Fact-finding Survey on Business Practices of Start-ups

November 2020
Japan Fair Trade Commission

I. Purpose and Conditions of the Survey

1. Purpose of the survey

As start-ups have the potential to greatly contribute to the productivity improvement of the Japanese economy by promoting innovation, importance has been placed in recent years on improvement of productivity through open innovation in which start-ups form business partnerships with large companies, etc. Under such circumstances, it is crucial for future Japanese economic development to ensure an environment in which start-ups can compete fairly and freely.

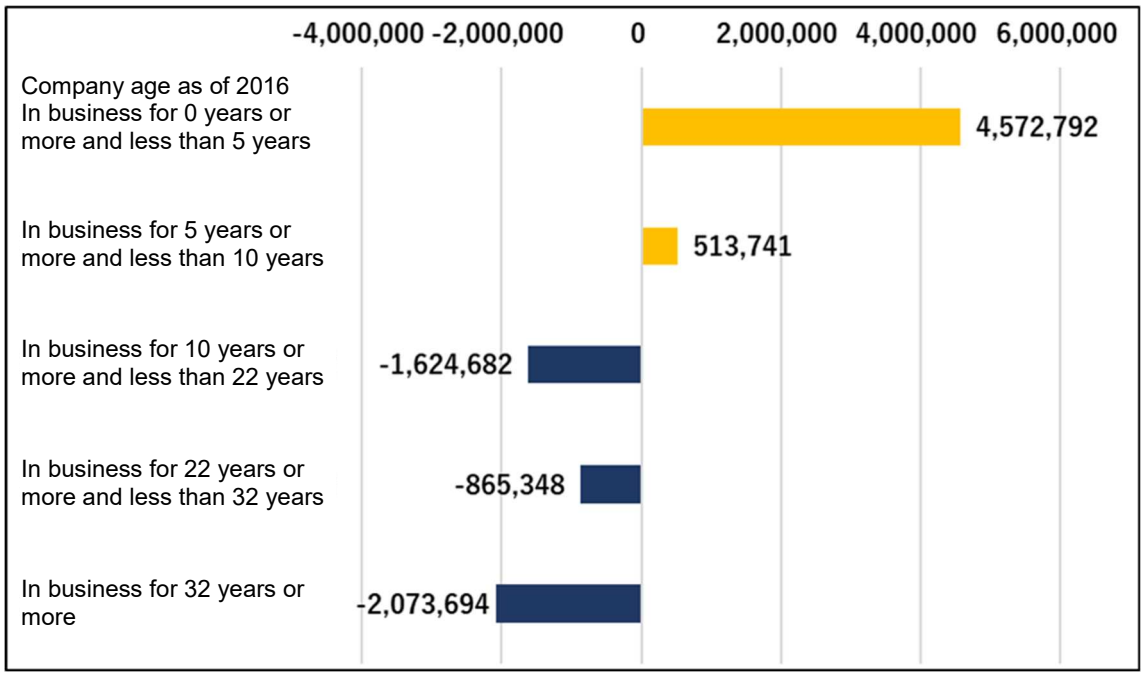
With regard to business partnerships between start-ups and large companies, the Japan Fair Trade Commission (JFTC) published the "Report on the Fact-Finding Survey on the Status of Abuse of Superior Bargaining Position involving Intellectual Property and Know-How of Manufacturers" on June 14, 2019. In this report, the JFTC has confirmed cases of transactions relating to know-how and intellectual property rights by small- and medium-sized enterprises (SMEs) in the manufacturing sector which could constitute problems under the Act on Prohibition of Private Monopolization and Maintenance of Fair Trade (hereinafter referred to as the "Anti-monopoly Act"). The JFTC also indicated a concern regarding the transaction environment of start-ups, stating as follows: "Venture businesses that have made up-front investments and have poor financial strength may be prone to falling into an inferior position against their trading partners. It is necessary to note that many enterprises pointed out this aspect in this fact-finding survey. If a venture business with breakthrough technology enters a market but is driven out of the market not as a result of competition, but due to an unjust act of a trading partner that has a superior bargaining position, competition in Japan could lose its vitality."[1]

In addition, start-ups are important not only in terms of promotion of innovation, but also in terms of creation of new jobs. For example, when changes in the number of workers are compared between the 2012 and the 2016 Economic Census for Business Activity, companies in business for 10 years or more are found to have decreased their number of workers, whereas those in business for less than 10 years have increased new employment (Figure 1).[2],[3] Given that founding of new start-ups also leads to development of the Japanese economy through creation of new jobs, it is essential to secure a fair and free competition environment to facilitate start-ups to newly enter the markets.

---

[1] p. 50 of the Report.
[2] The changes in the number of workers from 2012 to 2016 were calculated by subtracting the number of workers at places of businesses by time of establishment under the 2012 Economic Census for Business Activity from such number of workers under the 2016 Economic Census for Business Activity.
[3] According to "Nihon keizai saisei no gendōryoku wo motomete" [Seeking a driving force for revitalization of the Japanese economy] (FUKAO Kyoji and Hyeog Ug KWON (2010)), with regard to changes in the number of regular employees by company age between 2006 and 2001, there was a net increase of approximately 2.28 million employees for companies aged less than 10 years, while there was a net decrease of approximately 3.4 million employees for companies aged 10 years or more and less than 50 years.

Figure 1: Changes in the number of workers (between 2012 and 2016) by company age (Unit: persons)



Source: Created by the JFTC based on ”2012, 2016 Economic Census for Business Activity” (Ministry of Internal Affairs and Communications [MIC] and Ministry of Economy, Trade and Industry [METI]).

In view of the above, the JFTC conducted a survey to clarify the actual conditions of business practices of start-ups, not only in the manufacturing industry, but in a wide range of industries, from the perspective of promoting fair and free competition in start-ups’ business activities.

2. Survey status

The JFTC started the survey in November 2019. It carried out a questionnaire survey from February to June 2020, and released the “Interim Survey Report on Business Practices of Start-ups” on June 30, 2020, compiling a part of the questionnaire survey results. Subsequently, the JFTC conducted a further survey, held interviews with a total of 144 parties (126 start-ups, five investors, 10 experts, and three trade associations), and completed this final survey report.

3. Questionnaire survey

The questionnaire survey was conducted as follows.

(1)Targets of the questionnaire survey

The JFTC selected the targets for the questionnaire survey based on conditions such as being in business for 10 years or more and being unlisted, and sent the questionnaire to 5,593 start-ups.

(2)Method of the questionnaire survey

The questionnaire survey was conducted online.

(3)Periods of the questionnaire survey[4]

From February 21 to March 19, 2020.

From April 13 to June 11, 2020.

(4)Number of respondents

1,447 start-ups (response rate: about 25.9%)

[4] The questionnaire survey was conducted over two separate periods in consideration of the effects of the COVID-19 pandemic.

II. Outline of Start-ups

1. Definition of a "start-up"

There is no unified definition for a “start-up,” but a generally common idea is that it is an enterprise that has been in business for a few to about 10 years, conducting innovative business activities in a growth sector.[5] Start-ups’ business contents span a diverse range of industries including primary and secondary industries.

In this survey, the JFTC defined a “start-up” as an enterprise conducting business activities in a growth sector, which [i] has been in business for about 10 years[6] and which is [ii] an unlisted company,[7] and made such start-ups the survey targets.

2. Characteristics of a start-up

(1) Differences between a start-up and a small- and medium-sized enterprise (SME)

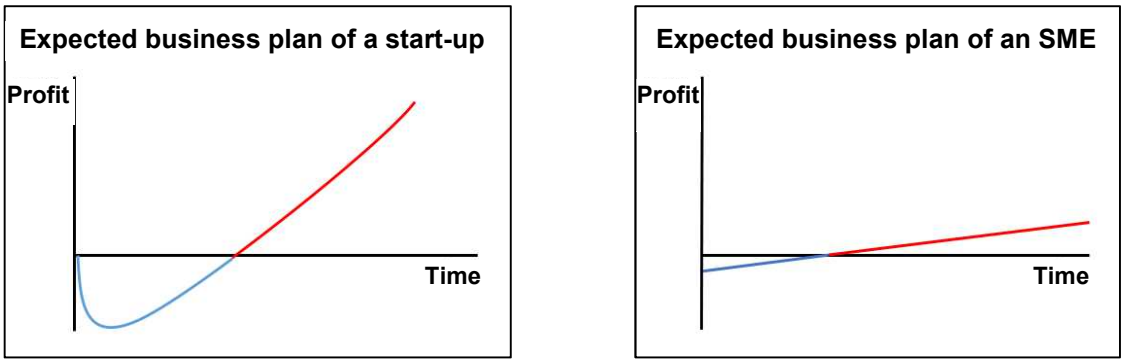
A. Difference in characteristics of the enterprise

A start-up has different characteristics from a general small- and medium-sized enterprise (SME) mainly in terms of its [i] own growth process and [ii] business purpose.

With regard to its [i] own growth process, a start-up is characteristic in that it uses a large amount of funds for investment in a new business in early years, and temporarily posts a deficit, but later increases its sales significantly in the short term by drawing a curve (called the "J curve") in the monetizing stage. On the other hand, a general SME grows linearly by gradually increasing its employees, products, stores, etc. (Figure 2).

[5] A growth sector refers to an industry that is expected to achieve a high growth rate in the future, such as through use of artificial intelligence (AI), Internet of Things (IoT), or big data.
[6] “In business for about 10 years” was set as a condition, because for many venture capital firms, the redemption period of the fund is about 10 years, and therefore a start-up aims to exit by becoming newly listed on a stock market or selling itself to another enterprise, for example, within this period.
[7] “Unlisted company” was set as a condition, because a listed company, which is considered to be capable of procuring funds from the stock market and have a legal framework, is less likely to experience the issue raised in this survey.

Figure 2: Expected business plans of a start-up and an SME



Source: Created by the JFTC based on "Guidelines for Collaboration between Business Entities and R&D-based Venture Businesses (Second Edition)" (METI).

In regard to its [ii] business purpose, a start-up generally conducts business activities mainly with an aim to achieve significant development in business, such as manufacturing or selling existing goods or services innovatively or efficiently, or providing goods or services in a field where sufficient demand has yet to emerge.

On the other hand, an SME generally conducts business activities mainly with an aim to acquire stable profits, such as providing goods or services in a field where a business model has already been established (e.g., a field in which there is already an established manufacturing method or sales method) or in a field where demand already exists.

When the JFTC asked start-up founders about these differences between a start-up and an SME in interviews, the following views were given.[8]

[8] As the interviews in this survey covered specific and individual information, modifications have been made to the contents as necessary, such as making information that could identify the relevant enterprise more abstract and making the expressions consistent overall (the same applies hereinafter).

- Start-ups, including our company, aim to achieve an explosive sales growth that would draw a J curve in the future, and would start business even at a stage when the product has not yet been completed. In the early stage of business when the company concentrates on research and development of its product, funds will be required for the research and development. However, as the product has yet to be completed, the company cannot make sales, and sometimes continues to operate in the red. On the other hand, SMEs have some kind of products they can sell and can earn stable revenue to a certain extent, so they are unlikely to run a deficit in the early stage of business as compared to start-ups.

- Start-ups are the same as other companies in that they have been in business for a short time. Unlike other companies, however, start-ups have limited experience of transactions as they are characterized by developing products using technologies that have yet to be established or provided on the market. As a result, start-ups lack the certain amount of trust which SMEs enjoy based on long experience of transactions, and compared to SMEs, start-ups are extremely weak in terms of the trust they receive from other companies and their positions in transactions.

- Products sold by general SMEs are intended for already existing markets and have the potential for stable sales. On the other hand, products subject to start-ups' research and development sometimes include new values and technologies and are intended for markets that have yet to emerge so as to cultivate new demand. Therefore, stable sales cannot be expected until the start-ups' business management reaches a stable level with steady progress of research and development, commercialization, and sales. Accordingly, the start-ups would go bankrupt unless they procure funds necessary for their business activities at the same time.

- Rather than aiming to achieve explosive growth, I think SMEs place importance on efficiently running the current business and achieving gradual growth. On the other hand, I understand that start-ups are companies aiming to attain explosive growth like a J curve, with large companies paying attention to the versatility and innovation of their technologies.

- A general SME generates stable revenue based on an already established business model. On the other hand, a start-up is required to achieve growth while using values and technologies that have yet to be recognized on the market and gaining market recognition of new businesses or products that have not existed before.

B. Difference in fund procurement

A start-up also differs from an SME in terms of procurement of the funds necessary for its business activities. An SME generally tends to acquire funds by receiving a loan from a financial institution. The loan is decided by comprehensively taking into consideration the SME's track record of business performance, financial conditions, trading volume, presence/absence of trading partners, etc. (procurement through indirect financing).

On the other hand, it is usually difficult for a start-up to receive a loan from a financial institution, because at the time when it starts business, it has no track record of business performance, financial conditions, trading volume, presence/absence of trading partners, etc. and at the time of fund procurement, it conducts business activities in a field with no or still-unclear demand, and therefore its future sales are difficult to predict. Therefore, a start-up procures the funds necessary for its business activities by issuing the start-up company's shares and receiving investments from investors such as a venture capital firm or a business company (procurement through direct financing).

When interviews were conducted with start-ups, etc., there were comments stating that it is difficult for start-ups to procure funds through indirect financing, and they have no choice but to rely on direct financing.

○ As a start-up has no track record of trading with companies, it is difficult for a start-up to procure a large amount of funds through indirect financing, such as a loan, from a financial institution, and it can only procure a large amount of funds through direct financing.

○ A start-up with no stable sales pertains high risk for a bank. Therefore, a start-up's fund procurement means will be limited to investments and loans from government-affiliated financial institutions. However, as the credit limit of the loan is low and only covers business operation expenses for one year, it is difficult for a start-up to continue business with loans alone, and it has no choice but to rely on investments.

○ In the case of fund procurement through borrowings from a financial institution, a company cannot receive a loan if it is in the red. In the case of a research and development start-up, in particular, the company, which does not have a product yet and has no prospect for revenue, has difficulty receiving a loan, so it has no choice but to rely on receiving investments by issuing shares.

<Expert opinions>

○ An SME can basically make a certain amount of sales even at the time of starting business,

so it can use the loan system. On the other hand, a start-up basically suffers a deficit at the time of starting business, growing in such a manner to draw a J curve. Therefore, it is difficult for a start-up to use a loan, and it has to rely on fund procurement through direct financing.

- Indirect financing by a private financial institution is premised on repayment. Thus, a bank does not provide a proactive support to a start-up, which cannot be expected to make sales immediately. Accordingly, under the present conditions, a start-up has to mainly procure funds through direct financing.

(2)Growth and exit of a start-up

A start-up often procures funds through direct financing, so it needs to conduct business activities in a manner to achieve an outcome on investment within a certain period.

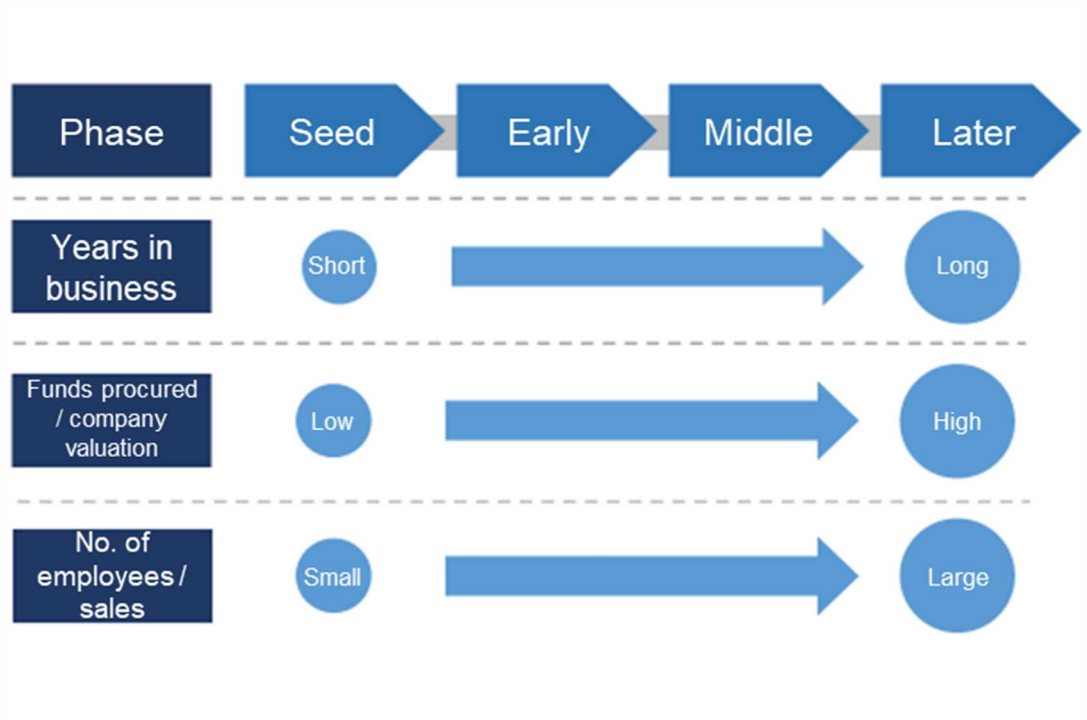
As the outcome on investment in a start-up, investors seek capital gain, which is a profit margin gained through an increase in the value of the shares the investors hold. Thus, when they invest in a start-up, they often require the start-up to aim to be listed on the stock market[9] or to sell itself to another enterprise[10] within a period of about 10 years. Realizing a return on investment in a start-up through any of these means is called an “exit.”

In addition, a start-up tends to procure funds that will be necessary until the listing on the stock market not at one time, but over several times according to its growth phase and business plan. Investors use the expression “stage” as an indication of the business scale of a start-up for determining the current business scale of the start-up they intend to invest in and how much the appropriate investment amount would be.

An example growth model of a start-up is to aim at growing in phases from "seed," "early," "middle," to "later," and finally accomplishing listing on the stock market within a period of about 10 years.[11] In reality, however, there are such cases as where a start-up is unable to grow at the planned pace, or a start-up aims to expand its business without listing its shares. The figure below shows the idea of a start-up’s business expansion in each stage.

[9] This refers to initial public offering (IPO).
[10] The sale in this context mainly refers to merger and acquisition (M&A).
[11] While establishment of approximately 114,000 companies was registered in 2016 (2019 White Paper on Small and Medium Enterprises in Japan), the number of companies newly listed on the Japan Exchange Group, Sapporo Securities Exchange, Nagoya Stock Exchange, and Fukuoka Stock Exchange in 2016 was 96 (calculated by the JFTC based on data from websites of the respective stock exchanges).

Figure 3: Idea of the growth model of a start-up



Source: Created by the JFTC based on the survey results.

A. Seed

Commercial business has yet to be fully launched, and the company engages in technology research and product development. While the business plan in the seed phase is to commercialize initial products, the company covers the personnel costs and research and development costs for achieving this plan either with its own funds or by procuring funds of a scale of several millions to several tens of millions of yen according to its business scale. The number of workers in the seed phase is normally several persons who engage in research and development.

B. Early

In this phase, the company continues with the development of products, etc. and starts sales of initial products, and is able to acquire early customers. However, as it is difficult to secure sufficient revenue to cover the costs of the development of products, etc. and it also becomes necessary to develop an internal framework for conducting sales and marketing, the company procures funds of approximately tens of millions to hundreds of millions of yen according to its business expansion. In this early phase, the company normally acquires workers in charge of marketing, etc., and the number of workers increases to about 10.

C. Middle

In this phase, the company acquires a certain number of customers, starts production and shipping of products, etc., and increases the amounts of stock and sales. By this phase, the company is likely to have decided on measures for monetization. It establishes a concrete business plan and builds a back-office framework. The company may procure funds of approximately hundreds of millions to billions of yen. In the middle phase, the number of workers normally increases to several tens of people.

D. Later

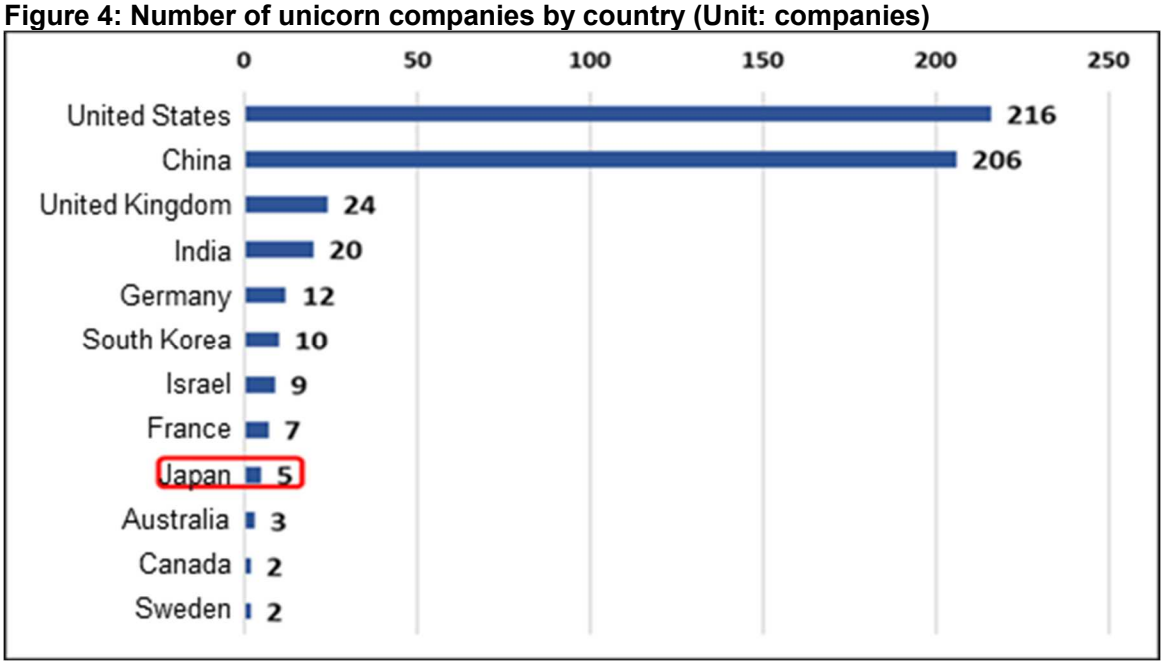
This is the phase of a business plan for exit through new listing on the stock market or sale of the company to another enterprise. In this phase, the organization of the company becomes established and the number of workers exceeds 50. The need for funds for the exit increases, and the amount of funds procured will be hundreds of millions to several billions of yen.

