated firms have relationship with the firm. In Japan's case, an important function of the conventional type of venture capital firms has been to make the small and medium companies understand the significance of equity finance. In this way they have played an important role in seeking to bring as many firms as possible to the stock market in a climate where indirect financing (borrowing from banks) is in an overwhelmingly strong position.

Japan's third venture boom hit a peak in 1996 and has subsequently fallen into a cooling off phase. Nevertheless, expectation is placed on an increase in finance to new venture companies. However, it will be necessary for changes to occur in the stance of the entrepreneurs in terms of ownership and management rights. At the same time, there is a possibility of the venture capital being required to perform the role played by general partners in the U.S. or U.K.

4) Manpower Problems related to the Venture Sector

This would make the existence of venture capitalists essential to respond to these demands. These people possess specialized knowledge of the sector, and are able to bring in other people with specialized knowledge of finance, marketing and technology. They are willing to make a commitment to management and enhance the value of the target company. In this sense, it is relevant in recent years, there has been widening recognition of the importance of the nurturing of human resources in venture related industry. The Ministry of Trade and Industry (MITI) introduced "Promotion of Training of venture capitalists both overseas and in Japan" (Budget 120 million yen), within the first supplementary budget for fiscal 1998 and implemented the operation from March 1999.

It is expected that pension funds will start to invest in private equity. It will be important for the funds to select the venture funds based on the quality of venture capital firms. They should check that firms are managed by talented people and not judge them based only on the size of the venture capital firm and its reputation up to now. By adopting this stance, talented manpower will be correctly evaluated, and it is expected that the venture capital industry will attract talented manpower from other industries and develop and advance.

The largest private equity investment entity in the U.S. is CALPERS "California Public Employee Retirement System." CALPERS adopts a clear stance that even if the firm is small, if it shows advanced management abilities, it will commission the firm to handle very large amounts of money. In 1989, CALPERS chose Pacific Corporate Group, at that time not so well known. In 1998 CALPERS again attracted attention by choosing Glove Street Advisers, another less known firm with a staff of two to manage a venture capital program worth 350 million dollars.

3. Buyout Related Movements

1) Debate over systems

As previously mentioned, buyout is a system expected to play a major role in facilitating the restructuring of existing companies in Japan. From October 1998, MITI started to hold study sessions on MBOs. MITI implemented research on the significance of MBOs and problems to be overcome in bringing this concept into general use. In the report published in April 1999, the areas that need improvement were pinpointed.

(1) The preparation of legal systems to facilitate unrestricted changes in the organization of companies in line with the transfer of operations (goodwill).

- Under existing laws, even if a company is established with the purpose of effecting a buyout, it is subject to certain conditions. In the case of a new company established less than two years, under commercial code 246 when it wishes to acquire sales assets worth one twentieth or over of the firm's capital, in principle it is necessary to undergo an examination by an inspector appointed by a court. It is thought that a reform of this law is necessary.
- A stock exchange system should be set up in which when minor stockholders excluding the seller hold some of the stock of the firm targeted for MBO, an exchange of this stock will become possible between the firm targeted for MBO and the firm seeking to make the purchase.

－ In addition, a reform of the takeover bid system, the introduction of a cash-out merger system allowing acquisition with cash and other assets of the stock of minor stockholders, and the reform in bankruptcy law etc., are also pointed out.

(2) The creation of tax systems to reduce or eliminate the tax burden on consolidated balance sheets and exchange of stocks.

(3) Measures to facilitate fund procurement by firms engaging in MBOs or MBO funds.

(4) The creation of a labor market promoting higher liquidity among manpower resource such as the portability of pensions.

Naturally, even if these improvements in the system are effected, it is not easy to find a buyer of divisions that are merely unprofitable. Companies or operational divisions that show promise of generating stable cash flows are suitable as targets for buyout funds. Normally, there are not so many firms wishing to get rid of such operational divisions. However, recently a phenomenon has emerged in Japan's industrial sector in which companies seek to concentrate their operational assets in core operations. There are also companies emerging which are even willing to sell divisions actually generating cash flows due to their cash flow difficulties.

2) The Present Situation and the Outlook

There are several firms in Japan existing with the purpose of effecting buyouts in anticipation of these changes (Table 1). In 1998, the first case of an MBO in Japan occurred. The management team of ICS (a firm publishing the magazine "Overseas Study Journal") and JAFCO established a holding company. The newly formed holding company purchased all the stock and the trading rights of ICS from WDI which is ICS's parent company and is engaged in catering operations. The management team of ICS invested 25% of the capital of 1.1 billion yen of the holding company and JAFCO invested the remaining 75% and holds subordinated bonds of 400 million yen. In addition Fuji bank and Tokio Marine & Fire Insurance implemented co-financing (provided a syndicated loan) of 1.9 billion yen. In this example, WDI sold ICS to concentrate on its main line of catering operations. This is a pioneering move in which a financial institution conducted lending based on cash flow and not on real estate collateral (which has been the usual method of lending up to now) while exercising due diligence.

Table 1 Japan's Main Buyout Fund Management Firms and the Scale of the Funds

(100 million-yen)

Management Firms	Amount
E.M Warburg Pincus and Company (U.S.)	1,200
Ripplewood (U.S.) / Mitsubishi Corporation	1,200
3i (U.K.) / The Industrial Bank of Japan	200
Rothschild (U.K.) / Mitsui & Co.	100～150
Schroder PTV Partners	approx. 90
Patricof Group/Globis	approx. 60

Note 1: Including anticipated
Note 2: Other such firms include Advantage Partners, and Unison Capital, etc.
Source: The Nihon Keizai Shinbun, April 15, 1999/Nomura Research Institute

Thus, signs of trading in the area of buyouts have emerged in Japan. Reflecting this, the management firms running funds in the West are beginning to show interest in Japan's buyout market. For example, it has been announced in the mass media that over the next three to five years, E.M Warburg Pincus will invest a total of 120 billion yen in Japanese companies.[4] This amount includes some aimed at investment in venture companies, but the main emphasis appears to be on investment buyout opportunities. The question as to whether the buyout market will achieve real development in Japan depends to a great degree on to what extent the value of the target firm increases after buyout. Other concerns include the question of whether existing management personnel are really talented, and if not, is it possible to find talented management staff on the outside markets. Moreover, it may well be that numerous case of reducing staff will occur to expand the cash flow. However, there would be major resistance to this in Japan. If it were difficult to solve these obstacles, the return on the funds would not be adequate. It should be clearly realized that MBOs are not a form of magical medicine allowing restructuring without pain.[5]

Another source of concern is that, at this stage where it is not yet certain that enough firms worthy of investing in can be found, the interest in MBOs is leading the way, and it may result in funds alone being gathered. As a result, when promising MBO target firms emerge, it would become a very expensive transaction, and this could well lead to hopes of good investment performance not being fulfilled.

4. Distressed market

From the autumn of 1997, the major city banks have been engaged in full-scale bulk sales of bad debts. From April 1998 to March 1999, it is thought that overseas securities firms and investment funds bought up a total of about 8 trillion yen (book value) in bad debt.[6] The leading purchasers included Goldman Sachs, CERBERUS (a major U.S. investment fund in the area of bad debt) and Lone Star Opportunity Fund (Table 2). The sellers, the Japanese banks, appear to have acquired a familiarity with the pricing method based on discounted cash flow methods and know-how on negotiating.

"Bad Debt" means that these debts are not able to provide the cash flow desired by the holder, and so they may be "Bad" in the eyes of the current holder. However, as long as there is still some possibility of generating a cash flow, they have some kind of market value. If they are supplied to the market at a really cheap price, buyers should emerge to purchase these investment instruments. They are "Bad" because they are on the balance sheet with unrealistic prices. For companies or banks able to withstand the loss on the sale of "Bad Loans" and in a hurry to effect restructuring, there is a movement underway to sell them in lump lots to these funds. In this way they can completely wipe them off their balance sheets rather than selling them off themselves in time-consuming ways such as going through court actions.