(3)Unicorn company

The corporate value of a start-up is assessed either based on the total amount of fund procurement or the corporate valuation amount. The corporate valuation amount is derived by a venture capital firm, etc. as monetary assessment of the value of a start-up by taking into account the start-up's business contents, expansion status, and future business prospects, among other factors. As such, this corporate valuation amount differs depending on the venture capital firm that conducts the assessment, but if a start-up is unlisted, and is given a corporate valuation amount of $1 billion or more, it is called a "unicorn company."[12]

As of February 2020, there were 5 unicorn companies in Japan (Figure 4).

Figure 4: Number of unicorn companies by country (Unit: companies)

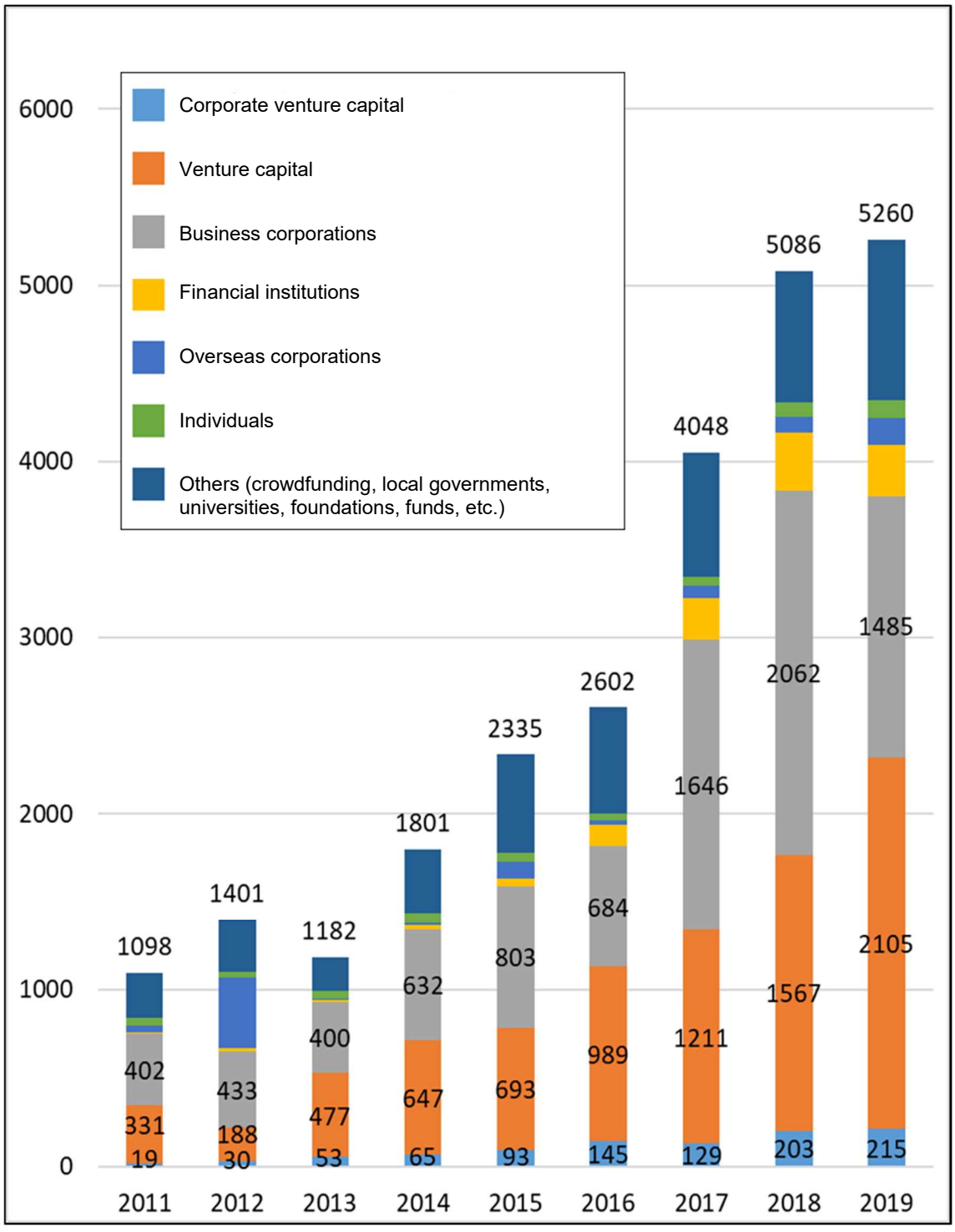


Source: Created by the JFTC based on data published on INITIAL (data as of February 7, 2020 and data as of February 10, 2020). In this table, the criterion for a unicorn company is having a valuation of 1 billion US dollars or more (the exchange rate at the time $1=¥110 is used for the conversion).

[12] The FY2020 Innovative Business Activity Action Plan (approved by the Cabinet on July 17, 2020) indicates "creating 50 unlisted venture companies (unicorns) or listed venture companies with a corporate value or a market capitalization value of $1 billion or more by FY2025" as one of the key performance indicators (KPIs) of the start-up policy. Start-ups valued at ¥100 billion or more are also sometimes referred to as unicorn companies.

(4)Changes in the amount of investments in start-ups

Figure 5: Changes in the amount of investments in start-ups (by type of domestic investors) (Unit: ¥100 million)



Source: Created by the JFTC based on data published in "Japan Startup Finance 2020 First Half."

A. Changes in the amount of investments

Changes in the amount of investments in start-ups are as shown in Figure 5. As for the overall trend, investments in start-ups had been sluggish since the financial crisis following the collapse of Lehman Brothers in 2008, but they began to show growth from around 2014 and have been on an increase thereafter. However, there are concerns that the recent COVID-19 pandemic would curb investors' appetite for investment and adversely affect start-ups' fund procurement.[13] The following comments were made by start-ups.

- Fund procurement is not going well due to the effect of the COVID-19 pandemic. We are facing a severe fund procurement environment, as start-ups seeking investments and listed companies after IPO which had relationships with venture capital firms are rushing to venture capital firms, and our company is conducting business with high risk and high return.

- A venture capital firm has told us that it wants to decide on investment in our company after watching how things progress, as effects of the COVID-19 pandemic are hard to predict. The scale of fund procurement dropped to one-tenth at the time of the financial crisis following the Lehman Brothers bankruptcy, so we are also concerned about the effects of the COVID-19 pandemic this time.

- Several investors had made investment offers to us, but due to the effect of the COVID-19 pandemic, some investors cancelled their offers. Investment by a business company was canceled because its business prospects became unclear due to the effect of the COVID-19 pandemic.

- The environment of the fund procurement market was favorable a few years ago, but due to the effect of the COVID-19 pandemic, we feel that fund procurement has become harder to access.

[13] Opinions of start-ups and investors on the effects of the COVID-19 pandemic are described later in III. 3 .(12).

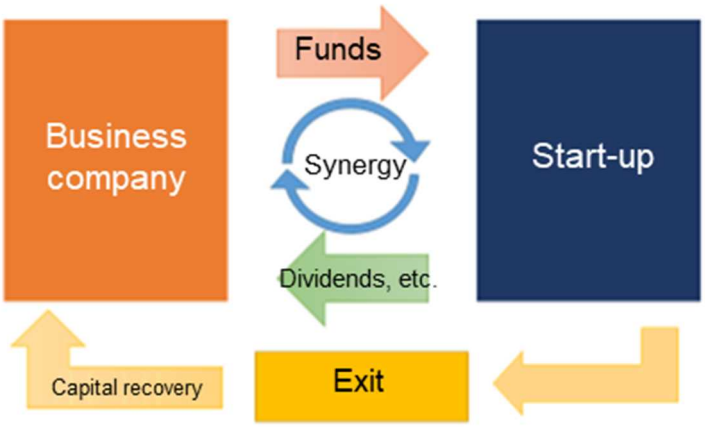
B. Types of investors

Investors that invest in start-ups mainly include business companies, venture capital firms, corporate venture capital firms, and angel investors. At present, investments by business companies and venture capital firms constitute most of the total amount of investments in start-ups (Figure 5). The purpose of investment differs by type of investor.

(A) Business company

A business company is an enterprise whose main business is not investment. It often invests in a start-up when the start-up's business contents are close to its business domain, so as to achieve synergy effects with its own business (Figure 6).

Figure 6: Transactions and flow of a business company's investment in a start-up



Source: Created by the JFTC based on the survey results.

(B) Venture capital and corporate venture capital

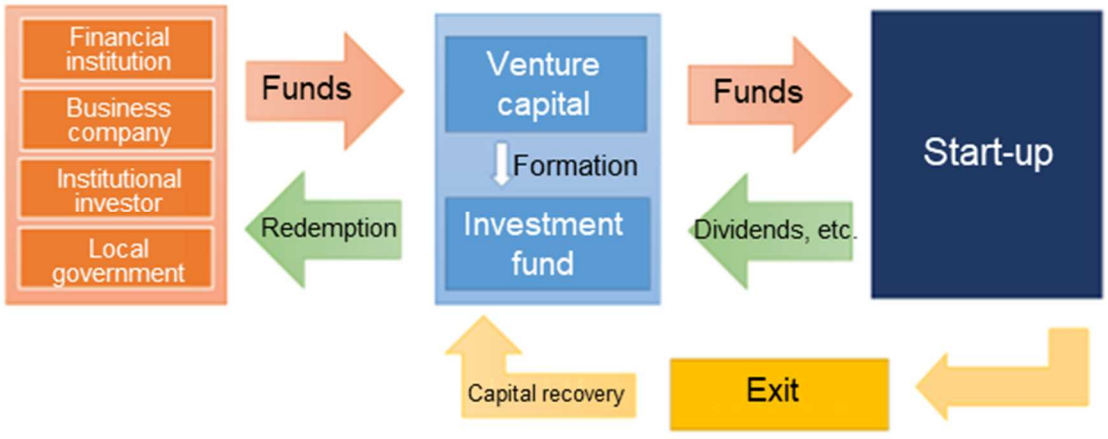
a. Venture capital

A venture capital firm is an investment company which invests funds collected from multiple financial institutions, business companies, institutional investors, local governments, etc. through, for example, investments in start-ups. The main purpose of venture capital is to realize a capital gain through investment in a start-up when it is not listed on a stock market, and sale of the start-up's shares at the time of exit when its corporate value has risen.

As for the flow of venture capital investment in a start-up, upon the investment, the venture capital firm forms a fund to execute the investment. In this process, the venture capital firm generally forms a fund by raising capital from a financial institution, etc., and investment is made by way of this fund acquiring shares of the start-up (Figure 7).

According to the Japan Venture Capital Association (JVCA), the number of venture capital members in FY2020 was 109 (Figure 9).

Figure 7: Transactions and flow of venture capital investment in a start-up



Source: Created by the JFTC based on the survey results.

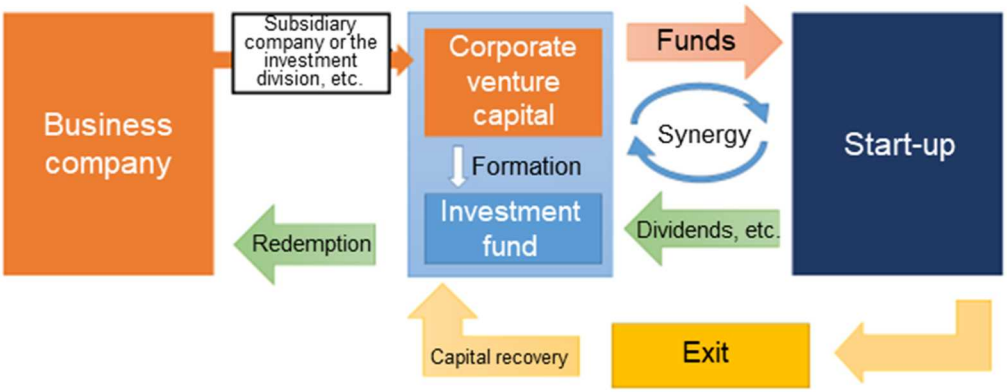
b. Corporate venture capital

In corporate venture capital, a business company operates the venture capital with its own funds, and invests in a start-up. As compared to venture capital, corporate venture capital is characteristic in that the investment is made in anticipation of not only a capital gain, but also a synergistic effect between the corporate venture capital firm's main business and the start-up in which it invests. It does not necessarily seek an exit of the start-up within a certain period. The number of corporate venture capital firms has increased in recent years in line with growing attempts of open innovation aimed at creating an innovation by using the funds and human resources of a large company and technologies of a start-up.

As for the flow of corporate venture capital investment in a start-up, the business company that operates the venture capital generally forms a fund by contributing capital by itself, and investment is made by way of this fund acquiring shares of the start-up (Figure 8).

According to the JVCA, the number of corporate venture capital members in FY2020 was 72 (Figure 9).

Figure 8: Transactions and flow of corporate venture capital investment in a start-up



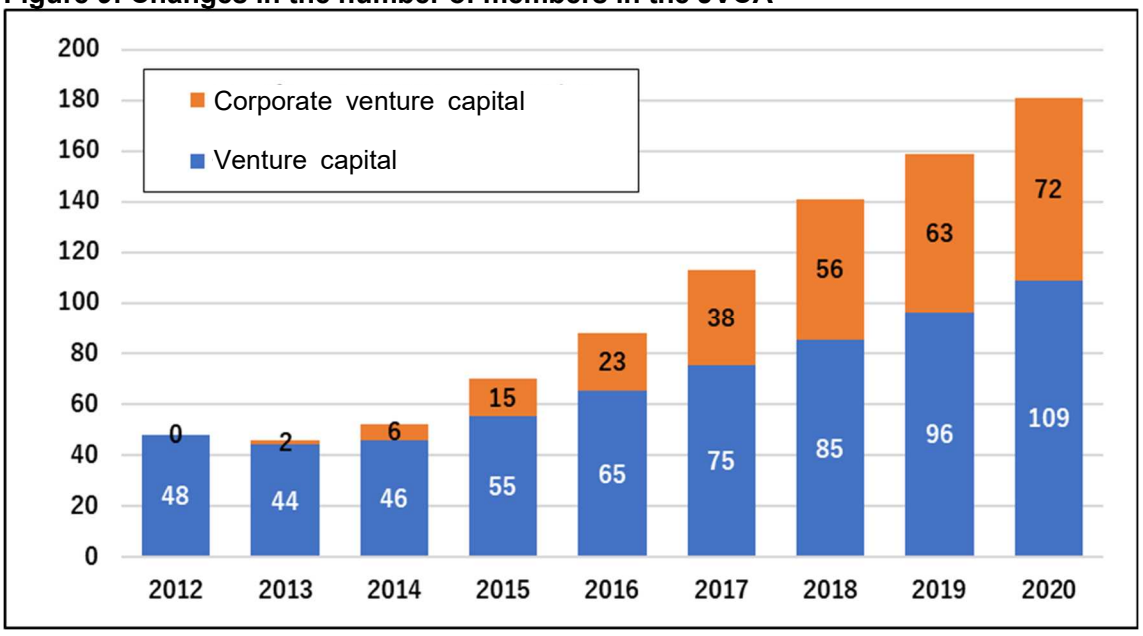
Source: Created by the JFTC based on the survey results.

c. Changes in the number of venture capital firms and corporate venture capital firms and the scale of their investments

According to the JVCA, while the number of venture capital members has been on an increase, the number of corporate venture capital members has surged in recent years (Figure 9).

Venture capital firms differ by their founding entity. For example, there is an independent venture capital firm with no affiliated company, a venture capital firm affiliated with a financial institution, a venture capital firm operated by a university, a local venture capital firm that makes local community-oriented investments, and a venture capital firm capitalized by the government. The scale, field, and stage of the start-up subject to investment often differ by the type of venture capital firm.

Figure 9: Changes in the number of members in the JVCA



Source: Created by the JFTC based on JVCA "Current status of the start-up ecosystem and contribution by the DBJ's special investment operations" and information published by the JVCA.

(C) Angel investor

An angel investor is an individual investor who makes investments based on assets obtained by founding a start-up and subsequently exiting that start-up or selling that start-up. An angel investor is characterized by investing in a start-up in the initial "seed" or "early" stage, without interfering with its business management, often investing smaller amounts of funds compared to business companies and venture capital firms.

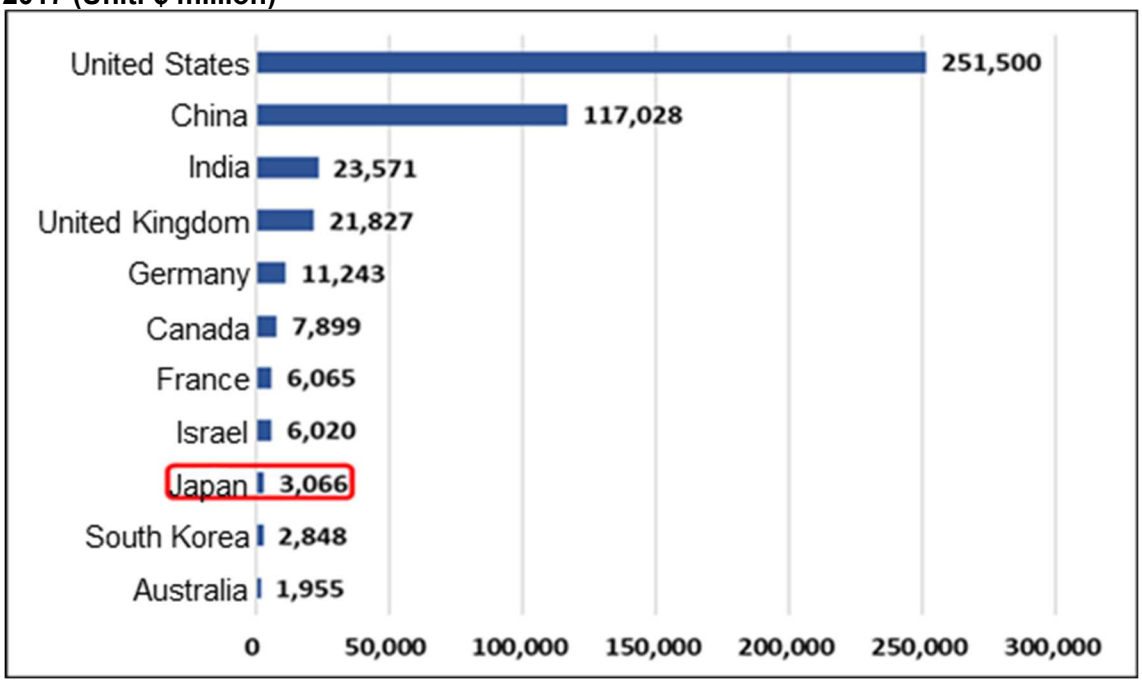
(5)Comparison of the amount of investments in start-ups in Japan and overseas

A. Comparison of the amount of investments in start-ups in major countries of the world

Among major countries of the world, the country in which the amount of investments in start-ups is the highest is the United States at approximately $251.5 billion over the period of 2015 to 2017. In recent years, the amount of investments in start-ups in China has also been increasing, notably at approximately $117.0 billion over the same period, marking the second highest amount following the United States (Figure 10).

In contrast, the amount of investments in start-ups in Japan over this period was approximately $3.1 billion, which is only about 1.2% of the investments in the United States and about 2.6% of the investments in China.

Figure 10: Amount of investments in start-ups in major countries of the world 2015 to 2017 (Unit: $ million)



Source: Created by the JFTC based on RISE OF THE GLOBAL START UP CITY.

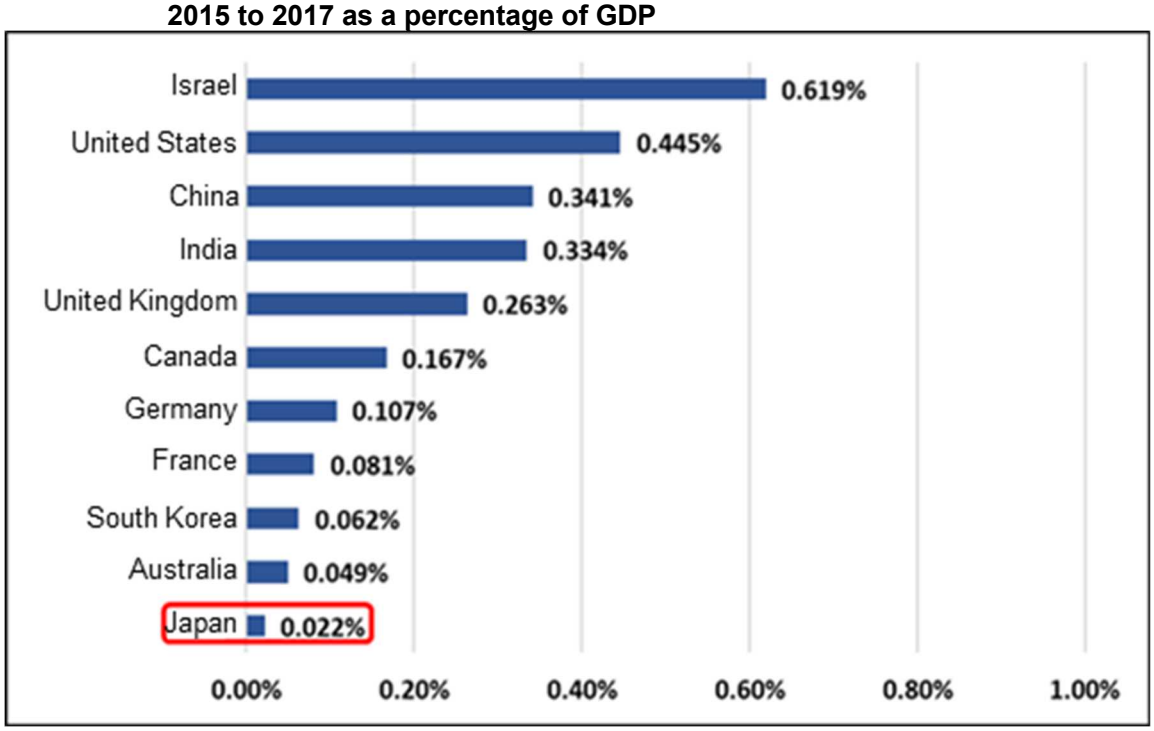
B. Comparison of the amount of investments in start-ups in major countries of the world as a percentage of GDP

Comparison of the amount of investments in start-ups as a percentage of GDP by country is as shown in Figure 11.