4 The Nihon Keizai Shinbun, March 22, 1999
5 For details, see "Japan's Financial and Corporate Systems Move in New Directions" by Yasuyuki Fuchita, *Capital Research Journal* Summer 1999 on the subject of effectiveness and limitations of MBOs in terms of improving industrial competitiveness.
6 The Nikkei Financial Daily, March 23, 1999

Those investing in funds are the pension funds and the affluent individuals in Europe and the U.S., the same kind of people as are investors in private equity funds. It is said that investment by Japanese financial institutions sometimes accounts for about 20%. In Japan, it is necessary to expedite the disposal of bad debts and bad assets in larger amounts. Therefore, attention is focused on whether a distressed market will be formed in Japan.

Table 2 Major Purchases of Bad Debt by Foreign Investors

Time	Buyer	Seller	Book value
Term to March 1998	Goldman Sachs	Sumitomo Bank	400
	Bankers Trust/ Deutsche Bank	Crown Leasing	2,800
	Goldman Sachs	Bank of Tokyo-Mitsubishi	125
	Lone Star	Bank of Tokyo-Mitsubishi	200
	Unknown	Sanwa Bank	1,500
	Merrill Lynch/ Lone Star	Sakura Bank	4,000
	Secured	Mitsui Trust and Banking	1,300
	Unknown	Sumitomo Bank	1,000
Term to March 1999	JP Morgan/ Daiwa Securities US	Bank of Tokyo-Mitsubishi	1,000
	Merrill Lynch/ Lone Star	Sanwa Bank	300
	Merrill Lynch/ Lone Star	Fuji bank	500
	Unknown	Dai-Ichi Kangyo Bank	2,000
	Unknown	Sumitomo Bank	600

Note: Market estimate/Amounts are in 100 million-yen units
Source: The Nikkei Financial Daily, March 23, 1999

Conclusion

The venture boom which hit a peak in 1996, cooled off rapidly in 1997 due to the surfacing of financial uncertainty. It is sometimes criticized that during the boom, an excessive amount of funds flowed from many of the venture capital firms to the venture companies and caused the management of venture companies to engage in excessive investment. In1999, activity returned to the OTC market after a considerable absence. It is thought desirable that venture company finance should take root and not just generate a temporary boom. In this sense, it is hoped that these various new measures will be effective.

Regarding buyouts and distressed markets, there is an increase in coverage by the mass media just like a boom. However, these markets should go on to take firm root in Japan as a new investment sector for institutional investors and as a new form of corporate finance and an alternative tool for corporate restructuring for the corporate sector. Japan's private equity market should no doubt aim for the same kind of development as seen in the West.

A good trend in this respect is the recent upsurge in cross border activity from Japan to the West and from the West to Japan. There is a clear movement in terms of Japan's investors and funds investing in U.S. private equity, a rapidly expanding sector. As can be seen in Table 3, up to now overseas venture investment by Japan has been undertaken very actively. However, this has mostly been centered on Asia and the Pacific area, and the relationship with the U.S. market, the real core of private equity, has been small. This relationship has increased in weight over the past few years.

Table 3 The Amount of Investment by Japan's Venture Funds in Companies by Region (New and Additional)

(Unit: 100 million yen/%)