The country in which the amount of investments in start-ups is highest as a percentage of GDP among major countries of the world is Israel, accounting for about 0.62% of GDP over the period from 2015 to 2017. The percentage in the United States is about 0.45% and that in China is about 0.34%, showing how the percentage of investments in start-ups in Israel is high.

In contrast, the amount of investments in start-ups in Japan over this period was approximately 0.02% of the GDP, which is one of the lowest percentages among major countries of the world in comparison to the country's economic scale.

Figure 11: Amount of investments in start-ups in major countries of the world from 2015 to 2017 as a percentage of GDP



Source: Created by the JFTC based on RISE OF THE GLOBAL START UP CITY and National Accounts.

3. Transactional relationships of a start-up

When a start-up conducts business activities for open innovation, it has a transactional relationship that can largely be categorized into one of the following two types. One type is where the start-up continuously maintains a business partnership with a business company. The main purpose of this transaction is to achieve a synergistic effect in business. The other type is where the start-up continuously receives investments from an investor such as a business company, venture capital firm, or corporate venture capital firm. The purpose of this transaction is to achieve a synergistic effect in business or to realize a capital gain through an increase in the start-up's corporate value.

(1)Regarding transactions/agreements between a start-up and a partner business

While start-ups have ideas on technology or business, they often do not have factors of production, such as big data and manufacturing equipment for conducting research to materialize those ideas, and sales channels, etc. Therefore, start-ups tend to conduct continuous transactions with enterprises for the purpose of business partnerships (hereinafter referred to as "partner businesses") to complement such factors of production and sales channels, etc.

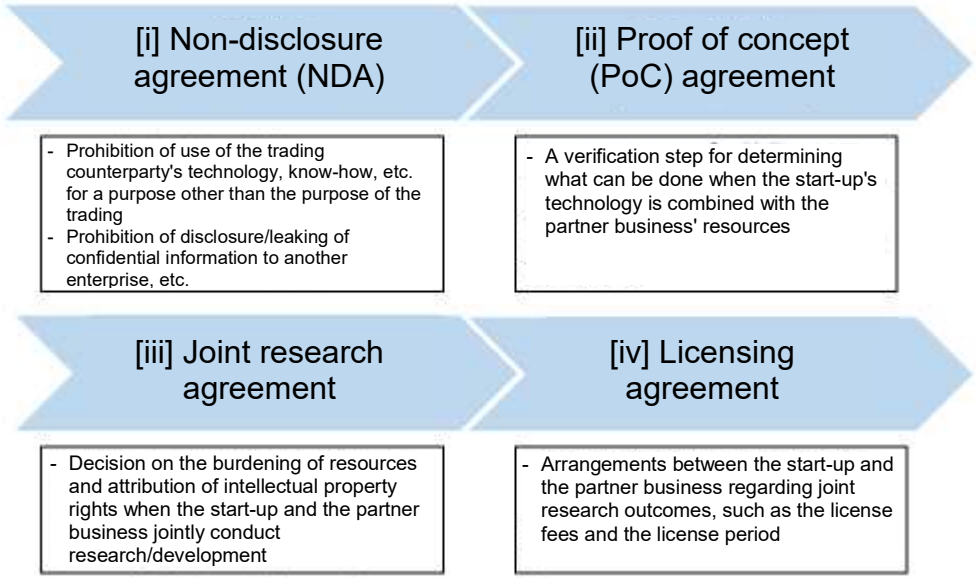
On the other hand, by forming business partnerships with start-ups that have innovative technology and ideas, partner businesses will be able to not only think about creating innovative technology and improving productivity in their own business domain, but also about advancing to a new business domain.

There are mainly four phases to transactions between a start-up and a partner business (Figure 12).[14] The partner business and the start-up continuously conduct necessary transactions according to the purpose of the business partnership (Figure 13).

[14] The start-up goes through the four phases with the same business partner. The transactions were divided into four phases for the purpose of sorting them out from a unified perspective. It is certainly possible that a transaction that is categorized as a PoC agreement in terms of its actual status and evaluation can also be categorized as a joint research agreement, etc.

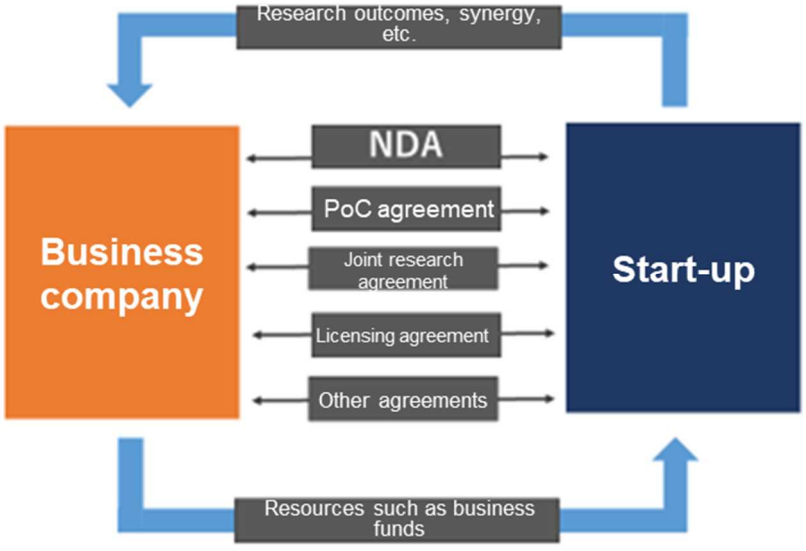
Figure 12: Regarding transactions/agreements between a start-up and a partner business

When forming a business partnership, the transactions and agreements set forth in [i] through [iv] below are generally conducted/concluded.



Source: Created by the JFTC based on the survey results.

Figure 13: Relationship of transactions/agreements between a start-up and a partner business



Source: Created by the JFTC based on the survey results.

A. NDA[15]

When a start-up and a partner business form a business partnership or determine whether a business partnership can be formed, the start-up and the partner business need to mutually exchange their business-related information. In that process, they may exchange confidential information concerning intellectual property rights and know-how, etc. as needed. Therefore, an NDA may be concluded between the start-up and the partner business so as to prevent the confidential information from being disclosed to persons other than the parties to the agreement and to prevent the information from being used for a purpose other than those specified by the agreement.

B. PoC[16] agreement

When a start-up conducts transactions with a partner business, PoC may be carried out in order to clarify the start-up's technological level and how its technologies can be applied. In particular, in the case of a research and development start-up, PoC is conducted as a trial before moving on to conclude a joint research agreement with the partner business, so it is positioned as the first step or a premise for a joint research agreement. In conducting this PoC, a PoC agreement is sometimes concluded between the start-up and the partner business.

With regard to PoC, if work arises on the start-up's side, the partner business normally requests the start-up to carry out PoC for a charge.

C. Joint research agreement

A start-up that cannot sufficiently procure funds necessary for its business activities by itself or a start-up that needs resources it does not have, such as big data, for research and development may supplement the funds or resources necessary for research and development by conducting joint research with a partner business. In conducting this joint research, a joint research agreement may be concluded between the start-up and the partner business.

D. Licensing agreement

If a start-up acquires intellectual property rights or know-how through research and development, but does not have production facilities or sales channels and cannot make use of them by itself, the start-up may make use of these rights or know-how by licensing them out to a partner business. In this licensing, a licensing agreement may be concluded between the start-

[15] Non-disclosure agreement.
[16] Proof of Concept.

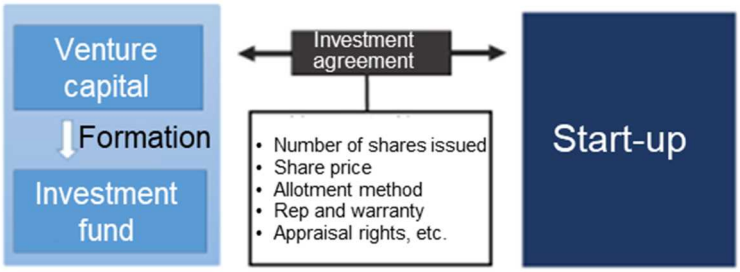
up and the partner business.

(2)Regarding transactions/agreements between a start-up and an investor

As mentioned earlier in 2.(1)B., a start-up often procures funds necessary for its business activities through direct financing, and continuously receives investments from an investor such as a business company, venture capital firm, or corporate venture capital firm.

When a start-up receives an investment from an investor, the start-up and the investor normally conclude a continuous agreement,[17] such as an investment agreement, with each other. The investment agreement provides for details on execution of investment with regard to wide-ranging items, such as the number of new shares issued, how shares are allotted to the investor, the amount paid by the investor as consideration for share issuance, representations and warranties to make sure that the start-up has not made a false report on its business activities to the investor, appraisal rights[18] in the case of a violation of the use of the invested funds or any other agreement terms, and the right to appoint a board observer, etc. (Figure 14).

Figure 14: Investment agreement between a start-up and an investment fund



Source: Created by the JFTC based on the survey results.

[17] A common agreement period is 10 years. This investment agreement sometimes includes not only an agreement between a start-up and an investor, but also an agreement between shareholders where there are multiple investors.

[18] In this survey, appraisal rights refer to rights of an investor to compel the start-up to buy back shares held by the investor under certain conditions (for example, if the start-up has violated the representations and warranties associated with the investment, if the start-up has failed to observe any matter agreed under the investment agreement, or if the business plan agreed between the start-up and the investor contains a serious violation). The rights enable an investor to avoid the investment risk against the start-up receiving the investment. On the other hand, they require the start-up to buy back shares it has issued to the investor, and as it is often difficult for the start-up to buy back the shares due to its financial conditions, it faces a possibility of reducing its capital or dissolving the company.

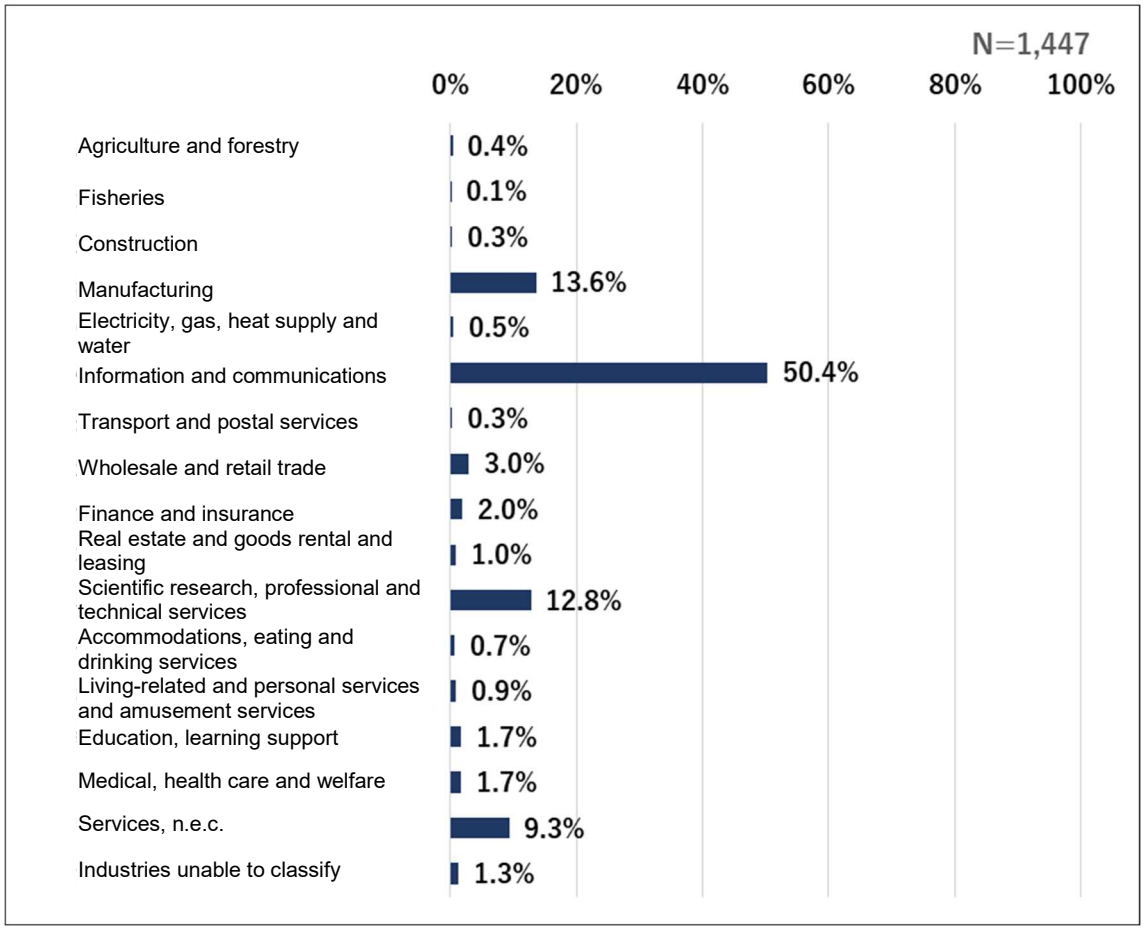
III. Survey Results

1. Basic matters

(1)Industries of respondents

The industries of the respondents were information and communications for about 50%[19] of the respondents, manufacturing for about 14% of the respondents, and scientific research, professional and technical services for about 13% of the respondents (Figure 15).

Figure 15: Industries of respondents (single answer)



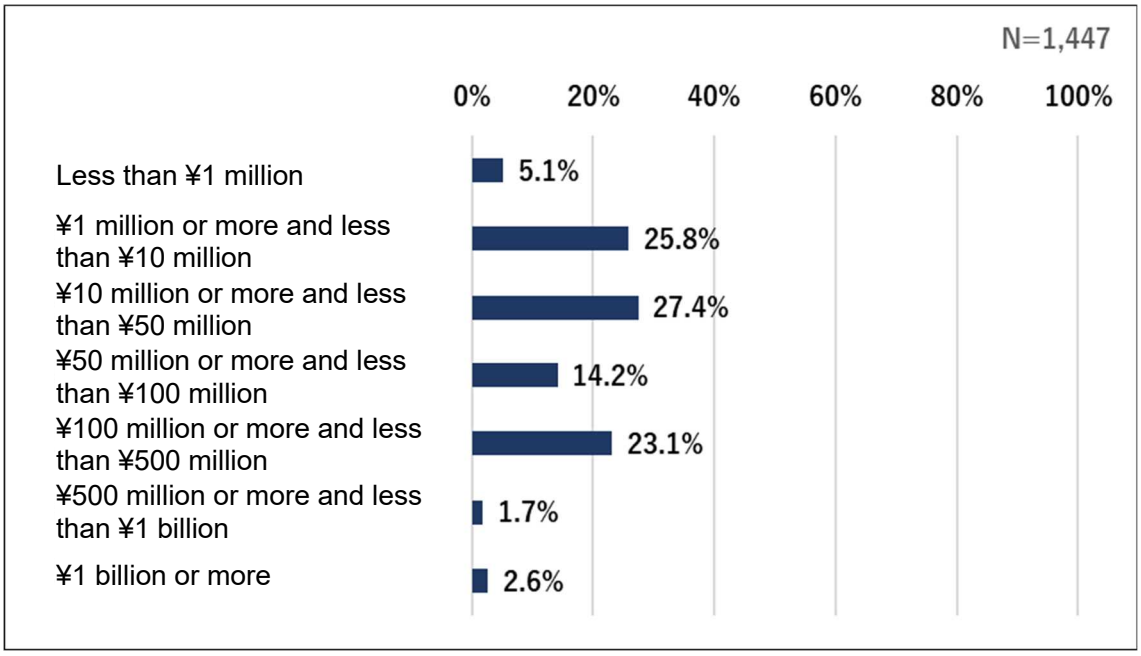
Source: Created by the JFTC based on the questionnaire survey results.

[19] The percentages in the figure were obtained by dividing the number of responses by the number of relevant respondents, and rounding the result to one decimal place. Therefore, the percentages may not add up to 100% (the same applies hereinafter).

(2)Stated capital of respondents

The stated capital of the respondents was ¥10 million or more and less than ¥50 million for about 27% of the respondents, ¥1 million or more and less than ¥10 million for about 26% of the respondents, ¥100 million or more and less than ¥500 million for about 23% of the respondents, and ¥50 million or more and less than ¥100 million for about 14% of the respondents (Figure 16).

Figure 16: Stated capital of respondents (free answer)

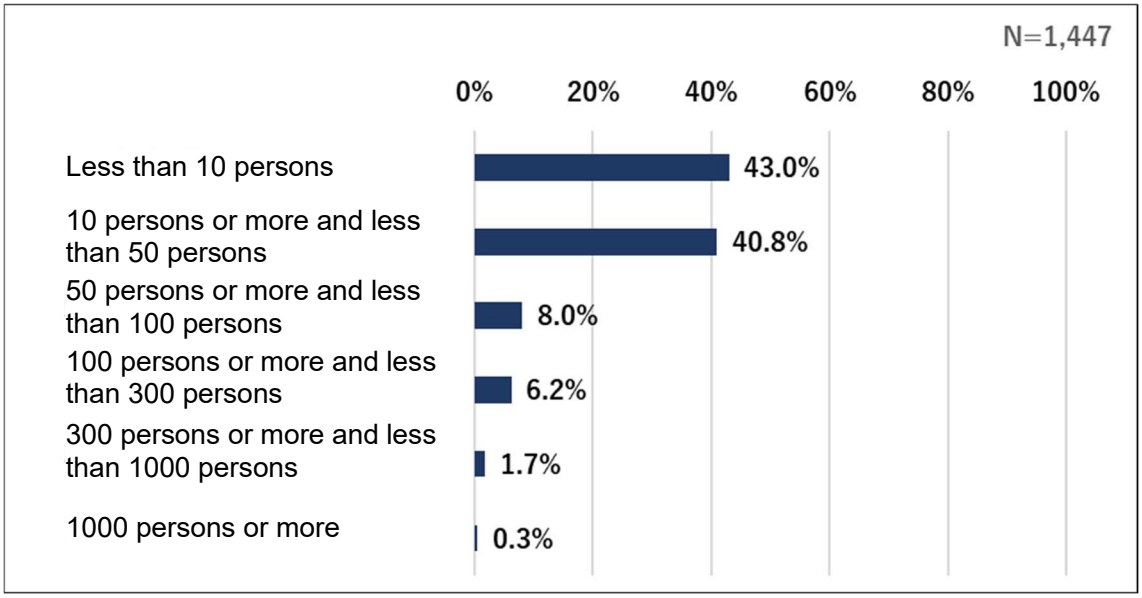


Source: Created by the JFTC based on the questionnaire survey results.

(3)Number of workers employed by respondents

The number of workers employed by the respondents was less than 10 persons for 43% of the respondents, and 10 persons or more and less than 50 persons for about 41% of the respondents (Figure 17).

Figure 17: Number of workers employed by respondents (free answer)

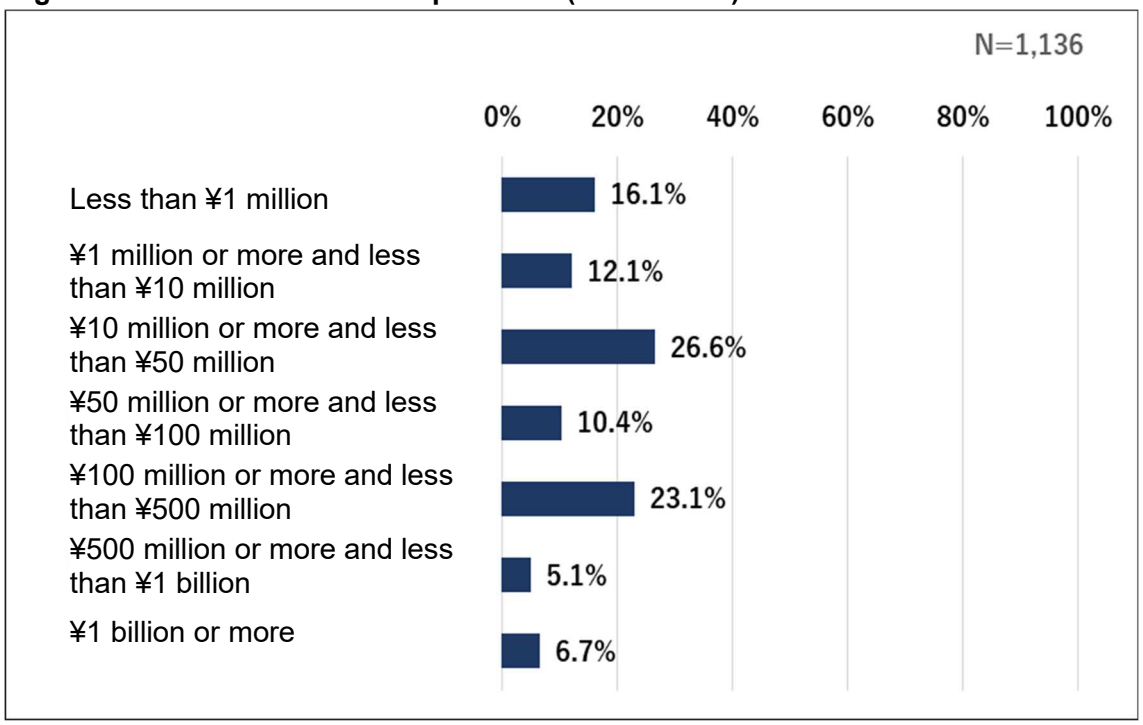


Source: Created by the JFTC based on the questionnaire survey results.

(4)Sales amounts of respondents

The sales amounts (average for FY2016 to FY2018) of the respondents were ¥10 million or more and less than ¥50 million for about 27% of the respondents, ¥100 million or more and less than ¥500 million for about 23% of the respondents, and less than ¥1 million for about 16% of the respondents (Figure 18).

Figure 18: Sales amounts of respondents (free answer)



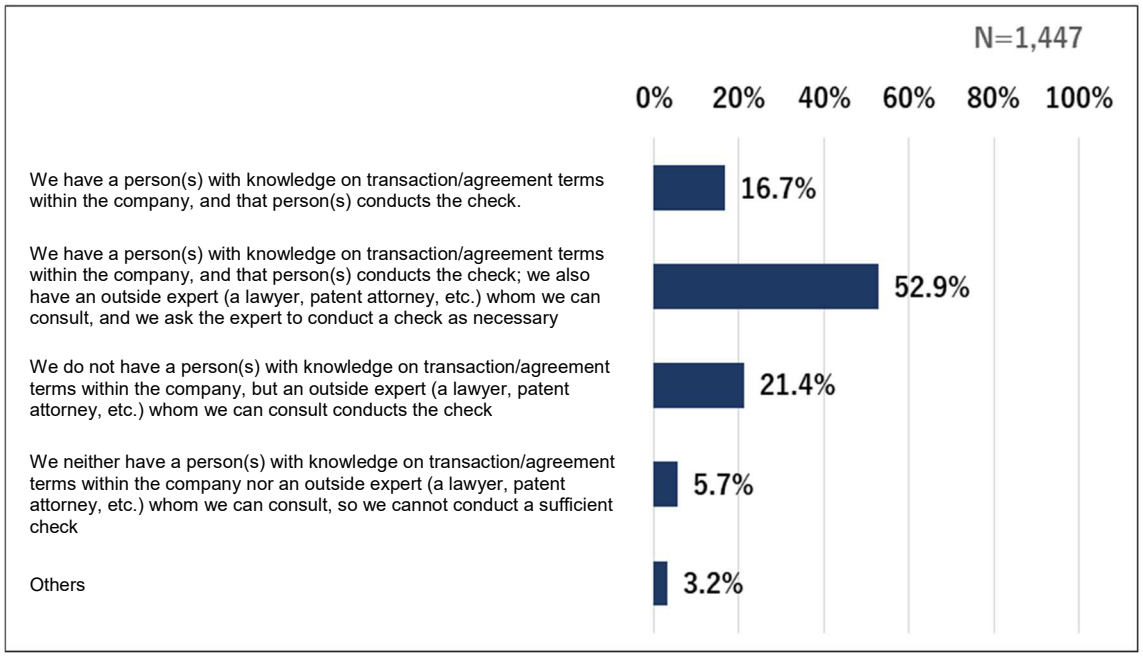
Source: Created by the JFTC based on the questionnaire survey results.

2. Internal framework for checking the transaction/agreement terms

When the start-ups were asked about their internal framework for checking the transaction/agreement terms with their partner business and investors,[20] about 70% of the respondents answered that they have a person(s) with knowledge on transaction/agreement terms.

Specifically, about 17% of the respondents answered “We have a person(s) with knowledge on transaction/agreement terms within the company, and that person(s) conducts the check,” about 53% answered “We have a person(s) with knowledge on transaction/agreement terms within the company, and that person(s) conducts the check; we also have an outside expert (a lawyer, patent attorney, etc.) whom we can consult, and we ask the expert to conduct a check as necessary,” and about 21% answered “We do not have a person(s) with knowledge on transaction/agreement terms within the company, but an outside expert (a lawyer, patent attorney, etc.) whom we can consult conducts the check” (Figure 19).

Figure 19: Respondents’ frameworks for checking the content of agreements (single answer)



Source: Created by the JFTC based on the questionnaire survey results.

[20] The “Report on the Fact-Finding Survey on the Status of Abuse of Superior Bargaining Position involving Intellectual Property and Know-How of Manufacturers” indicates that, when companies were asked whether they have a person(s) in charge of checking the handling of know-how and intellectual property rights, 92.1% of large companies answered ”We have a person(s) in charge of conducting the check” or ”We don’t have a person(s) in charge of conducting the check, but we have an outside expert (a lawyer, patent attorney, etc.) whom we can consult,” but only 72.6% of the SMEs gave such answers.

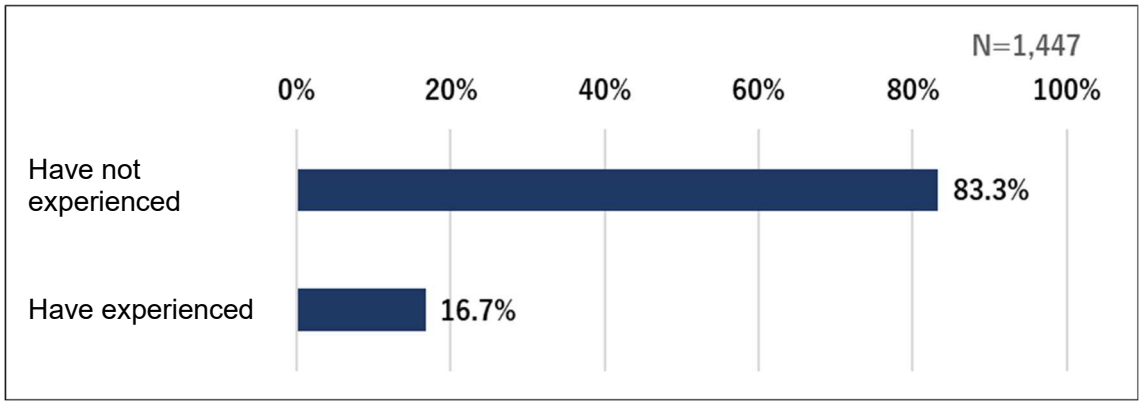
3. Transactions/agreements between a start-up and a partner business or investor

(1) Experience of an unsatisfactory act in a transaction or agreement with a partner business or investor

242 enterprises, accounting for about 17% of the respondents, answered that they “Have experienced” an unsatisfactory act in a transaction or agreement with a partner business or investor (Figure 20).

A total of 279 cases of unsatisfactory acts were reported. As the number of cases exceeds the number of enterprises that have experienced an unsatisfactory act, it is considered that some enterprises have experienced multiple unsatisfactory acts committed by a partner business or investor.

Figure 20: Experience of an unsatisfactory act committed by a partner business or investor (single answer)



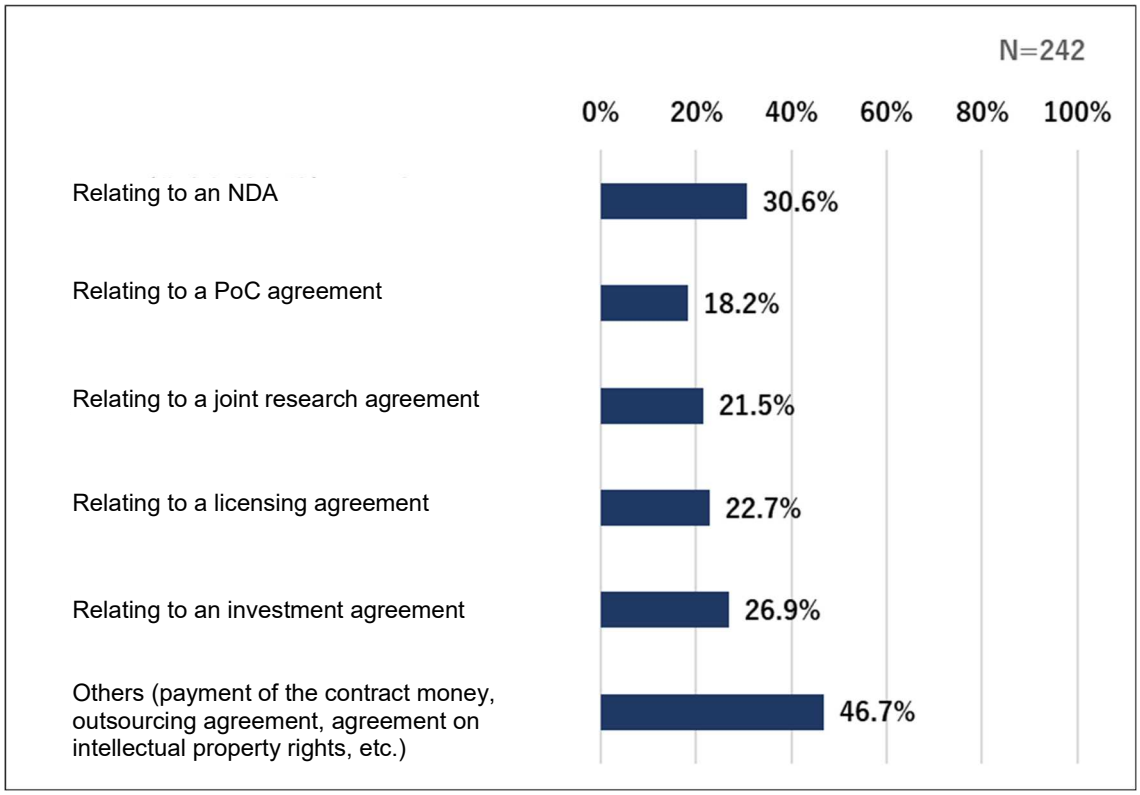
Source: Created by the JFTC based on the questionnaire survey results.

(2)Transaction/agreement phase in which the unsatisfactory act was experienced

With regard to the question in (1) above, about 31% of the unsatisfactory acts experienced were acts “relating to an NDA,” about 27% were acts “relating to an investment agreement,” about 23% were acts “relating to a licensing agreement,” about 22% were acts “relating to a joint research agreement,” and about 18% were acts “relating to a PoC agreement.”

Other answers (about 47%) included that unsatisfactory acts were experienced in relation to payment of the contract money, an outsourcing agreement, an agreement on intellectual property rights, etc. (Figure 21).

Figure 21: Transaction/agreement phase in which the unsatisfactory act was experienced (multiple answer allowed)

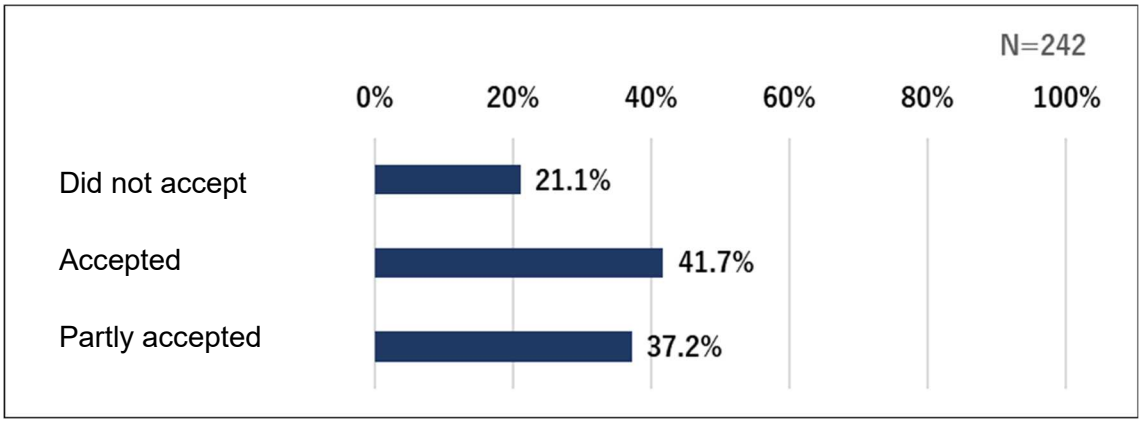


Source: Created by the JFTC based on the questionnaire survey results.

(3)Acceptance of an unsatisfactory act

Among the start-ups which answered that they “have experienced” an unsatisfactory act to the question in (1) above, about 42% “accepted” the act and about 37% “partly accepted” the act, suggesting that about 79% of start-ups that have experienced an unsatisfactory act have accepted the unsatisfactory act at least in part (Figure 22).

Figure 22: Acceptance of an unsatisfactory act committed by a partner business or investor (single answer)

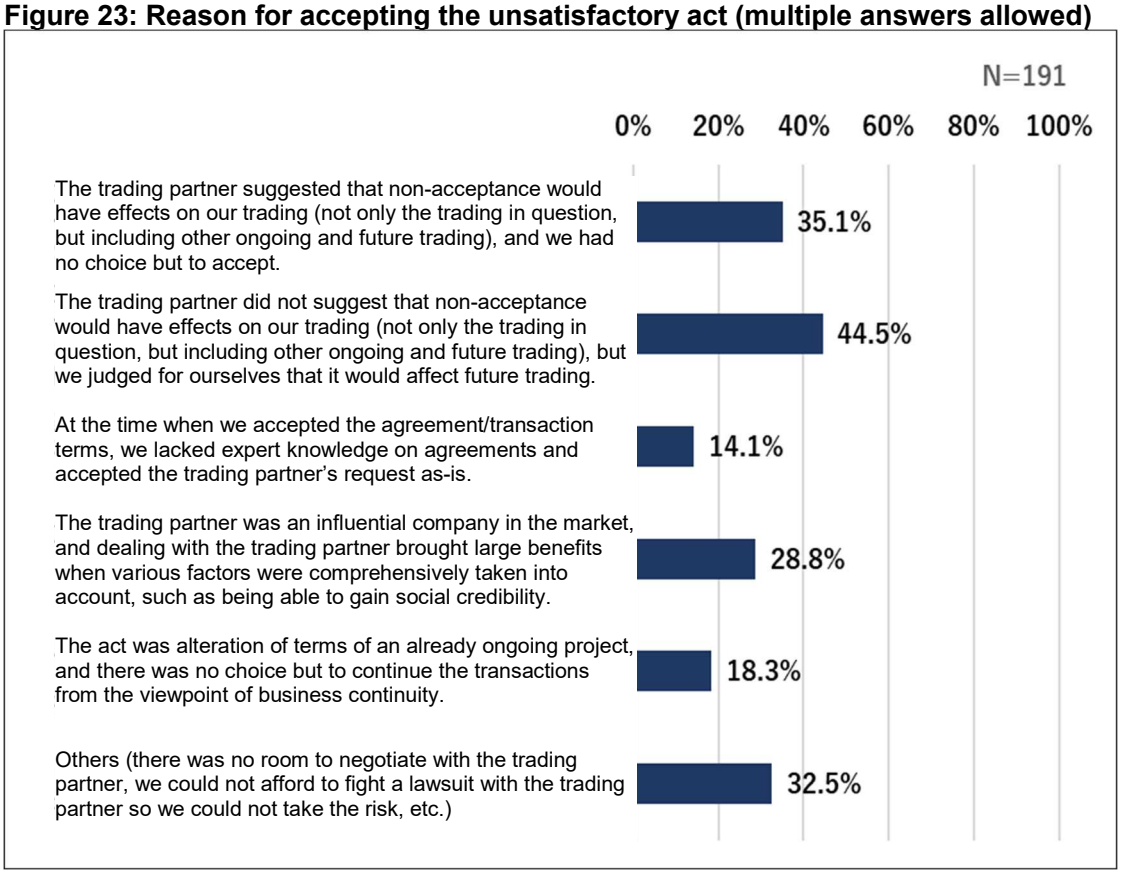


Source: Created by the JFTC based on the questionnaire survey results.

(4) Reason for accepting the unsatisfactory act

The start-ups which answered that they accepted the unsatisfactory act in (3) above were asked the reason for accepting the act. About 45% of those start-ups answered “The trading partner did not suggest that non-acceptance would have effects on our trading (not only the trading in question, but including other ongoing and future trading), but we judged for ourselves that it would affect future trading,” about 35% answered “The trading partner suggested that non-acceptance would have effects on our trading (not only the trading in question, but including other ongoing and future trading), and we had no choice but to accept,” about 29% answered “The trading partner was an influential company in the market, and dealing with the trading partner brought large benefits when various factors were comprehensively taken into account, such as being able to gain social credibility,” about 18% answered “The act was alteration of terms of an already ongoing project, and there was no choice but to continue the transactions from the viewpoint of business continuity,” and about 14% answered “At the time when we accepted the agreement/transaction terms, we lacked expert knowledge on agreements and accepted the trading partner’s request as-is.” Apart from these, there were such answers as “There was no room to negotiate with the trading partner” and “We could not afford to fight a lawsuit with the trading partner so we could not take the risk” (Figure 23).

Figure 23: Reason for accepting the unsatisfactory act (multiple answers allowed)



Source: Created by the JFTC based on the questionnaire survey results.

(5)Awareness of a partner business' or investor's bargaining position over the start-up

A. Start-ups’ awareness

In the interview survey, start-ups, etc. gave the following opinions concerning a partner business' or investor's superior bargaining position over the start-up.

[High dependence on the transactions]

○ While our company runs a deficit every term due to research and development costs, we are able to make profits through collaboration with the partner business. Therefore, we are highly dependent on the partnership contract. We would inevitably accept disadvantageous contract terms rather than having the contract terminated and losing the sales altogether.

○ At the time when we started business, our company was financially strained, and the transaction with the trading partner was our first continuous transaction in that situation. The consideration paid by the trading partner was low in light of the man-hour and other costs required. However, for our company’s operation at the time, that consideration, though being low, was extremely important, and we were highly dependent on that trading partner. When we thought about the risk that negotiating the terms, etc. with the trading partner may have an adverse influence on our future trading, such as the transaction becoming terminated, we could not express our opinion any further.

○ Due to the nature of our business and our internal resources, our company needs to focus on one project. As we can only carry out about two or three transactions concurrently, each transaction is important. If a problem occurs in a transaction with a partner business, it greatly affects our sales. Even when a trading partner presented a contract document disadvantageous for us, we sometimes had to conclude the contract in such disadvantageous state by prioritizing our sales and track record of transactions, in order to secure sales.

○ Our company, which has only just started business and is in the seed phase, sometimes has such difficulty securing funds for business activities that it is difficult to make the month-end payments. In order to earn working capital, we had no choice but to rely on business entrustment from the partner business. Such circumstances on our side make us even more prone to inevitably accepting unilateral agreement terms presented by the partner business.

○ Regarding investments, when the business scale of our company was small, we had to put our top priority on acquiring funds, and even if the investors and business companies presented extremely severe terms for our company, we had to conclude the agreement. There were restrictions on the sale

of our products to other companies, such as an exclusive agreement for the investors and business company, and the terms were apparently disadvantageous for our business expansion. Therefore, thinking about it later, we should not have concluded the agreement under such terms. However, as we could not continue our business activities unless we somehow acquired funds and we were highly dependent on the investors and business companies at the time, we had no choice but to accept the agreements they proposed.

<Opinion of an expert>

○ A start-up runs a deficit at the time it starts business, so it has difficulty using a bank loan and basically has to rely on fund procurement through share issuance. If it cannot procure funds through investments, it cannot acquire funds for its business activities, and will go bankrupt. Therefore, it becomes highly dependent on an investor that provides funds during the deficit period, becoming unable to act on an equal basis with and weakening its bargaining position against such investor. This tendency becomes stronger for a start-up that is in its seed phase.

[Partner business' position in the market]

○ The company that misappropriated our know-how was a large influential company which acted like an influencer in the market.

[Possibility for changing the trading partner]

○ In a joint business with a partner business, we provide product design and technical know-how, and the partner business is in charge of manufacturing and selling the product. If we are to have an enterprise other than the partner business manufacture and sell the product, we need to change the product design and specifications, etc., which would require substantial costs. Therefore, it is difficult for a small-scale start-up like ourselves to change the trading partner. The partner business knows this, so it has a strong negotiating power against our company, and we are in a position to inevitably accept even disadvantageous terms.

○ There was a case where our company and an investor were negotiating an investment, but the investor looked at our cash flow, and intentionally prolonged the negotiation and delayed the investment decision until just before our business funds ran out. Regarding investment, we also need to issue our company’s shares, so it is difficult to negotiate with all kinds of investors at the same time. As the negotiation became prolonged and funds were running out, we became impatient to conclude an agreement, but we were also running out of time to freshly start negotiations with other investors, so we had no choice but to conclude an agreement with that investor even under disadvantageous terms.

○ When we were conducting a negotiation for an investment agreement, the contents of the agreement concerning already agreed matters were suddenly changed immediately before concluding the agreement, and terms disadvantageous for our company were added. We had no choice but to conclude an agreement under disadvantageous terms, because the negotiation had already taken time and we were already running out of sufficient business funds on hand, and we had no time and room to change to a new investor.

<Opinion of an expert>

○ Behind the issue of a start-up conducting a disadvantageous transaction with a large company, there is the problem of a negotiable period. Normally, when a start-up negotiates a business partnership or investment with a large company, the start-up often faces a situation where its funds on hand will run out in few months' time. Therefore, if the negotiation becomes prolonged, it is difficult for the start-up to continue negotiating without compromising on the terms, and it will be compelled to accept even disadvantageous terms.

[Other specific facts indicating the need to conduct the transactions]

(Securing of credit through transactions)

○ When we conclude an agreement in a transaction with a large company, we are always requested to conclude a unilateral agreement in which our company alone is required to assume some burden. If we decline such agreement, and the large company decides to cancel the transaction with our company, it would mean that we lose transactions with a large company, so we cannot quite negotiate strongly. Even so, we try to conduct transactions with a large company, because in order for a start-up like our company to expand business, we need to win the trust of other companies, and if we have a track record of conducting transactions with large companies, it enhances other credit. Accordingly, it is inevitable to conduct transactions with large companies even under terms that are disadvantageous for our company.

(Difference in business scale)

○ A start-up and a large company are so far different in business scale that the negotiating power of the large company is incomparably stronger. Moreover, due to the contract structure, while technology and know-how are provided by the start-up, the funds and resources required for their research and development are provided by the large company. Therefore, the large company's negotiating power becomes even larger(*).

(*) The following opinion was observed as another background behind the strong negotiating power of large companies.
At the time when a start-up is established, it focuses its resources on research and development and has no room to build a legal framework; therefore, its legal framework tends

to be weak. As a result, even if a large company with a legal framework presents an agreement under terms advantageous for the large company, the start-up does not realize it at that point, and notices that it has concluded a disadvantageous agreement some time after concluding the agreement.

<Opinion of an expert>

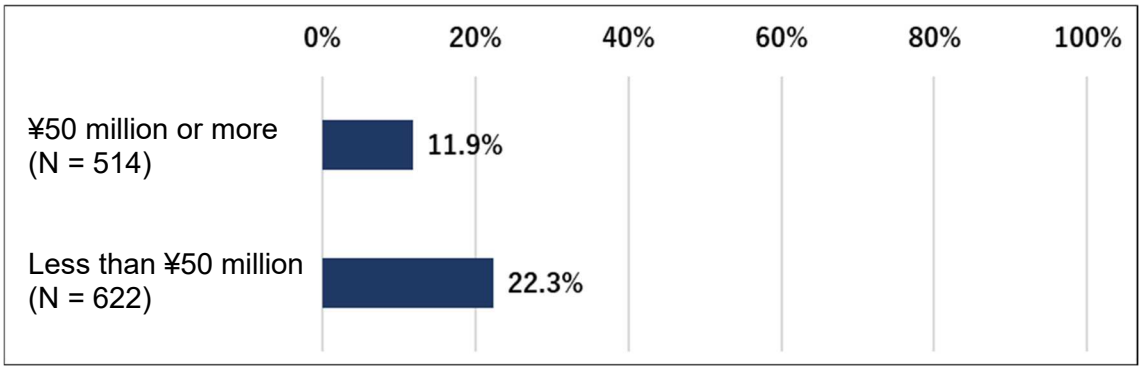
○ As a start-up makes a small amount of sales and its business contents are often hard to understand, it cannot gain trust and funds easily. First, it must accumulate the track record of transactions with other companies. In that process, if, for example, the start-up is able to indicate to other companies that a large company is using its goods or services, it will be easier to conduct transactions with other companies. Thus, a start-up needs to have a track record of transactions with large companies. As a result, a start-up would have to accept transactions with a large company even under disadvantageous terms.