	Japan		Asia and Pacific area excluding Japan		North America		Europe		Latin America		Other Regions		Total
	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount
1982	0.0	(0.0)	0.0	(0.0)	0.0	(0.0)	0.0	(0.0)	0.0	(0.0)	0.0	(0.0)	0.0
1983	16.0	(100.0)	0.0	(0.0)	0.0	(0.0)	0.0	(0.0)	0.0	(0.0)	0.0	(0.0)	16.0
1984	51.2	(100.0)	0.0	(0.0)	0.0	(0.0)	0.0	(0.0)	0.0	(0.0)	0.0	(0.0)	51.2
1985	64.0	(98.8)	0.0	(0.0)	0.8	(1.2)	0.0	(0.0)	0.0	(0.0)	0.0	(0.0)	64.8
1986	39.8	(92.1)	0.0	(0.0)	3.1	(7.2)	0.3	(0.7)	0.0	(0.0)	0.0	(0.0)	43.2
1987	32.4	(97.0)	0.0	(0.0)	1.0	(3.0)	0.0	(0.0)	0.0	(0.0)	0.0	(0.0)	33.4
1988	32.5	(47.9)	25.5	(37.6)	1.0	(1.5)	8.9	(13.1)	0.0	(0.0)	0.0	(0.0)	67.9
1989	57.9	(36.6)	90.9	(57.5)	3.6	(2.3)	1.1	(0.7)	4.6	(2.9)	0.0	(0.0)	158.1
1990	116.3	(59.8)	67.2	(34.5)	6.2	(3.2)	4.9	(2.5)	0.0	(0.0)	0.0	(0.0)	194.6
1991	146.5	(55.8)	105.6	(40.2)	6.7	(2.6)	3.6	(1.4)	0.0	(0.0)	0.0	(0.0)	262.4
1992	150.8	(63.7)	69.9	(29.5)	8.1	(3.4)	6.8	(2.9)	1.0	(0.4)	0.0	(0.0)	236.6
1993	53.4	(57.5)	33.9	(36.5)	3.9	(4.2)	1.2	(1.3)	0.5	(0.5)	0.0	(0.0)	92.9
1994	97.4	(47.9)	88.0	(43.2)	15.0	(7.4)	2.8	(1.4)	0.3	(0.1)	0.0	(0.0)	203.5
1995	94.5	(47.8)	86.6	(43.8)	12.0	(6.1)	2.2	(1.1)	1.5	(0.8)	1.0	(0.5)	197.8
1996	107.1	(49.8)	79.3	(36.8)	23.1	(10.7)	2.8	(1.3)	1.2	(0.6)	1.7	(0.8)	215.2
1997	145.1	(59.4)	61.9	(25.3)	30.9	(12.6)	0.3	(0.1)	3.2	(1.3)	3.0	(1.2)	244.4
1998	21.8	(50.0)	7.6	(17.4)	14.2	(32.6)	0.0	(0.0)	0.0	(0.0)	0.0	(0.0)	43.6

Source: Compiled from "Venture Capital and Performance Benchmarks", MITI

These days, there are more opportunities for Japan's venture companies to come into contact with the private equity funds and investment banks of Europe and the U.S. In reality, Japan's venture companies have come up against the tight credit squeeze implemented by Japan's commercial banks at a time when they are being asked to repay their debts to the banks. Some of them have made an approach to the investment banks of the U.S., and in a few cases they have been able to find quick equity financing in the U.S. market. Although it is still a long way from being a full-scale movement, there is a move underway for the pension funds of the West to invest in Japan's venture capital. In addition to E.M. Warburg Pincus, other prime U.S. private equity funds such as Patricof made an entry into the Japanese market lately. There are also some movements in terms of joint ventures between prime U.K. institutions such as 3i and Rothschild and Japanese firms.

It is likely that differences in culture, history, employment systems and financial systems between Japan and other countries will emerge, and processes of trial and error will be repeated by those involved. However, with the advances made through Japan's Big Band, the thinking and behavior of Japan's institutional investors and companies are moving toward global standards. There can be no doubt that the stance of investors who invest in funds and the stance of those of the corporate sector who receive funds will change.

At the time when the U.S. pension funds and foundations began investing in private equity, there were not many fund management firms with adequate experience and track records. In fact, the fund management firms themselves were nothing more than venture companies. However, the major U.S. institutional investors went ahead with their investments, cautiously but resolutely, and they were rewarded with success. At that time, the NASDAQ was a far smaller market than it is today.

The reason for the development of today's private equity market in the U.S. was not due to the existence of a high liquidity NASDAQ. Outstanding companies were nurtured through the mechanism of the private equity market and this led to the development of the NASDAQ market. That is to say, investors such as pension funds funded small but effective funds. The companies receiving investment and management advice from the talented managers of these funds prospered and developed. As a result, the fund management companies themselves also grew and the institutional investors benefited from a good return. This justified the next round of investment by institutional investors in private equity. NASDAQ, which accepted these successful companies, grew too, and this promoted the existence of a smooth exit market. This benevolent circle functioned and the private equity market developed. Internet companies emerged and large-scale mergers among companies were expedited. These developments have come to support the dynamism of the U.S. economy and industry today.

In Japan, there is a major lack of investment by institutional investors and a lack of commitment by general partners to boost the value of the target companies. Signs of change are emerging. We need to see the shoots of a mechanism to create new values emerging that will generate the dynamism required by Japan's economy and industry in the 21st century, and not the start of a quick transitory boom.