B. Analysis of the questionnaire survey

In the questionnaire survey, about 17% of the start-ups answered that they have experienced an unsatisfactory act committed by another enterprise, as mentioned in (1) above. The percentages of the start-ups that experienced an unsatisfactory act were further compared based on the scale of the start-ups by sales amount and based on whether the start-ups have legal staff.

First, with regard to the sales amount, when the percentage of experiencing an unsatisfactory act was compared between "start-ups with a sales amount of less than ¥50 million," which are considered to be particularly small in scale, and "start-ups with a sales amount of ¥50 million or more," the former was about 22% and the latter was about 12%, indicating that the percentage of experiencing an unsatisfactory act increased to about 1.9 times according to the difference in the sales amount (Figure 24).

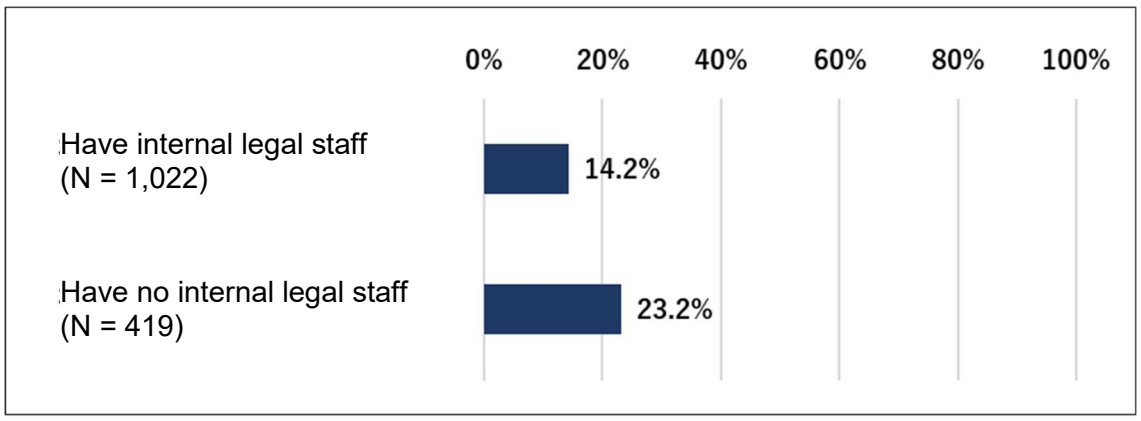
Figure 24: Percentage of experiencing an unsatisfactory act compared between "start-ups with a sales amount of less than ¥50 million" and "start-ups with a sales amount of ¥50 million or more"



Source: Created by the JFTC based on the questionnaire survey results.

Next, when the percentage of experiencing an unsatisfactory act was compared between "start-ups that have internal legal staff" and "start-ups that have no internal legal staff," the former was about 14% and the latter was about 23%, indicating that the percentage of experiencing an unsatisfactory act increased to about 1.6 times according to the difference in whether the start-up has internal legal staff (Figure 25).

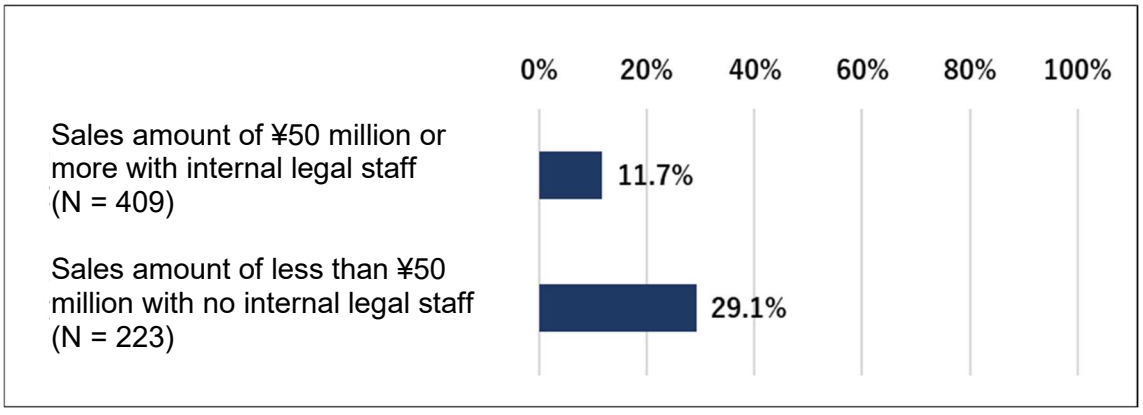
Figure 25: Percentage of experiencing an unsatisfactory act compared between "start-ups that have internal legal staff" and "start-ups that have no internal legal staff"



Source: Created by the JFTC based on the questionnaire survey results.

Moreover, when the percentage of experiencing an unsatisfactory act was compared between the "start-ups with a sales amount of less than ¥50 million that have no internal legal staff" and "start-ups with a sales amount of ¥50 million or more that have internal legal staff," the former was about 29% and the latter was about 12%, indicating a difference of about 2.5 times in the percentage of experiencing an unsatisfactory act (Figure 26).

Figure 26: Percentage of experiencing an unsatisfactory act compared between "start-ups with a sales amount of less than ¥50 million that have no internal legal staff" and "start-ups with a sales amount of ¥50 million or more that have internal legal staff"



Source: Created by the JFTC based on the questionnaire survey results.

(6)Specific contents of unsatisfactory acts

Start-ups which answered that they “have experienced” an unsatisfactory act in (1) above were asked about the specific contents of the act through an interview survey. The answers given can be largely divided as follows.

A. Transactions/agreements between a start-up and a partner business

(A) Acts relating to an NDA

Disclosure of trade secrets

[Case 1]

In a transaction with a partner business, we wanted to conclude an NDA, but the partner business requested us to disclose program source codes and business ideas without concluding an NDA while saying that it would conclude an agreement sometime later, and we were forced to disclose such information. Soon after that, our trading was suspended and the partner business announced the commencement of similar services using our source codes. We were just established at the time and needed to makes sales, so we could not strongly request the partner business to sign a written agreement in fear that the partner business would suspend the transaction if we insisted on the written agreement.

[Case 2]

If we provide the partner business with source codes, which constitute the very know-how of the web services we developed, the partner business will be able to develop similar services. If the partner business, which has higher sales capabilities than our company, sells those services, our services will no longer sell, and further, we will be unable to collect the development cost of those services and will fall into the red. Because of this, we explained to the partner business that it would be impossible to provide the partner business with all source codes. However, the partner business suggested that if we would not provide all source codes, this would exert an adverse influence on our future trading. In this manner, we were forced to provide all source codes without concluding an NDA.

Conclusion of a unilateral NDA, etc.

[Case 3]

In order for our company and the partner business to jointly carry out business, it was necessary to share with each other important confidential information for our respective business activities. However, under the concluded agreement, we were unilaterally forced to disclose our trade secrets while the partner business was exempt from disclosure duty.

[Case 4]

We were forced to conclude a unilateral agreement with the partner business which obliges us to keep confidential information of the partner business but does not oblige the partner business to keep confidential information of our company, allowing the partner business to freely handle our company's confidential information.

[Case 5]

In a partnership with a large company, we were forced to conclude a disadvantageous NDA that is not renewed automatically and whose term is very short compared to that of an ordinary NDA, given that we could use the large company's resources and, having just started business, we had no major track record. After concluding the NDA, we lost contact with the partner business regarding the business partnership. Immediately after the expiration of the term of the NDA, that large company announced the commencement of similar services.

Breach of an NDA

[Case 6]

We concluded an NDA in a business partnership. However, confidential information of the partner business was not at all disclosed, while only we had disclosed our confidential information upon request. Later, the partner business commenced the provision of similar services by the use of our confidential information, in breach of the NDA, and has become our competitor instead of a partner. However, as we did not have sufficient resources to dispute with the partner business, we could not take any action against the breach of the NDA and misappropriation of our confidential information by the partner business, and had to give up.

[Case 7]

We disclosed our program source codes after concluding an NDA prohibiting use for other purposes with the partner business. After that, we lost contact with the partner business. While we were concerned about what had happened, the partner business announced the commencement of the provision of similar services whose characteristic points were all the same as those of our services. Although the initial purpose was business partnership, the partner business has become our competitor. The partner business is a large company, and if we are to compete over the same

products, our company, which has fewer marketing and sales resources, will be far from being able to compete, and will even have trouble collecting the development costs of our products.

<Opinions of economic organizations and their member enterprises (large companies, etc.) concerning NDAs in general>

○ Some start-ups request conclusion of an NDA from the initial information exchange stage. If a large company is requested to conclude an NDA at a stage when it has no idea of the overview of the start-up's technologies, it may find it difficult to hold discussions toward a business partnership.

○ Even if we conclude an NDA that obligates a long-term confidentiality duty of about three years, technical contents make daily progress during that period, and sometimes the large company's internal research and development outpace the start-up's technologies. In this way, there are circumstances that make it difficult for the large company's side to conclude a long-term confidentiality duty in an NDA with a start-up.

(B) Acts relating to a PoC agreement

Work without compensation, etc.

[Case 8]

Even if we conduct a PoC free of charge in order to undertake a subsequent transaction, we can only receive an order for a subsequent transaction in about a quarter of cases. In the past, the partner business requested us to conduct a PoC for which additional work unexpected at the time of estimating the budget would be necessary, while making a verbal promise to surely conclude an agreement after the completion of the PoC. Therefore, we conducted the PoC, but could not receive compensation for the additional work, nor could we conclude an agreement with the partner business.

[Case 9]

We concluded a PoC agreement for developing a trial AI system, but the trading partner said that our products may not operate properly on the trial AI system, and that an official system would be necessary for checking the operation of our products for verification. We were thus forced to do development work for its official system without compensation.

[Case 10]

We conducted a PoC for developing an AI system as requested by the partner business, but as the partner business did not specify clear work contents and outcome, the partner business looked at the PoC results and requested us to do additional work without compensation. We had no choice but to do the additional work without compensation in spite of incurring additional costs, because the PoC results would have a decisive influence on whether we would be able to conclude a joint research agreement or have a deal with the partner business in the future.

[Case 11]

We asked the partner business to pay consideration for the PoC period several times, but the partner business repeatedly requested us to add modifications, stating that the AI under production had poor accuracy, without clarifying problems. The partner business did not conclude a PoC agreement with us until the end. Eventually, we were forced to spend a considerable amount of money but could receive the payment of only around one-fifth of the total cost from the partner business.

[Case 12]

The terms of the PoC agreement with the partner business were such that it allowed the partner business to endlessly request a start-up to do work. We had completed a PoC as instructed by the partner business but were requested to do additional work based on newly created specifications

again and again, and were forced to continue responding to such requests until the large company was satisfied with the results.

[Case 13]

Although the scope of operations was clearly defined in an agreement between the partner business and our company, after we had completed a PoC as instructed by the partner business, we were requested to do additional work beyond the agreement repeatedly until the partner business became satisfied. However, we could not receive compensation commensurate with the work.

<Opinions of economic organizations and their member enterprises (large companies, etc.) concerning PoC agreements in general>

○ When we request a start-up to conduct a PoC, we often find that the technological level of the start-up is not as high as the prior explanation. Many start-ups are struggling to raise funds through an overblown promotion activity beyond their true state.

○ When a large company carries out its own technological development, it verifies multiple technologies after concluding a PoC agreement, and adopts an optimal technology. A start-up's technology also becomes one of the options, but it is unknown whether it will be adopted as a result of the verification. On the other hand, a start-up considers that its technology is the only technology and an optimal one, and there are differences between the ideas of the large company and the start-up.

(C) Acts relating to a joint research agreement

Unilateral attribution of intellectual property rights

[Case 14]

We concluded an agreement on transactions at the time of commencing a PoC and joint research, but with regard to intellectual property rights, the partner business forcibly recommended a template without giving any consideration to the circumstances of the transactions with us. That written agreement provided that rights based on outcomes of a PoC and joint research would be all attributed to the partner business one-sidedly. As there are differences in the negotiating power and the trading position between our company and the partner business, even if we negotiated, the rights based on the outcomes would be all attributed to the partner business as provided by the template of the written agreement.

[Case 15]

At the time when we just started business and had no funds to spare, we were forced to provide our intellectual property rights to the partner business without compensation in a joint research program.

[Case 16]

If we are to transfer intellectual property rights obtained through joint research to a large company, we should receive additional consideration. However, the large company had a superior bargaining position when concluding a joint research agreement, and we had difficulty in making negotiations. Under such circumstances, we were requested to transfer our intellectual property rights to the partner business one-sidedly.

Nominal joint research

[Case 17]

In joint research between our company and the partner business, we only receive development funds, etc. from the partner business, and we conduct all work for the development of the program, which is the core of the joint research. However, we were forced to conclude a one-sided agreement to the effect that patents obtained based on joint research outcomes are all attributed to the partner business.

[Case 18]

In joint research, we only receive development funds and data from the partner business, and we develop the program all by ourselves, but we were forced by the partner business to accept a one-sided agreement to the effect that patents obtained through joint research are all attributed to the

partner business.

[Case 19]

We have provided most of the technology, know-how, and idea for joint research and the partner business has made almost no contribution, but the partner business insisted that applications for patents for joint research outcomes should be filed jointly.

[Case 20]

We were negotiating a joint research agreement with the partner business. Although we conduct research and development activities in full and the partner business only conducts test trials of the technology we developed, we were forced to conclude an agreement advantageous to the partner business to the effect that half of the rights for developed technology is to be transferred to the partner business.

Restrictions on the use of joint research outcomes

[Case 21]

When we intended to introduce services, the partner business instructed us not to sell the services to any other competitors, while stating that otherwise it would pull out of the deal and would prohibit us to publish the fact that we conducted transactions with the partner business. The research and development of the services were conducted by our company alone, and the partner business merely cooperated in operating the services we developed. Therefore, we thought there is no reason for us to be prohibited from sale of the services to other companies, but we had no choice but to accept the instruction because the partner business was a large company.

[Case 22]

The partner business insists that rights on the outcomes are attributable to the partner business based on the idea that it is providing funds and data. In order to make the AI we developed function at the partner business, we need to input the data provided by the partner business in the AI, so we will not sell the completed AI, which contains material information of the partner business, to other enterprises. Nevertheless, the partner business also requested us not to sell to other enterprises the AI which we originally developed independently, which contains no material information of the partner business, and which we improved based on the experience of business partnership.

<Opinions of economic organizations and their member enterprises (large companies, etc.) concerning joint research agreements in general>

○ The ownership of technologies developed through joint research often becomes an issue between our company and a start-up. We want to use the technologies we developed only for the purpose

of increasing our competitiveness, but the start-up's side wants to widely disseminate the technologies to other enterprises, so there is a difference in our positions.

○ Even if we invest in a start-up for the purpose of joint research and development, the start-up often faces financial difficulties during the progress of the research and development, and the joint research does not proceed smoothly in some cases, with a need to not only support the research and development, but also financially support the start-up's business management itself.

(D) Concerning licensing agreements

Granting of a license without compensation

[Case 23]

We developed and obtained a patent for the technology of certain products. As we do not have a marketing framework to sell the products, we decided to grant a license for that technology to the partner business to have it sell the products, but we were forced to grant the license without compensation.

Restrictions on patent applications

[Case 24]

The partner business one-sidedly sent us a written agreement containing a clause to prohibit us from obtaining patents for any of the know-how and technologies that we independently develop in the process of developing software as entrusted by the partner business, possibly based on an idea that we will be in competition with the partner business. As development had already been commenced at that stage and cancelation of the project would cause enormous damage, and as the partner business told us that we could not move on to the next development phase unless we conclude the agreement, we were somewhat forced to conclude the agreement under the presented terms.

[Case 25]

We had conducted joint research with the partner business, and although we produced new technologies in our research and development independent of the joint research, the partner business decided that we should discuss the attribution of the rights for those technologies, including the possibility of joint patent applications, and added a clause to prohibit us from solely filing patent applications in the agreement.

Restrictions on customers

[Case 26]

Our company, which conducts a data-handling business, depends on the partner business for both funds and data in developing our services. We were forced to conclude an exclusive agreement that prohibits our provision of services, even those not including the partner business's data, to any enterprises other than the partner business.

[Case 27]

As we had only just started business and the partner business was to proactively sell our products, we had to conclude an exclusive distributorship agreement with the partner business as a condition. The partner business requested us to conclude an agreement which includes a term that does not

even allow our company to conduct sales activities, and which imposes a penalty if we breach this term of the agreement. However, the partner business did not sell our products proactively. We wanted to sell the products by ourselves because that would rather increase our sales, but as the agreement made it difficult for us to sell the products, we could not conduct sales activities by ourselves during the agreement period.

<Opinions of economic organizations and their member enterprises (large companies, etc.) concerning licensing agreements in general>

○ One of the general issues is that the attribution of the outcomes, such as intellectual property rights, produced through a business partnership becomes ambiguous. Thus, while promoting open innovation, there is considered to be a need to establish a mechanism, such as an agreement, for avoiding such situation.

○ While a large company places emphasis on strategies and medium- to long-term viewpoints, a start-up places emphasis on short-term profits. Therefore, a large company wants to exclusively use a start-up's technologies, but the start-up wants to leave open the possibility for collaboration with other large companies. Due to such difference in their purposes, it is difficult to find the synergistic effect of open innovation in some cases.

(E) Other acts (relating to overall agreements, etc.)

Provision of customer information

[Case 28]

While working in partnership with the partner business for selling our products, we were requested to provide our customer information. Although we did not want to share our customer list, as it is our confidential information, we had no choice but to share our customer list in consideration of our relationship with the partner business. As a result, the partner business started to sell products competing with our products to our customers, and almost stole our transactions.

[Case 29]

In a cooperative business with the partner business, we were forced to provide information on our customers, which falls under a trade secret, to the partner business, but the partner business did not disclose its information at all.

Reduction of consideration and delay in payment

[Case 30]

Under a joint research agreement concluded with the partner business, we were to receive the predetermined amount of money over several years, but during the term of the agreement, the partner business reduced the amount of consideration one-sidedly without justifiable reasons.

[Case 31]

The partner business insisted on concluding an agreement without determining the amount of consideration to be paid to us, stating that the amount of consideration will be determined on a later date under the written agreement, and we concluded the agreement. We concluded the agreement without determining the amount of consideration because the partner business presented a specific amount of consideration while not only our company, but also third parties, were listening. We later conducted the work, but the partner business suddenly said that the work became unnecessary and one-sidedly reduced the amount of consideration it had presented on the ground that the amount of consideration was not stated in the written agreement.

[Case 32]

In the final phase of AI development, when the AI was almost completed, the partner business suddenly requested us to guarantee the performance, quality, accuracy, etc. of the product. Although we had told the partner business that it would be difficult to guarantee these matters before concluding the agreement, the partner business reduced the amount of consideration, stating that if we cannot guarantee these matters, it cannot pay the promised consideration to the full amount.

[Case 33]

In a transaction with the partner business, we had promised to deliver our products based on an agreement. As some of the products were high-priced, the partner business was to make advance payment to us. However, the partner business deferred payment.

Unilateral bearing of liability for damages

[Case 34]

The partner business unilaterally decided that in the event of any failure in products with a system that we developed and delivered to the partner business, we should bear liability for damages in full, while the partner business will not bear liability.

[Case 35]

We were not saying that we would not bear liability for damage caused by our company. Instead of unlimited liability under which we would be held liable for all kinds of risks, we, for example, requested an agreement under which we bear liability up to the amount of trading with the partner business. However, the partner business did not accept this request, and due to our weak bargaining position, we were forced to accept an agreement that requires us to take all risks.

[Case 36]

With regard to liability for damages, the partner business presented to us a written agreement under which we bear total liability for the transaction, so that, for example, if a bug occurs in the system we develop and the system stops, the partner business can claim compensation for the damage that occurs due to that stop, including the lost profits which could have been obtained during that period. We were forced to bear liability for damages at an amount several to tens of times the amount of trading with the partner business. When we conduct business activities, such agreement would only be a risk.

Restrictions on trading partners

[Case 37]

When concluding a business partnership contract with the partner business, we naturally resisted the partner business's request not to deal in products of other enterprises, but had no choice but to accept the request because we could not find any other trading partner to form a business partnership with at the time.

Most favored treatment clause

[Case 38]

We were forced by the partner business to accept the business term that we would set sales prices of our products lowest for the partner business compared with those for other enterprises and to secure a certain amount of sales quantity.

[Case 39]

While we provide services to multiple large companies, one of the large companies requested us to set service prices lowest for it compared with those for the other large companies.

[Case 40]

In conducting transactions with the partner business, we were requested by the partner business to make the partner business most prominent in the media we operate and to set business terms for the partner business equal to or superior to those for other enterprises that operate similar media.

B. Transactions/agreements between a start-up and an investor

Disclosure of trade secrets

[Case 41]

In a meeting whereby an enterprise or venture capital firm, etc. invests in or supports a start-up to create a new business (accelerator program), a venture capital firm refused to conclude an NDA with us, and strongly requested us to explain our business model that includes our trade secrets to the firm. As a result, our business model was misappropriated and our information was leaked to our competitor which was another investee of that investor.

[Case 42]

Although we licensed our technologies to an investor by limiting the scope of trade secrets so as to prevent leakage of our intellectual property rights and know-how, we were forced to disclose, free of charge, our know-how on the entire manufacturing process beyond the contents of our investment agreement in order to enable the investor to internally manufacture our products.

Breach of an NDA

[Case 43]

As an investor requested us to disclose our confidential information in business to the investor as a condition for investment, we disclosed the information after concluding an NDA with the investor. However, the investor leaked our trade secrets to another investee, which is an enterprise that could become our competitor, in a manner that enables the enterprise to misappropriate them. After all, even if an investor concludes an NDA, the investor breaches the agreement and leaks confidential information. We have not filed a lawsuit because we do not have sufficient personnel and capital strengths to file a lawsuit and dispute over leakage of information such as know-how. The investor took advantage of this, and leaked the information thinking that we would not file a lawsuit. This means that the NDA practically does not function.

Work without compensation

[Case 44]

When an investor was launching a new business, we were requested by the investor to do work beyond the scope of business decided under the agreement free of charge. As we were in a difficult position to negotiate because of the future trading planned with the investor, we were compelled to actually do work free of charge.

Bearing of costs for business entrusted by the investor to a third party

[Case 45]

We were pressed to bear the high costs for due diligence which an investor entrusted to an outside party, although the costs should have been borne by the investor. As we needed investments, we had no choice but to pay for the costs.

<Opinion of an expert>

○ There are cases in which an investor requires a start-up to pay costs which the investor should actually bear in full. For example, an investor sometimes sets an unreasonable clause which disadvantages the start-up's side, such as requiring the start-up to bear all costs for due diligence implemented by the investor and costs for accountants and lawyers necessary for concluding an agreement.

Purchase of unnecessary goods/services

[Case 46]

We already had hired a back office expert when we needed, and although we did not need an expert, we were instructed by an investor to use an expert who was affiliated with the investor. Although we did not have room to bear such personnel costs, it was difficult to oppose the investor's instruction, so we were unilaterally forced to bear personnel costs and our business funds decreased.

[Case 47]

We were requested by an investor to place an order for work with an enterprise which was another investee of the investor as a condition for investment, but the work was completely unnecessary for us in executing the relevant business. However, as it was difficult to find another investor, we had to accept even disadvantageous terms, and suffered a loss in the amount of the costs for that unnecessary work.

Appraisal rights

(A) Disadvantageous request backed by appraisal rights

[Case 48]

We were steadily conducting business and achieved the business plan goal that had been agreed with the investor in advance. However, the investor requested us to conduct disadvantageous transactions, such as transferring our intellectual property right to the investor, and suggested that the investor would exercise appraisal rights if we did not accept the request.

<Opinion of an investor>

○ Appraisal rights are hardly ever exercised. In Japan, they are exercised only a few times a year,

if at all. One way of using appraisal rights is, instead of actually exercising the rights, to present them as a material for negotiation in managing the operation of a start-up.

<Opinion of an expert>

○ Few investors exercise their appraisal rights, but investors make various disadvantageous requests to start-ups by using the appraisal rights clause as a threat. For example, some investors remove the founder from the position as the representative of the company, purchase all shares of the founder, and take over the company. There are investors that, instead of exercising their appraisal rights, make a start-up in the seed phase receive excessive orders for business entrustment, earn the amount of recovery, and work like a slave.

Appraisal rights

(B) Establishment of entitlement to appraisal rights based on which the purchase may be demanded at an extremely high price

[Case 49]

In an agreement with an investor, the investor established a condition that enables the investor to exercise appraisal rights even in the case of a minor breach of agreement on our side, such as failing to regularly make a business report, etc., and unilaterally included a clause that enables the investor to demand the purchase of shares against us at a price several times higher than at the time of the investment when the investor exercises the appraisal rights. Although we opposed this, the negotiations did not end easily, and we needed the funds, so we had to accept these conditions.

[Case 50]

In a negotiation with an investor concerning an investment agreement, the investor told us that it would not invest unless the agreement is concluded at an early stage, and we were extremely rushed to conclude an agreement. Under such circumstance, despite being an investment agreement, the investor presented a condition that we must buy back shares at a price almost twice the investment amount a few years later. As it was soon after establishment of our company and we were facing financial difficulty, we had no choice but to accept that condition.

<Opinion of an investor>

○ In the past, investments were sometimes made under terms similar to those of loans, but such investments are considered to be rare these days.

<Opinions of experts>

○ A certain number of investors in Japan think that they can have the invested money back if some problem occurs, making investments with a stance similar to loans.

○ There are cases where the terms of an agreement allow an investor to demand appraisal of an extremely high amount of shares even in the case of a minor breach of obligation by a start-up. The requirements for exercising this clause and the method for deciding the purchase price are often unclear in the written agreement, which is considered to be unreasonable.

○ An investment agreement often provides that the purchase price of a demand for appraisal is determined by applying the calculation method that derives the highest amount among several calculation methods, and may not always correctly reflect the corporate valuation amount of the start-up at the time.

Appraisal rights
(C) Exercise of appraisal rights when the conditions for exercise are not met

[Case 51]

When we changed the method of equipment procurement so that we can sell our product at a lower price, within an extent that poses no problem at all in terms of executing the business plan, an investor indicated an intention to exercise appraisal rights. We told the investor that there is no problem in the manufacturing of the product and the change was made for the company's profit, and that this change was not categorized as a material change to the business plan and therefore the conditions for exercise of the appraisal rights were not met. However, the investor unilaterally exercised the appraisal rights.

<Opinion of an investor>

○ Today, the start-up's side has learned well about how to receive investments. Thus, unless there is a material violation, such as a false report, concerning checking of facts about transactions, etc. of the start-up's side, appraisal rights are unlikely to be exercised, and there are actually few cases in which appraisal rights are exercised. If an investor sets the terms of investment based on an idea of agreement similar to a loan, and exercises appraisal rights, that is considered to be a problem. Most investors do not make such vicious investments.

<Opinions of experts>

○ It is wrong to hold the investor responsible even when the start-up's side is clearly at fault, such as in the case of making a false report or submitting a false statement of accounts. Therefore, it is considered reasonable to have terms under which the investor may pursue the start-up's responsibility in such case.

○ In the United States, investments in shares are recognized as supply of risk money, so it is rare for an investment agreement to provide for appraisal rights.

Appraisal rights
(D)Appraisal rights which may be exercised against individuals

[Case 52]

The investor strongly insisted on including personal guarantee from the founder in the investment agreement, and this was unilaterally provided for in the agreement. The existence of this personal guarantee made it difficult to gain the family's understanding, and our founder could not jointly start our company with another founder. If the individual founder is held liable, no one will ever try to start business by taking the risk.

[Case 53]

An investment agreement provides that, if we implement business without the consent of the investor, the investor can unilaterally exercise appraisal rights against the founder as a breach of agreement. When our cash flow became tight, we tried to liquidate our company, but the investor said this was a breach of agreement, and threatened to exercise appraisal rights against the individual founder. After all, it became necessary to cut into the individual founder's living expenses and use them as our company's working capital, causing a major impediment to maintaining the founder's livelihood.

<Opinions of investors>

○ As we invest at a stage when the start-up's scale is small, about the only collateral would be the founder's motivation. Under such circumstances, if there was a false report in the representations and warranties, such as the existence of an enormous debt, we include the individual founder in the billing list.

○ Appraisal rights themselves are rarely exercised, and as far as I know, there has been no case in which a start-up's manager filed for personal bankruptcy as a result of an investor buying back the start-up's shares.

○ An investor in a start-up also needs to pursue the responsibility of the start-up's side in order to protect investors. In start-up investments in the United States, when there was a responsibility attributable to the start-up's side, damages were claimed against an individual in some cases. As a Japanese investor would exercise appraisal rights against an individual only in the case of a highly malicious breach of an investment agreement that would become a criminal case, I believe there is no problem in having provisions for pursuing the responsibility also against individuals.

<Opinions of experts>

○ When I asked entrepreneurs, they said that they feel quite relieved just by having no personal guarantee. As for appraisal rights, I think the rights themselves can be allowed, but the

responsibility therefor should be limited to the issuing company alone, and it is better not to pursue the responsibility of an individual founder. I think that would be the common ground for an agreement between a start-up and an investor.

○ In many investment agreements, the billing list for appraisal rights includes the entity issuing the shares and the individual founder. In the world of loans, the “Guidelines for Personal Guarantee Provided by Business Owners” have been published, stating that it is unreasonable to attach personal guarantee to a corporate manager. In such a situation, it is not appropriate to attach personal guarantee to the investment that is executed by taking more risk. In addition, there have been cases in which appraisal rights were actually invoked, and the founder went into bankruptcy because the founder could not repurchase the shares.

Restrictions on research and development activities

[Case 54]

We intended to start development of AI in a certain field by applying our technology. However, in spite of the fact that the business domain was not restricted under the investment agreement, the investor opposed our business plan, stating that development of AI in that field would constitute a breach of the investment agreement. If we continued with the business against the investor’s intention, there was a risk that we would have to pay a penalty, so we had to give up the development.

Restrictions on trading partners

[Case 55]

We concluded an exclusive agreement with the investor, including a business partnership with the investor, but we were not only prohibited from partnering with enterprises that were in competition with the investor, but were also restricted from dealing with enterprises that were not considered to be competitors, which was beyond a reasonable extent. We want to expand our sales through transactions with other companies, but due to such restrictions, we are prohibited from dealing with other companies and are put to a difficult position.

[Case 56]

As we concluded an agreement with a promise to carry out joint business with the investor, we accepted exclusive contract terms to the effect that we can only deal with the investor, and concluded an investment agreement. Subsequently, however, progress of the joint business with the investor stagnated. As a result, in spite of the fact that we could no longer conduct joint business, only the exclusive agreement, which prohibits dealings with enterprises other than that investor under the agreement, remained, and we could not partner with another enterprise even if we wanted

to.

[Case 57]

An investment agreement had a clause to the effect that we must obtain advance permission from the investor when forming a new business partnership with another company or procuring funds from another company. The agreement also included such terms as not to carry out new fund procurement, not to conduct transactions with the investor's competitors, and not to form a business partnership with another company for a specific period. Although we should be able to conduct transactions, etc. with other companies, our business activities have been extremely restricted due to this clause.

[Case 58]

An existing investor requested us to add an agreement term to the effect that the business terms between the existing investor and us would be changed to those that are considerably disadvantageous for us if we receive investments from a new investor.

Most favored treatment clause

[Case 59]

We accepted a most favored treatment clause providing that, if another investor concludes an investment agreement with us on more favorable terms in the future, the same terms will be applied to the investor. However, this clause only served as a disadvantage for us in procuring a large amount of funds.

[Case 60]

A most favored treatment clause existed between an existing investor and us. Because the existing investor was not cooperative with additional investment, we could not receive additional investment from an investor that was considering newly making an investment due to the investor's dissatisfaction over the existence of the most favored treatment clause for the investor that was not cooperative with additional investment. Thus, the existence of a most favored treatment clause may sometimes make additional investment difficult. In the first place, a start-up's business performance varies depending on the time period, so its negotiating power also varies depending on the time of investment by each investor. Therefore, it is considered unreasonable to set a uniform most favored treatment clause.

<Opinion of an investor>

○ The most favored treatment clause generally used to be intended for preventing other investors from getting to enjoy more favorable treatment, rather than for binding the start-up. Today, when a new investor joins in, a new shareholders agreement is concluded among the investors, and

investors that occupy important positions in the investments at the time will receive preferential treatment. Therefore, the most favored treatment clause rarely takes effect in practice. Accordingly, it is considered meaningless to include the most favored treatment clause in an agreement, but the clause likely remains because the past contract culture to include the clause still exist.

<Opinions of experts>

○ The most favored treatment clause had been used to prevent a specific investor from enjoying advantageous treatment from among investors making investments in the same period. The idea is that, as long as investors invest in the same start-up, they must equally receive returns according to their invested amounts, or else investments in start-ups would decrease, and there is no problem about that. However, if the time of investment differs, the corporate value of the start-up also differs, so using the most favored treatment clause to apply the same conditions among investors that invested at different times is improper as an investment principle.

○ The most favored treatment clause could cause a start-up to bear quite a large cost for making adjustments among shareholders, and restrict freedom of additional capital increase and setting of agreement terms, etc. As long as shareholders continue to hold the shares, the relationship between the start-up and shareholders will continue for lifetime, so investment agreements and the most favored treatment clause would be important for a start-up. For example, if an investor making investments later than other investors makes the right of prior approval for business activities a condition for investment in the start-up, the start-up needs to recognize the right of prior approval also for investors that invested earlier due to the most favored treatment clause. However, it would require enormous costs on the part of the start-up to obtain prior approval from all shareholders for merely conducting business activities. While speed is the key for a start-up, this could delay the decision-making speed of the management team.

<Opinions of economic organizations and their member enterprises (large companies, etc.) concerning investments in general>

○ There are cases where a start-up requests financial support at an early stage, but it is difficult for a large company to make an investment decision immediately without being able to measure the feasibility of commercialization.

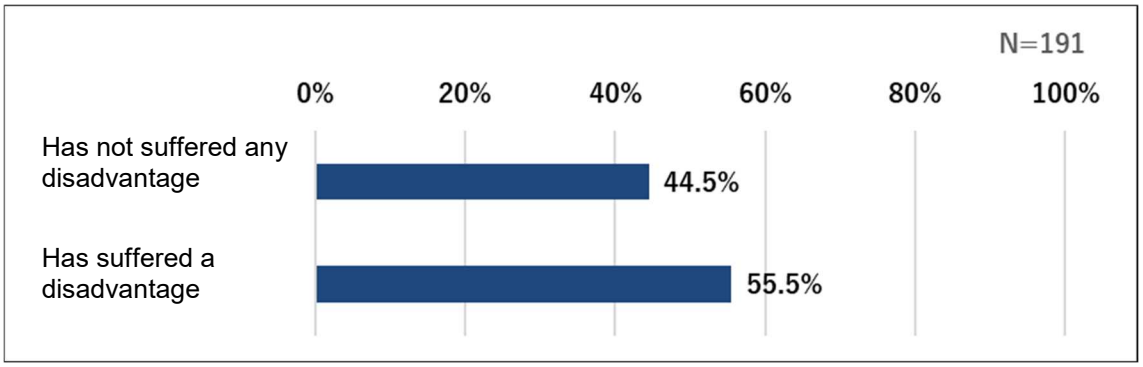
○ Normally, when a large company exchanges a written agreement with another company, it first presents an agreement that is not disadvantageous to its own company and then, through its legal department, the company works out the details to make the contents of the agreement mutually equitable. An investor which is a large company takes the same action against a start-up, but the start-up may think that it will not be able to receive investment unless it concludes the agreement as-is, perhaps because it does not have legal experts.

- In some cases, a start-up conceals information that it would prefer to keep secret, and such information becomes revealed after investment. It would be appreciated if start-ups would also disclose such information to investors.

(7)Whether start-ups have suffered disadvantages due to accepting the unsatisfactory act

Among start-ups that accepted the unsatisfactory act in (3) above, about 56% answered that they “have suffered a disadvantage” (Figure 27).

Figure 27: Has your company suffered any disadvantage due to accepting the unsatisfactory act? (single answer)

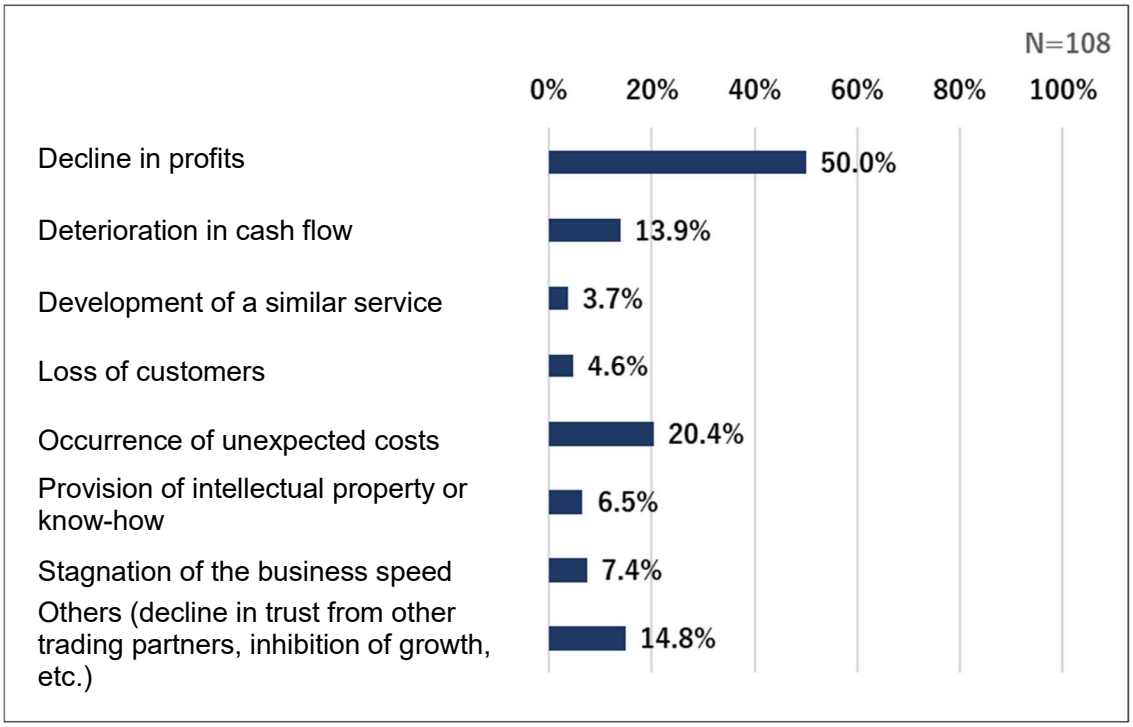


Source: Created by the JFTC based on the questionnaire survey results.

(8)Specific contents of the disadvantage

When the start-ups which answered that they have suffered a disadvantage in (7) above were asked about the specific contents of the disadvantage, 50% answered “decline in profits,” about 20% answered “occurrence of unexpected costs,” about 14% answered “deterioration in cash flow,” about 7% answered “stagnation of the business speed,” and about 7% answered “provision of intellectual property or know-how” (Figure 28).

Figure 28: Specific contents of the disadvantage (free answer)

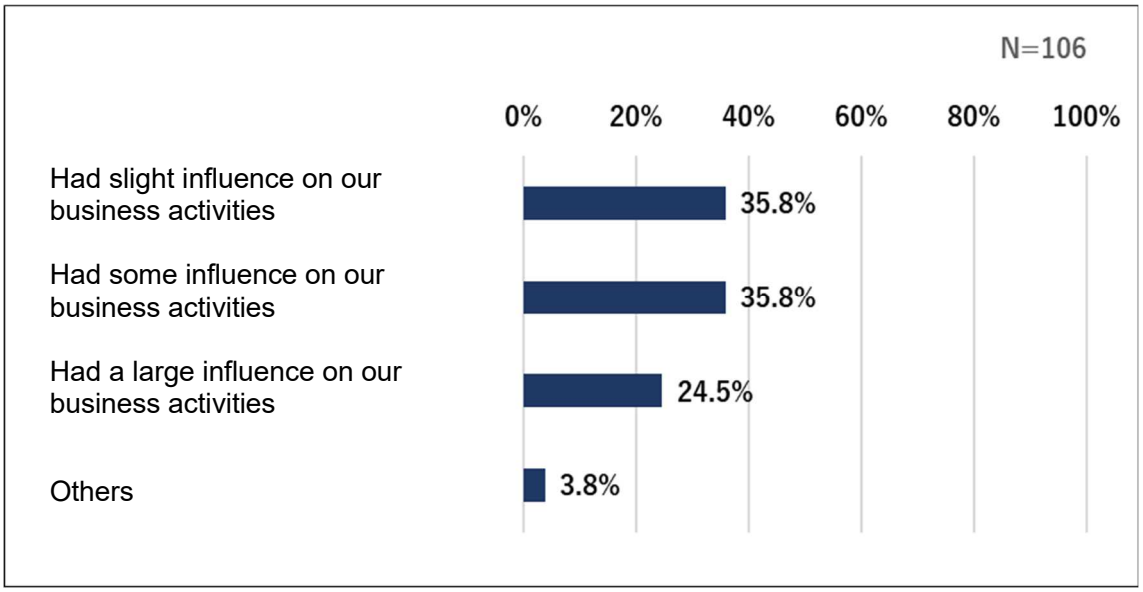


Source: Created by the JFTC based on the questionnaire survey results.

(9)Influence of the disadvantage on business activities

When start-ups were asked about how much influence the disadvantage mentioned in (7) above had on their business activities, about 36% answered that it “had some influence on our business activities” and about 25% answered that it “had a large influence on our business activities (Figure 29).

Figure 29: Influence of the disadvantage on business activities (single answer)



Source: Created by the JFTC based on the questionnaire survey results.

(10) Relationship between a start-up and competitors

A. Acts by competitors against the start-up's sales

[Case 61]
A large competitor has attached, to an agreement with a service supplier, exclusive terms that exclude us by name, and we are no longer able to provide services to that supplier.

[Case 62]
A competitor made an offer to our trading partner that it will provide its services free of charge on condition that the trading partner will not conduct transactions with us.

[Case 63]
A competitor prohibits our trading partner from using our services under its terms of service, etc.

[Case 64]
A large competitor is telling our trading partner not to conduct transactions with us by name. The trading partner has a business relationship with the competitor in other transactions as well, so it is unlikely to be able to resist this.

[Case 65]
There have been cases in which large competitors spread groundless rumors or criticisms that are completely untrue about the performance, etc. of our products, by themselves or through the industry. As a result, our business was obstructed, we actually lost orders for projects, and we were excluded from candidates for procurement by our trading partners.

[Case 66]
Although there is no evidence that our company is infringing on a competitor's patent, the competitor suddenly sent us a written warning alleging that our company is infringing on the competitor's patent. In addition, the competitor conducted an act to obstruct our business by telling our trading partner that using our products constitutes infringement on the competitor's patents.

B. Acts by competitors against the start-up’s purchase (procurement)

[Case 67]

Our large competitor has been pressuring our common supplier to quote a higher price to us than the quote for the competitor, and we have been presented with a quote that is higher than usual and higher than the quote for the larger competitor. In some cases, the products were only handled by that supplier or our customers specified that we only use that supplier's products. In such cases, the purchase cost became high and it became difficult for us to compete with the large competitor on price in a competition conducted by comparing quotations.

[Case 68]

A large competitor, which provides a system necessary for our services, not only provides the system but also uses the system by itself to provide services similar to those of start-ups. The competitor allows many start-ups that conduct the same business as us to use the services by collecting a normal fee for the use of the system. However, the competitor charged only our company a higher fee than other start-ups for the use of the system, refusing to allow us to use the system in effect, and we were unable to find a new trading partner.

(11) Other opinions of economic organizations and their member enterprises (large companies, etc.)

Economic organizations and their member enterprises (large companies, etc.) gave the following opinions concerning the status of implementation of a partnership with start-ups and future challenges.

A. Status of implementation of a partnership with start-ups

○ Out of the research and development we conduct, we conduct joint research and development with start-ups on new technologies that are difficult for us to handle or technologies that are different from our business fields.

○ We actively promote open innovation with start-ups. Specifically, we have established a corporate venture capital firm and a fund management company to discover, nurture, and support start-ups and accelerate innovation in our services, technologies, and processes.

○ Although specific details have not yet been worked out, we plan to promote open innovation with start-ups in the future for the purpose of creating new markets and expanding existing businesses.

○ In some cases, start-ups with unique technologies are negotiating transactions and agreements on an equal footing with large companies. It is considered undesirable to give preferential treatment only to start-ups, just because they are start-ups, given that start-ups are wide-ranging and diverse start-ups exist.

○ As a start-up cannot continue its business unless it develops a relationship with a large company, it inevitably needs to collaborate with a large company. As a result, it becomes difficult for the start-up to complain to the large company, and the start-up will be placed in a disadvantageous position compared to the large company in various situations.

B. Future challenges

(A) Challenges facing both start-ups and large companies

○ Unlike a large company, a start-up emphasizes flexibility to changes and is fast-paced, making it difficult to coordinate its corporate culture with that of a large company. Therefore, there is a need for a department that can liaise between the large company and the start-up, understand the

cultures of both companies, respond to the speed of both companies, and skillfully connect the gears of both companies.

○ The exchanges of human resources between large companies and start-ups are not progressing well, making it difficult for large companies to understand the start-ups and for the start-ups to understand the large companies.

(B) Challenges facing large companies

○ In large companies, it takes time to gain internal approval, and it is not always possible to sufficiently respond to the demand of the start-up side.

○ Since there are a certain number of cases in which a large company cannot internally approve an agreement unless it gives priority to the interests of the large company, it would be good to have guidelines to ensure that start-ups and large companies are on an equal footing in their discussions.

○ It is necessary to change the awareness of large companies, as it seems that there are some transactions with start-ups that prioritize the interests of large companies.

○ There is a difference in eagerness toward open innovation between departments. It is necessary to foster an open innovation mindset within the company, without being bound by the old logic and organizational structure.

(C) Challenges facing start-ups

○ It is also necessary for the start-up side to have some understanding of the business practices of large companies (e.g., it may take time to gain an approval through the internal decision-making process, and commercialization cannot be achieved unless quality is guaranteed). While changing the awareness of the large company side is a challenge, it is also necessary for the start-up side to change their awareness to show their understanding of large companies.

○ A start-up company does not have a well-developed internal organization, and when a large company forms a business partnership with such company, it may have to take a somewhat strict stance against the start-up in the contract negotiations in order to reduce risk.

○ A start-up sometimes seeks to impose an obligation that prohibits a large company from forming a

business partnership with others, but a large company would want to avoid terms that would make it bound to a relationship with a single specific company at a stage when the feasibility of commercialization cannot be measured.

○ Some start-ups simply explain their technologies alone. It would be easier to positively consider open innovation if explanations were added as to how the technologies fit the needs of the large company, what role the start-up can play in the collaboration, and what differentiates the start-up from its competitors.

○ In some cases, a start-up does not have personnel who are knowledgeable about legal affairs and intellectual property rights, so it does not understand the appropriateness of the terms of the agreement. In such cases, the start-up sometimes thinks that the large company is setting one-sided terms, and the discussions do not progress.

○ Start-ups have many interesting technologies, but they have few (or no) financial managers who can take charge of business plans, fund procurement plans, etc., and it is difficult to discuss the capital aspect of the business.

○ There are cases where a start-up's business continuity or creditworthiness is perceived as a risk, and even useful services cannot be adopted.

(12) Effects of the COVID-19 pandemic on start-ups

According to the answers given in 1.(1) above, many start-ups conduct business activities in the growth sector, information and communications, and some enterprises are powerfully supporting economic activities that are affected by the COVID-19 pandemic. On the other hand, similar to SMEs, start-ups gave following opinions on the adverse effects of the COVID-19 pandemic on their business activities.

Opinions of start-ups

○ Although we withdrew from some unprofitable businesses, we are receiving increasing inquiries for our core e-commerce business.

○ We used to provide educational support contents in person, but now we provide them as online services, and we are receiving an increased number of inquiries due to the COVID-19 pandemic.

○ We no longer receive inquiries, and since all ordering consultation meetings have been canceled, we have not been able to do any sales at all.

○ Sales are expected to be lower than last year due to declining demand and price reduction requests from existing users.

Opinions of investors

○ There are often delays in the progress of negotiations for investment agreements.

○ Among investors, there are some business companies whose core business has been negatively affected, resulting in a negative impact on their start-up investments.

○ The investment capacity of the entire investment industry itself is in an ample state. Therefore, start-ups for which investment had been decided before the COVID-19 pandemic have been able to secure funds steadily without having to cancel their investments, even if there are delays in the investment dates, and investors' appetite for investment is not likely to decline in the future.

IV. Actual Conditions of Start-ups' Business Practices and Principles under the Antimonopoly Act

1. General overview of the survey results and basic principles

Start-ups not only have the potential to contribute to the productivity improvement of the Japanese economy through innovation, but they are also expected to create new jobs. Therefore, it is important for the further development of the Japanese economy to ensure a fair and free competition environment for start-ups and to promote the founding and growth of start-ups.

However, the results of this survey indicate that the operating foundations of many start-ups are currently weak and their business environment is severe. For example, about 30% of the start-ups that responded to the survey did not have anyone within their company with knowledge of transaction/agreement terms, and it cannot be said that they have a sufficient legal framework. Many of the start-ups are considered to run a large deficit in the early stage of business, many conduct business activities in fields where demand still does not exist or has not sufficiently emerged, and many of them are unable to generate stable revenue until they reach a certain stage of growth. In addition, many are not able to obtain stable revenue until they reach a certain stage of growth. Furthermore, many start-ups are unable to receive sufficient loans from financial institutions and have to rely on fund procurement through investment, and the amount of investments in start-ups in Japan is not large compared to other major countries.

About 80% of the start-ups that responded to the questionnaire said that they “have not experienced" an unsatisfactory act committed by a partner businesses or investor, and as seen in the opinions of large companies, etc., some of the start-ups are considered to be dealing with partner businesses or investors on a somewhat equal footing. However, under the severe management conditions and business environment described above, about 20% of the start-ups that responded to the questionnaire “have experienced" an unsatisfactory act committed by a partner business or investor. Many of the specific contents of those acts could, as described in 3. below, constitute problems from the viewpoint of “abuse of superior bargaining position” which is prohibited by the Antimonopoly Act, similar to the cases indicated in the "Fact-Finding Survey on the Status of Abuse of Superior Bargaining Position involving Intellectual Property and Know-How of Manufactures.” In addition, there were also some acts that could constitute problems from the viewpoint of other types of acts prohibited by the Antimonopoly Act.

For further development of the Japanese economy, it is strongly expected that start-ups that do not have solid operating foundations and partner businesses or investors will cooperate with each other in terms of technology and finance to enter and expand existing markets with innovative ideas and technologies, and to develop new goods and services by utilizing such ideas and technologies, etc. and form their markets. Nevertheless, if unjustifiable acts committed by partner businesses or investors against start-ups unfairly disadvantage start-ups and, as a result, impede fair and free competition in existing or potential markets, not only will the seeds of innovation be nipped in the bud, but also the productivity improvement and the creation of new jobs in the Japanese economy will be adversely affected. In addition, such acts may allow partner businesses and investors to gain profits that the start-up should have gained or to shift their own burdens to the start-up, but from a longer-term perspective, they may lose the possibility of further growth through open innovation and the opportunity to expand their investment.

Based on this awareness of the issue, in 2. below, the principles of a partner business' or investor's bargaining position over a start-up and its nature to impede fair competition will be indicated. In 3. below and thereafter, the results of the questionnaire survey and the interview survey regarding the unsatisfactory acts committed by partner businesses or investors that were experienced by start-ups will be summarized, and the principles under the Antimonopoly Act will be shown. By doing so, violations of the Antimonopoly Act by partner businesses and investors will be prevented in advance, and thereby an environment of fair and free competition in start-ups will be secured.

2. Principles of a partner business' or investor's bargaining position over a start-up and its nature to impede fair competition

(1)Actual conditions

As a result of the survey, the following answers and opinions were given.

[i] Among start-ups that responded to the questionnaire that they “have experienced” an unsatisfactory act committed by a partner business or investor, about 80% answered that they “accepted” or “partly accepted” the unsatisfactory act (III.3.(3)).

[ii] Among start-ups that responded to the questionnaire that they “accepted” or “partly accepted” the unsatisfactory act, about 60% answered that they “have suffered a disadvantage” as a result of accepting that act (III.3.(7)), and about 60% of them answered that the contents of the disadvantage “had a large influence on our business activities” or it “had some influence on our business activities” (III.3.(9)).

[iii] With regard to transactions (partnership) with partner businesses, there were several opinions indicating that the transactions of start-ups are highly dependent on their partner businesses, with start-ups stating that they have to rely on sales through partnership even under disadvantageous transaction terms as their business management conditions are severe, and that they have to rely on orders received through partnership even under disadvantageous transaction terms as their supply capacity is low. In addition, there were opinions that the partner business has a high position in the market, that it is difficult for a start-up to change the partner business to another enterprise, that conducting transactions with the partner business leads to securing the start-up's credibility, and that there is a big difference in business scale between a partner business and a start-up (III.3.(5)A,).

[iv] With regard to transactions(investment) with investors, there were several opinions that it is difficult for a start-up to receive loans from a financial institutions and that it has to rely on fund procurement through investments from investors (II.2.(1)B.). There were also multiple opinions indicating that it is difficult for a start-up to change the investor to another enterprise, such as that an investment agreement is often concluded just before a start-up's funds run out and it is difficult for the start-up to start negotiations for concluding an investment agreement with another enterprise at that point. Some start-ups also commented that they are highly dependent on their investors; for example, they have no choice but to conclude an investment agreement even if exclusive terms are imposed due to the severe business management conditions (III.3.(5)A.).

[v] The percentage of start-ups that responded to the questionnaire that they “have experienced” an unsatisfactory act was about 1.9 times higher for start-ups with a low sales amount (sales amount of less than ¥50 million) than for start-ups with a high sales amount (sales amount of ¥50 million or more). In addition, the percentage was about 1.6 times higher for start-ups that have no internal legal staff than for start-ups that have internal legal staff. Moreover, the percentage was about 2.5 times higher for start-ups with a low sales amount that have no internal legal staff than for start-ups with a high sales amount that have internal legal staff (III.3.(5)B).

(2)Principles

A. Applicability of a superior bargaining position

If there is a circumstance where business management of an enterprise (*B*) will be substantially hindered if it becomes difficult for *B* to continue transactions with another enterprise (*A*), which is its trading partner, and because of this, *B* has no other choice but to accept *A*’s request which is extremely disadvantageous for *B*, then *A* is considered to have a superior bargaining position against *B* under the Anti-Monopoly Act.

In determining whether or not *A* has a superior bargaining position against *B*, the degree of dependence of *B* on *A*, A’s position in the market, the possibility for *B* to change its trading partner, and other specific facts indicating *B*’s necessity to conduct transactions with *A* are comprehensively taken into consideration.

In this regard, as described in (1)[v] above, start-ups that are small in scale and lack a legal framework tend to experience an “unsatisfactory act" committed by a partner business or investor more frequently. In addition, as described in (1)[ii] above, most of the "unsatisfactory acts" committed by partner businesses or investors against the start-ups were those that would have a large or some influence on the start-ups’ business activities, but as described in (1)[ii] above, most start-ups have accepted all or part of the acts.

Regarding transactions (partnership) between a start-up and a partner business, as described in (1)[iii] above, there were opinions indicating the necessity for a start-up to conduct transactions with a partner business, mainly due to the start-up's high dependence on the partner business. With regard to transactions (investment) between a start-up and an investor, as described in (1)[iv] above, there were opinions indicating the necessity for a start-up to conduct transactions with an investor, mainly because a start-up has to rely on fund procurement through investment from an investor,[21] but it is difficult for the start-up to change the investor.

Therefore, it is considered that, in transactions/agreements with a start-up that has experienced an "unsatisfactory act" committed by a partner business or investor, the partner business or investor is found to have a superior bargaining position over the start-up in many

[21] A start-up sometimes procures funds repeatedly from a same investor.

cases.[22]

B. Nature of abuse of superior bargaining position to impede fair competition

If a party whose bargaining position is superior to its trading counterparty makes use of that position to disadvantage the trading counterparty unjustly in light of normal business practices, it may impede the trading counterparty's transactions conducted based on its free and independent judgment, and tends to put the trading counterparty at a competitive disadvantage against its competitors while putting the person committing the act at a competitive advantage against its competitors. Therefore, such act is regulated by the Anti-Monopoly Act as an “abuse of superior bargaining position.” In what cases an act is found to be one that tends to impede fair competition will be determined on a case-by-case basis, taking into consideration the degree of the disadvantage in question, the extent of the act, and other factors.

In this regard, a start-up is very different from an ordinary company in that its growth draws a J curve, and the market it has entered or plans to enter has a possibility to grow dramatically due to its innovative ideas, technologies, etc. Under such circumstances, even where an act has disadvantaged only a specific start-up, for example, [i] if the start-up's business is innovative and there is a possibility that the market will expand in the future because of this, and the degree of the disadvantage is strong, or [ii] if the start-up and the business or investor are in a competitive relationship (including the case where the partner business or investor is in a potentially competitive relationship, such as planning to enter the market in the future), and the degree of the disadvantage is strong, the act is more likely to be found to be one that tends to impede fair competition. In addition, [iii] if a partner business or investor disadvantages a large number of start-ups, in an organized manner,[23] it is likely to be found to be an act that tends to impede fair competition.[24].

Since start-ups have the potential to grow dramatically, their business capabilities vary greatly depending on the stage, and it goes without saying that start-ups in the seed or early phase and those in the later phase cannot be uniformly assessed.[25] Whether or not an act is ultimately found to be one that tends to impede fair competition will be determined on a case-by-case basis, taking into consideration the overall business capabilities of the start-up and the position of the partner business or investor in the market.

---

[22] In the case where a partner business or investor is the parent company of a start-up, whether or not transactions between the parent and subsidiary companies become subject to regulation as unfair trade practices, such as abuse of superior bargaining position is as described in “Appendix: Transactions between Parent and Subsidiary Companies or between Fellow Subsidiaries” of “Guidelines Concerning Distribution Systems and Business Practices under the Antimonopoly Act” (July 11, 2021, JFTC Secretariat).

[23] For example, there can be a case where a partner business or investor disadvantages many start-ups by using written agreements of the same template for them.

[24] The investment terms should be set appropriately in consideration of the risk-return balance based on the business plan, etc., and should not be set based on the balance with the disadvantage caused to the start-up.

[25] For example, if a start-up in the later phase has become a leading enterprise in the market due to its innovative ideas or technologies, etc., a start-up in the seed or early phase would suffer a higher degree of disadvantage that the start-up in the later phase from the same disadvantageous act committed by a partner business or investor.

C. Nature of an act of non-price restraint to impede fair competition

The “unsatisfactory acts” committed by partner businesses or investors which were experienced by start-ups included acts that could pose a problem as abuse of superior bargaining position as well as acts of non-price restraint such as restrictions on trading partners, as shown in 3. below and thereafter. Acts of non-price restraint are determined to have a risk of impeding fair competition if, for example, the acts cause foreclosure effects.[26] The higher the position of the actor in the market, the more likely foreclosure effects will occur, compared to the case where the actor’s position in the market is not high, but the determination will be made on a case-by-case basis, taking into consideration the overall business capabilities of the start-up and the status of competition in the market, etc.

[26] Details of foreclosure effects are as described in I.3.(2)A. of the ”Guidelines Concerning Distribution Systems and Business Practices under the Antimonopoly Act.”

3. Transactions/agreements between a start-up and a partner business

(1)Acts relating to an NDA

A. Disclosure of trade secrets

(A) Actual conditions

According to the survey results, there were cases in which a start-up was requested by its partner business to disclose trade secrets without concluding an NDA (Cases 1 and 2).

(B) Principles

If a start-up's trade secret is disclosed without an NDA without justifiable reasons, there is a risk that the trade secret will be used by the partner business or leaked to a third party and used by the third party.

In the case where a partner business that has a superior bargaining position over a start-up requests the start-up, a trading counterparty, to disclose a trade secret free of charge without concluding an NDA although there were no justifiable reasons, and in the case where the start-up has no choice but to accept the request in fear of any adverse influence on their future trading,[27] such act could disadvantage the start-up unjustly in light of normal business practices, and could pose a problem as an abuse of superior bargaining position (Article 2, paragraph (9), item (v) of the Anti-Monopoly Act).

B. Conclusion of a unilateral NDA, etc.

(A) Actual conditions

According to the survey results, there were cases in which a partner business requested a start-up to conclude a unilateral NDA that only imposes confidentiality and disclosure obligations on the start-up side and does not impose such obligations on the partner business side (hereinafter referred to as a “unilateral NDA”) (Cases 3 and 4), and a case in which a start-up was requested to conclude an NDA with a short contract term which is not automatically renewed (hereinafter referred to as "short-term NDA") (Case 5).

(B) Principles

If a unilateral NDA is concluded between a start-up and a partner business, there is a risk that the trade secrets of the start-up will be used by the partner business or disclosed to a

[27] Even at the beginning of a transaction, for example, if it is difficult for a start-up to change its partner business to another enterprise due to the characteristics of a start-up that develops its business in a field where sufficient demand has yet to fully emerge under severe business management conditions, it may lead to a “case where the start-up has no choice but to accept the request in fear of any adverse influence on their future trading"..

third party and used by the third party, even within the NDA term. In addition, if a short-term NDA is concluded between a start-up and a partner business, there is a risk that the trade secrets will be used by the partner business or disclosed to a third party and used by the third party after the NDA term but before the trade secrets become obsolete.

When a partner business that has a superior bargaining position over a start-up requests the start-up, a trading counterparty, to conclude a unilateral NDA or a short-term NDA one-sidedly, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act could disadvantage the start-up unjustly in light of normal business practices, and could pose a problem as an abuse of superior bargaining position (Article 2, paragraph (9), item (v) of the Anti-Monopoly Act).

C. Breach of an NDA

(A) Actual conditions

According to the survey results, there were cases in which a partner business stole a start-up's trade secrets in breach of an NDA, and started selling goods and services that competed with the start-up's goods and services (Case 6 and Case 7)

(B) Principles

Misappropriation of a trade secret[28] breaches an NDA, which imposes a mutual obligation of confidentiality of information between a start-up and a partner business and prohibits use for other purposes, and is clearly unfair as a means of competition.

Therefore, when a partner business misappropriates a trade secret of a start-up, in breach of an NDA, and sells goods or provides services in competition with the start-up's goods or services to the start-up's trading partners, and thereby interferes with transactions between the start-up and its trading partners, such act of the partner business may fall under interference with a competitor's transactions (paragraph (14) of the General Designation of Unfair Trade Practices).

[28] "Misappropriation" in this context includes a case where a partner business uses a start-up's trade secrets and files a patent application without notifying the start-up..

(2)Acts relating to a PoC agreement

A. Work without compensation, etc.

(A) Actual conditions

According to the survey results, there were cases in which the start-up was not paid the necessary consideration for the outcome of the PoC by the partner business (Cases 8 to 10), and cases in which the start-up was asked to redo the PoC after its implementation and was not paid the necessary consideration for the redo (Cases 11 to 13).

(B) Principles

If [i] a PoC is conducted free of charge without justifiable reasons, [ii] a PoC is conducted for an extremely low amount of consideration, [iii] the amount of consideration for a PoC is reduced without justifiable reasons after implementation of a PoC, or [iv] the start-up is requested to redo the PoC after implementation of a PC without justifiable reasons, the cost that should be borne by the partner business will be transferred to the start-up.

When a partner business that has a superior bargaining position over a start-up [i] requests the start-up, a trading counterparty, to conduct a PoC free of charge without justifiable reasons, [ii] requests the start-up to conduct a PoC for a considerably small consideration one-sidedly, [iii] reduces the amount of consideration provided for in the agreement after the completion of a PoC without justifiable reasons, or [iv] requests the start-up to redo a PoC after the completion thereof without justifiable reasons, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act could disadvantage the start-up unjustly in light of normal business practices, and could pose a problem as an abuse of superior bargaining position (Article 2, paragraph (9), item (v) of the Anti-Monopoly Act).

(3)Acts relating to a joint research agreement

A. Unilateral attribution of intellectual property rights

(A) Actual conditions

According to the survey results, there were cases in which a start-up was requested by a partner business to conclude an agreement providing that intellectual property rights based on the outcomes of joint research would be attributed only to the partner business (Cases 14 to 16).

(B) Principles

If both the start-up and the partner business contributed to the joint research, but the intellectual property rights based on the outcomes of the joint research are attributed only to the partner business beyond the degree of its contribution, the start-up cannot enjoy the outcomes, and only the partner business enjoys the outcomes.

When a partner business that has a superior bargaining position over a start-up requests the start-up, a trading counterparty, to provide intellectual property rights based on joint research outcomes free of charge without justifiable reasons, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act could disadvantage the start-up unjustly in light of normal business practices, and could pose a problem as an abuse of superior bargaining position (Article 2, paragraph (9), item (v) of the Anti-Monopoly Act).

B Nominal joint research

(A) Actual conditions

According to the survey results, there were cases in which the start-up was requested by the partner business to conclude an agreement providing that intellectual property rights based on the outcomes of the joint research would be attributed only to the partner business or to both parties, even though most of the joint research was conducted by the start-up (Cases 17 to 20).

(B) Principles

If intellectual property rights based on the outcomes of joint research are attributed only to the partner business or to both parties beyond the degree of its contribution, even though most of the joint research was conducted by the start-up, the start-up will not enjoy outcomes commensurate with its degree of contribution, and the partner business will enjoy outcomes

beyond the degree of its contribution.

When a partner business that has a superior bargaining position over a start-up requests the start-up, a trading counterparty, to provide all or part of the joint research outcomes without compensation, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act could disadvantage the start-up unjustly in light of normal business practices, and could pose a problem as an abuse of superior bargaining position (Article 2, paragraph (9), item (v) of the Anti-Monopoly Act).

C. Restrictions on the use of joint research outcomes

(A) Actual conditions

According to the survey results, there was a case in which a start-up was restricted by a partner business from selling goods and services based on the outcomes of joint research (Case 21), and another case in which a start-up was restricted from selling new goods and services that were developed based on the experience of joint research (Case 22).

(B) Principles

It is considered that, in principle, there is no problem under the Anti-Monopoly Act if a partner business, in order to maintain the confidentiality of the outcomes of joint research such as know-how, imposes a restriction on the start-up, a trading counterparty, to sell goods and services based on the outcomes only to a specific enterprise for a reasonable period.

However, when a partner business, which is an influential enterprise in the market,[29] imposes restrictions on a start-up, a trading counterparty, regarding customers for goods or services based on joint research outcomes or customers for goods or services newly developed based on joint research experience, without limiting a reasonable period of time, and there is a risk that such restrictions may have foreclosure effects,[30] such act of the partner business may fall under trading on exclusive terms (paragraph (11) of the General Designation of Unfair Trade Practices) or trading on restrictive terms (paragraph (12) of the General Designation of Unfair Trade Practices).

[29] Details of the influential enterprise in the market are as described in I.3.(4) of the “Guidelines Concerning Distribution Systems and Business Practices under the Antimonopoly Act.”
[30] Details of foreclosure effects are as described in I.3.(2)A. of the “Guidelines Concerning Distribution Systems and Business Practices under the Antimonopoly Act.”

(4)Acts relating to a licensing agreement

A. Granting of a license without compensation

(A) Actual conditions

According to the survey results, there was a case in which a start-up was requested by a partner business to grant a license for intellectual property rights without compensation (Case 23).

(B) Principles

If a license for intellectual property rights of a start-up is provided free of charge without a justifiable reason, the start-up cannot recover the cost of developing the intellectual property rights and the partner business can use the intellectual property rights without incurring any cost.

When a partner business that has a superior bargaining position over a start-up requests the start-up, a trading counterparty, to grant a license for an intellectual property right free of charge without justifiable reasons, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act could disadvantage the start-up unjustly in light of normal business practices, and could pose a problem as an abuse of superior bargaining position (Article 2, paragraph (9), item (v) of the Anti-Monopoly Act).

B. Restrictions on patent applications

(A) Actual conditions

According to the survey results, there were cases in which a start-up was requested by a partner business to restrict patent applications for technology that the start-up had developed and licensed to the partner business (Case 24 and Case 25).

(B) Principles

If a start-up is restricted from filing a patent application for a technology that it has developed and licensed to a partner business, the start-up may have difficulty in legitimately protecting the technology it has developed from the partner business and third parties.

When a partner business that has a superior bargaining position over a start-up one-sidedly requests the start-up, a trading counterparty, to restrict patent applications for technologies that the start-up developed, and the start-up has no choice but to accept the restrictions in fear of any adverse influence on their future trading, such act could

disadvantage the start-up unjustly in light of normal business practices, and could pose a problem as an abuse of superior bargaining position (Article 2, paragraph (9), item (v) of the Anti-Monopoly Act).

C. Restrictions on customers

(A) Actual conditions

According to the survey results, there were cases in which a partner business restricted a start-up from selling goods or services to another enterprise, etc. (Cases 26 and 27).

(B) Principles

It is not considered to be a problem under the Anti-Monopoly Act, in principle, if a partner business restricts the start-up, a trading counterparty, to sell the start-up’s goods or services only to itself, when it is necessary to maintain the confidentiality of the partner business's know-how, etc. used in the start-up's goods or services.

However, when a partner business, which is an influential enterprise in the market, prohibits a start-up, a trading counterparty, from selling its goods or services to other enterprises or restricts the start-up's own sales activities beyond a reasonable extent, and there is a risk that such prohibition or restrictions may have foreclosure effects, such act of the partner business may fall under trading on exclusive terms (paragraph (11) of the General Designation of Unfair Trade Practices) or trading on restrictive terms (paragraph (12) of the General Designation of Unfair Trade Practices).

(5)Other acts (relating to overall agreements, etc.)

A. Provision of customer information

(A) Actual conditions

According to the survey results, while customer information of a start-up is a trade secret but is often not subject to an NDA, there were cases in which a start-up was requested by a partner business for provision of customer information (Cases 28 and 29).

(B) Principles

If a start-up's customer information is provided to a partner business without justifiable reasons, such customer information may be used by the partner business or leaked to a third party and used by the third party.

When a partner business that has a superior bargaining position over a start-up requests the start-up, a trading counterparty, to provide its customer information free of charge without justifiable reasons, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act could disadvantage the start-up unjustly in light of normal business practices, and could pose a problem as an abuse of superior bargaining position (Article 2, paragraph (9), item (v) of the Anti-Monopoly Act).

B. Reduction of consideration and delay in payment

(A) Actual conditions

According to the survey results, there were cases in which a partner business reduced the amount of consideration to be paid to a start-up (Cases 30 to 32) or delayed in paying consideration (Case 33).

(B) Principles

If the amount of consideration is reduced or its payment is delayed without justifiable reasons, the cost that should be borne by the partner business will be shifted to the start-up (including temporary shift due to a delay in payment).

When a partner business that has a superior bargaining position over a start-up, [i] after purchasing goods or services, reduces the amount of consideration determined in an agreement without justifiable reasons or [ii] does not pay consideration by the payment date determined in an agreement without justifiable reasons, and the start-up has no choice but to accept the reduction or the delay in payment in fear of any adverse influence on their future trading, such act could disadvantage the start-up unjustly in light of normal business practices,

and could pose a problem as an abuse of superior bargaining position (Article 2, paragraph (9), item (v) of the Anti-Monopoly Act).

C. Unilateral bearing of liability for damages

(A) Actual conditions

According to the survey results, there were cases in which a start-up was requested by a partner business to conclude an agreement providing that only the start-up bears the liability for damages for goods or services based on the outcomes of the business partnership (Cases 34 to 36).

(B) Principles

If the start-up and the partner business form a business partnership, but only the start-up bears the liability for damages for goods or services based on the outcomes of the business partnership, the start-up alone bears the risk of damages and the partner business bears none of the risk.

When a partner business that has a superior bargaining position over a start-up requests the start-up, a trading counterparty, to solely bear liability for damages for goods or services based on joint business outcomes without justifiable reasons, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act could disadvantage the start-up unjustly in light of normal business practices, and could pose a problem as an abuse of superior bargaining position (Article 2, paragraph (9), item (v) of the Anti-Monopoly Act).

D. Restrictions on trading partners

(A) Actual conditions

According to the survey results, there was a case in which a start-up was restricted by a partner business from conducting transactions with other enterprises (Case 37).

(B) Principles

It is not considered to be a problem under the Anti-Monopoly Act, in principle, if a partner business restricts the start-up, a trading counterparty, to sell the start-up’s goods or services only to itself, when it is necessary to maintain the confidentiality of the partner business's know-how, etc. used in the start-up's goods or services.

However, when a partner business, which is an influential enterprise in the market, prohibits a start-up, a trading counterparty, from selling its goods or services to other enterprises beyond a reasonable extent, and there is a risk that such prohibition may have

foreclosure effects, such act of the partner business may fall under trading on exclusive terms (paragraph (11) of the General Designation of Unfair Trade Practices) or trading on restrictive terms (paragraph (12) of the General Designation of Unfair Trade Practices).

E. Most favored treatment clause

(A) Actual conditions

According to the survey results, there were cases in which a start-up was subjected to a most favored treatment clause (a condition in which the terms of trade of the partner business are at least as favorable as those of the other trading partners) by the partner business (Cases 38 to 40).

(B) Principles

It is not immediately problematic under the Anti-Monopoly Act for a partner business to establish a most favored treatment clause against a start-up, a trading counterparty, to the transaction.

However, when a partner business, which is an influential enterprise in the market, sets a most favored treatment clause in an agreement with a start-up, a trading counterparty, and there is a risk that such clause makes it difficult for its competitors to have a deal with the start-up on more favorable terms and reduces those competitors' incentives for a deal, thereby impeding competition between the partner business and those competitors and resulting in having foreclosure effects, such act of the partner business may fall under trading on restrictive terms (paragraph (12) of the General Designation of Unfair Trade Practices).

4. Transactions/agreements between a start-up and an investor

(1)Disclosure of trade secrets

A. Actual conditions

According to the survey results, there were cases in which a start-up was requested by an investor to disclose trade secrets without signing an NDA (Cases 41 and Case 42).

B. Principles

If a start-up's trade secret is disclosed without concluding an NDA without justifiable reason, there is a risk that the trade secret will be used by the investor or leaked to a third party and used by the third party.

When an investor that has a superior bargaining position over a start-up requests the start-up, a trading counterparty, to disclose a trade secret free of charge without concluding an NDA although there are no justifiable reasons, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading,[31] such act could disadvantage the start-up unjustly in light of normal business practices, and could pose a problem as an abuse of superior bargaining position (Article 2, paragraph (9), item (v) of the Anti-Monopoly Act).

(2)Breach of an NDA

A. Actual conditions

According to the survey results, there was a case in which an investor leaked trade secrets such as business ideas to other investors in breach of an NDA, and those other investors started to sell goods or services that competed with the start-up's goods or services (Case 43).

B. Principles

The leakage of the trade secret and its use by the leaked party breaches the NDA, which imposes a mutual obligation of confidentiality of information between the start-up and the investor and prohibits use for other purposes, and is clearly unfair as a means of competition.

Therefore, when an investor leaks a trade secret of a start-up to another investee, in breach of an NDA, and that investee sells goods or provides services in competition with the start-up's goods or services to the start-up's trading partners, and thereby interferes with trading between the start-up and its trading partners, such act of the investor may fall under interference with a competitor's transactions (paragraph (11) of the General Designation of Unfair Trade Practices).

[31] Even at the time of starting a transaction, if it is difficult for a start-up to change the investor to another enterprise, for example, if an investment agreement is concluded just before the start-up's funds run out and it is difficult for the start-up to start negotiations for concluding an investment agreement with another enterprise at that time, the case may constitute a "case where the start-up has no choice but to accept the request in fear of any adverse influence on their future trading."

(3)Work without compensation

A. Actual conditions

According to the survey results, there was a case in which a start-up was requested by an investor to do work without compensation, which was not stipulated in the agreement (Case 44).

B. Principles

If work without compensation, which is not stipulated in the agreement, is performed without justifiable reasons, the cost that should be borne by the investor will be shifted to the start-up.

When an investor that has a superior bargaining position over a start-up requests the start-up, a trading counterparty, to do work that is not provided for in the agreement free of charge without justifiable reasons, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act could disadvantage the start-up unjustly in light of normal business practices, and could pose a problem as an abuse of superior bargaining position (Article 2, paragraph (9), item (v) of the Anti-Monopoly Act).

(4)Bearing of costs for business entrusted by the investor to a third party

A. Actual conditions

According to the survey results, there was a case in which a start-up was requested by the investor to bear all the costs related to the due diligence (i.e., investigation and verification for risk assessment and valuation of the target company on the part of the investor, etc.[32]) that the investor had entrusted a third party to conduct (Case 45).

B Principles

If the start-up is solely responsible for all the costs associated with the work that the investor entrusts to a third party, the costs that should be borne by the investor will be shifted to the start-up.

When an investor that has a superior bargaining position over a start-up unilaterally requests the start-up, a trading counterparty, to bear all costs relating to work which the investor entrusted to a third party, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act could disadvantage the start-up unjustly in light of normal business practices, and could pose a problem as an abuse of superior bargaining position (Article 2, paragraph (9), item (v) of the Anti-Monopoly Act).

[32] “Standard Procedure Manual for Intellectual Property Due Diligence” (March 2018, Japan Patent Office).

(5)Purchase of unnecessary goods/services

A. Actual conditions

According to the survey results, there were cases in which a start-up was requested by its investor to purchase unnecessary goods/services from enterprises designated by the investors, including other investors (Cases 46 and Case 47).

B. Principles

If unnecessary goods or services are purchased from an enterprise designated by the investor, including other investors, the start-up pays for the unnecessary goods or services, and the investor makes the enterprise designated by the investor, including other investors, receive compensation for the goods or services that were not originally purchased.

When an investor that has a superior bargaining position over a start-up requests the start-up, a trading counterparty, to purchase goods/services other than those relating to the transaction in question, and although the goods/services are unnecessary for executing the relevant business or the start-up does not want to purchase them, the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act could disadvantage the start-up unjustly in light of normal business practices, and could pose a problem as an abuse of superior bargaining position (Article 2, paragraph (9), item (v) of the Anti-Monopoly Act).

(6)Appraisal rights

A. Actual conditions

According to the survey results, the following cases were found.

[i] A case in which a start-up was requested by an investor to transfer intellectual property rights free of charge, etc., and the investor suggested that it would exercise its appraisal rights if the start-up did not accept the request [Case 48].

[ii] In a situation where the start-up's business funds were being depleted, the start-up received a request from the investor for the establishment of entitlement to appraisal rights based on which the purchase may be demanded at a price extremely higher than the amount of investment (Cases 49 and 50).

[iii] A case in which an investor exercised its appraisal rights for a part of the shares it holds in spite of the fact that the conditions for exercise of the appraisal rights were not met (Case 51).

[iv] Cases in which a start-up was requested by an investor to establish appraisal rights that would allow the investor to exercise appraisal rights against individuals such as a managing

shareholder (Case No. 52 and 53).

B. Principles

(A) Appraisal rights may enhance the investor's bargaining position against the start-up in that it enables the investor to gain an advantage in the negotiation by, for example, suggesting a possibility of exercising the rights to the start-up (see (B) below). In addition, the establishment or exercise of appraisal rights may cause a significant disadvantage for a start-up depending on their contents and method (see (C) and (D) below).

(B) If, as in case [i], the start-up's intellectual property rights are transferred free of charge without justifiable reasons, the start-up is unable to recover the costs of developing the intellectual property rights, and the partner business can acquire the intellectual property rights without bearing the costs.

When an investor that has a superior bargaining position over a start-up makes a disadvantageous request to the start-up, a trading counterparty, such as a request for transfer of an intellectual property right free of charge, without justifiable grounds, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, and the possibility of exercise of the appraisal rights, such act could disadvantage the start-up unjustly in light of normal business practices, and could pose a problem as an abuse of superior bargaining position (Article 2, paragraph (9), item (v) of the Anti-Monopoly Act).

(C) In the case of a request for purchase at a price significantly higher than the amount of investment, as in case [ii], a start-up is obliged to reimburse the investor with the amount of money significantly exceeding the amount of investment, and the investor has the right to receive reimbursement of the amount of money significantly exceeding the amount of investment.

When an investor that has a superior bargaining position over a start-up makes a unilateral request to the start-up, a trading counterparty, to establish entitlement to appraisal rights based on which the purchase may be demanded at a price extremely higher than the investment amount, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act could disadvantage the start-up unjustly in light of normal business practices, and could pose a problem as an abuse of superior bargaining position (Article 2, paragraph (9), item (v) of the Anti-Monopoly Act).

(D) If, as in case [iii], the condition for exercising appraisal rights had not been met, but some of the shares held were purchased, the funds that the start-up could have continued to use would have been recovered by the investors.

When an investor that has a superior bargaining position over a start-up demands that the

start-up, a trading counterparty, purchase a part of the shares held by the investor without justifiable grounds, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act could disadvantage the start-up unjustly in light of normal business practices, and could pose a problem as an abuse of superior bargaining position (Article 2, paragraph (9), item (v) of the Anti-Monopoly Act).

(E) As shown in case [iv], it is considered that appraisal rights that can be exercised against individuals such as a managing shareholder would hinder the incent ive for founders, who often become the managing shareholder after founding a start-u p, to start a business by receiving investments from investors. Therefore, from the vi ewpoint of enhancing start-ups' entrepreneurial motivation and promoting open inn ovation and employment, it is desirable in terms of competition policy to exclude i ndividuals, such as managing shareholders, from those against whom appraisal ri ghts may be exercised, even in the case of providing for appraisal rights in an in vestment agreement.

(7)Restrictions on research and development activities

A. Actual conditions

According to the survey results, there were cases in which start-ups were prohibited by their investors from conducting research and development activities for new products (Case 54).

B. Principles

An investor's act to restrict a start-up's free research and development activities, such as prohibiting the start-up from conducting research and development by itself or jointly with a third party generally has a risk of diminishing competition in the future technology market or market of goods, etc. through its influence on competition over research and development.

Accordingly, such act of an investor to restrict a start-up's free research and development activities is highly likely to fall under trading on restrictive terms (paragraph (12) of the General Designation of Unfair Trade Practices).

(8)Restrictions on trading partners

A. Actual conditions

According to the survey results, there were cases in which start-ups were prohibited from partnerships with other businesses and restricted from other transactions by their investors (Cases 55 and 56), and cases in which start-ups were restricted from investments by other investors (Cases 57 and 58).

B. Principles

It is not immediately problematic under the Anti-Monopoly Act for an investor to restrict a start-up from conducting transactions with other businesses.

However, when an investor, which is an influential enterprise in the market, prohibits a start-up, a trading counterparty, from dealing with other enterprises beyond a reasonable extent, and there is a risk that the prohibition may have foreclosure effects, such act of the investor may fall under trading on exclusive terms (paragraph (11) of the General Designation of Unfair Trade Practices) or trading on restrictive terms (paragraph (12) of the General Designation of Unfair Trade Practices).

(9)Most favored treatment clause

A. Actual conditions

According to the survey results, there were cases in which start-ups were subjected to the most favored treatment clause (a condition that makes the terms of the investor's transactions equal to or more favorable than those of other investors) by the investor (Cases 59 and 60).

B. Principles

It is not immediately problematic under the Anti-Monopoly Act for an investor to establish a most favored treatment clause for a start-up that is the counterparty to a transaction.[33].

However, when an investor, which is an influential enterprise in the market, sets a most favored treatment clause in an agreement with a start-up, a trading counterparty, and there is, for example, a risk that such clause makes it difficult for its competitors to have a deal with the start-up on more favorable terms and reduces those competitors' incentives for a deal, thereby impeding competition between the investor and those competitors and resulting in having foreclosure effects, such act of the investor may fall under trading on restrictive terms (paragraph (12) of the General Designation of Unfair Trade Practices).

[33] When investors invest in a startup at the same time, for example, it is quite possible that the terms of investment in the startup are the same among the investors, and as a result, the terms of investment among the investors are the same.

5 Relationship between a start-up and competitors

(1)Acts by competitors against the start-up's sales

A. Actual conditions

According to the survey results, the following cases [i] and [ii] were found.

[i] Cases in which a competitor restricted its customers from purchasing competing products from a start-up, which is its competitor (Cases 61 to 64)

[ii] Cases in which a competitor interfered with a start-up's transactions with its customers by spreading bad reviews about the start-up's products, etc. to its customers (Cases 65 and 66).

B. Principles

(A) It is not immediately problematic under the Anti-Monopoly Act for a start-up's competitor to restrict its trading partner from conducting transactions with other businesses. However, for example, if a competitor, which is an influential enterprise in the market, restricts its trading partners from purchasing from a start-up which is that competitor's competitor, beyond a reasonable extent, as described in [i] above, there is a risk that foreclosure effects may be caused by such restriction. In such a case, it may fall under trading on exclusive terms (paragraph (11) of the General Terms and Conditions) or trading on restrictive terms (paragraph (12) of the General Designation of Unfair Trade Practices).

(B) If a competitor interferes with transactions between a start-up, which is that competitor's competitor, and its customers by, for example, spreading bad reviews about the start-up's products to the start-up's customers, as described in [ii] above, such interference, if it is by means of unfair competition, may be considered as an obstruction of transactions against a competitor (paragraph (14) of the General Designation of Unfair Trade Practices).

(2)Acts by competitors against the start-up's purchase (procurement)

A. Actual conditions

According to the survey results, the following cases [i] and [ii] were found.

[i] A case in which a competitor forced a supplier manufacturer to set a higher selling price to a start-up than its competitors and caused the start-up to lose the order in a competition at the customer conducted by comparing quotations (Case 67).

[ii] A case in which a competitor practically refused to deal with a particular start-up by setting the price of goods, etc. at a significantly higher price than for other customers (Case 68).

B. Principles

(A) If a competitor, for example, as described in [i] above, causes a supplier manufacturer to set a higher sales price to a start-up than the competitor, causes the start-up to lose the order in a competition at the customer conducted by comparing quotations, and interferes with the transactions between the start-up which is its competitor and its customers, it may pose a problem as an obstruction of transactions against a competitor if it is by means of unfair competition (paragraph (14) of the General Designation of Unfair Trade Practices)

(B) Even if a competitor makes a difference in the transaction price, it is not immediately a problem under the Anti-Monopoly Act, nor is it basically a problem under the Anti-Monopoly Act if a competitor does not conduct transactions with a certain enterprise.

However, if a competitor, which is an influential enterprise in the market, for example, as described in [ii] above, sets the price of goods, etc. for a start-up, which is its competitor, at a significantly higher price than for other customers and practically refuses to conduct transactions with the competitor, it may pose a problem under the Anti-Monopoly Act as discriminatory pricing (paragraph (3) of the General Designation of Unfair Trade Practices) or other refusal of transactions (paragraph (2) of the General Designation of Unfair Trade Practices), if it is conducted as a means to achieve an unjustifiable purpose under the Anti-Monopoly Act, such as to exclude a competitor start-up from the market.

V. The JFTC's Actions

1. Public awareness activities to prevent problematic activities, etc.

In this survey, many cases were observed which may pose a problem under the Anti-Monopoly Act as abuse of superior bargaining position, similar to the cases reported in the "Report on the Fact-Finding Survey on the Status of Abuse of Superior Bargaining Position involving Intellectual Property and Know-How of Manufacturers." In addition, there were also several cases that could pose a problem under the Anti-Monopoly Act as trading on restrictive terms, etc.[34].

As stated in III.3.(12) above, in light of the possibility that the business management conditions of some start-ups have become even more severe due to the impact of the COVID-19 pandemic, the JFTC is releasing the results of this survey and disseminating this report widely and promptly in order to prevent acts that may pose problems under the Anti-Monopoly Act. The JFTC will make the results of this investigation public and disseminate this report widely and promptly in order to prevent any conduct that may be problematic under the Anti-Monopoly Act.

In addition, based on the results of this study, the JFTC and the Ministry of Economy, Trade and Industry will jointly prepare by the end of this year a draft guideline that outlines examples of problems in agreements between start-ups and partner businesses, the direction of specific improvements, and the principles of the Anti-Monopoly Act, in response to the Action Plan of the Growth Strategy (approved by the Cabinet on July 17, 2020), and will begin a public comment solicitation process.

2. Strict response to violations

The JFTC will continue to collect information on Anti-Monopoly Act issues regarding transactions/agreements between start-ups and partner businesses or investors, and will strictly deal with any violations of the Anti-Monopoly Act.

[34] Needless to say, if general SMEs which are not start-ups are disadvantaged or restricted by the same acts as those in these cases, such acts may also pose a problem under the Antimonopoly Law if there is a risk that they would impede fair competition.