

JAPAN



Law and Practice

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1. Trends

1.1 VC Market

In 2024, Japan's start-up ecosystem witnessed relatively robust VC activity, with several groundbreaking transactions that showcased the growing maturity and global appeal of the country's entrepreneurial landscape.

The most notable VC financing during this period was Sakana AI's JPY30.1 billion Series C round, led by New Enterprise Associates (NEA), Khosla Ventures, and Lux Capital. In this round, Sakana AI achieved unicorn status, doing so faster than any other Japanese company before it. The participation of foreign investors in the financing round also underlines the increasing interest of international investors in Japanese start-ups.

In addition, the Japanese government has decided to invest JPY100 billion in Rapidus, a company that aims to produce next-generation semiconductors within Japan, by the end of 2025. The purpose of this investment is thought to be twofold: to clarify the government's stance on strengthening support for the domestic semiconductor industry and to attract the necessary private-sector investment and loans for mass production of Rapidus's products as quickly as possible. Private companies such as Toyota Motor and NTT are also planning to invest a total of approximately JPY100 billion, bringing the total expected investment amount to around JPY200 billion.

The Japanese IPO market also saw several high-profile debuts in 2024. Timee, an on-demand job introduction and matching platform, went public with an initial market capitalisation of JPY176 billion. Astroscale Holdings, a space sustainability company focused on removing space debris,

also completed a successful IPO with an initial market cap of JPY144.8 billion.

There was considerable activity in the M&A space as well, with major acquisitions such as that of fundbook, an investment management SaaS platform, and Cancerscan, a preventive healthcare service for municipalities.

These sizable transactions are indicative of the increasing scale and sophistication of Japanese start-ups at a time of growing interest from global investors.

1.2 Key Trends

Although the Japanese VC market is relatively small considering the size of Japan's economy, the market is growing and there is generally a feeling of optimism among market participants. While there is an increasing number of Japanese start-ups facing down or flat rounds, the downturn has been more moderate than in other key global VC markets such as the United States.

The challenges facing the Chinese economy, combined with a significant number of global investors opting to retreat from China, have benefited Japan as the recipient of a substantial share of the funds that had previously been pouring into China. Some well-known overseas VC funds entered the Japanese market in 2024, and Andreesen Horowitz also announced its plans to open a Japan office, bolstering the image of Japan as a stable and low-risk haven in an otherwise volatile region.

Despite these positive trends, unicorns (private companies with a USD1 billion-plus valuation) remain rare in Japan. Among the 1,250 unicorns that existed worldwide at the end of 2024, only eight were based in Japan, according to CB Insights' State of Venture 2024 Report.

Due to the increase in interest from global investors and the growing maturity of the ecosystem for start-ups in Japan, many observers expect the Japanese VC market to continue developing at a steady clip. Government-backed funds have also entered the VC market in recent years, demonstrating a growing awareness and emphasis on the need to support and develop the country's VC market.

In contrast to countries with VC markets that are perceived to be founder-friendly (eg, the United States and Israel), Japan has a reputation for being an investor-friendly market.

In terms of financing methods, for start-ups in Japan at the earliest stages, 2024 saw continued popularity of the J-KISS convertible equity instrument for seed round financings (additional detail on the J-KISS is provided in **3.3 Investment Structure**). There has also been a notable growth trend in venture debt financings, including loans with stock acquisition rights and convertible bonds, as alternatives to traditional equity fundraising.

1.3 Key Industries

According to the 2024 Japan Start-up Finance report by Speeda, the SaaS and generative AI sectors led in both total funding raised and number of companies securing investments, followed by the IoT and healthcare sectors. Smart HR, a prominent HR tech company, raised over JPY20 billion in its Series E round, while Sakana AI, a generative AI start-up, raised JPY30.1 billion, the most funding raised by a Japanese start-up in 2024.

Comparing median funding amounts by sector in 2024, the autotech and space sectors stood out, with values more than 1.5 times that of the third-place SaaS sector, according to Speeda's

2024 report. Notable investments include TIER IV, which develops automated driving software, and ArkEdge Space, which develops nano-satellites, both ranking among the top ten start-up funding rounds in Japan in 2024 in terms of total funds raised.

Despite a downward trend in total funding and number of companies raising capital since 2022, the average and median funding amounts per company have increased. This trend appears consistent across sectors, with no significant difference between industries in terms of VC-backed exits or growth in funding rounds.

2. Venture Capital Funds

2.1 Fund Structure

VC funds are often organised as investment limited partnerships (commonly referred to as LPS or, in Japanese, *toshi jigyo yugen sekinin kumiai*) in Japan or similar structures formed outside Japan due to their tax benefits and flexibility in allocating profit distribution. Ordinary limited liability partnerships (LLPs) are poorly suited as fund investment vehicles because an LLP's decision-making authority is generally allocated among all the partners in the partnership under Japanese law.

Except for certain legal forms, there are no restrictions on the qualifications of the general partner (GP) of an LPS. However, the GP bears unlimited liability for the LPS's liabilities, and in order to avoid the risk of this unlimited liability being imputed to the GP's owners and investors, it is common for the GP to be a corporation (*kabushiki kaisha*) or limited liability company (*godo kaisha*).

Similar to other jurisdictions, in Japan, a VC fund in the form of an LPS is formed by entering into a Limited Partnership Agreement for Investment (LPSA) among the GP, who is responsible for the management of the fund, and the limited partners (LP's), who provide the capital. The specific provisions regarding governance of an LPS, including the authority of the GP and the LPS's, as well as the management of the LPS's assets, are set forth in the LPSA. A model LPSA has been published by Japan's Ministry of Economy, Trade and Industry.

When a VC makes investment decisions, it is common for an investment committee composed of officers, employees and other members of the GP, to be convened. The decision to proceed with an investment is typically made based on the outcome of the committee's discussions.

2.2 Fund Economics

In Japan, Fund Principals participate in the economics of VC funds using similar means as in many other jurisdictions: primarily carried interest and management fees. With respect to carried interest, the GP receives a fixed percentage (for example, 20%) of the returns exceeding a certain threshold, often the amount of the fund's capital contributions. An important caveat to this is that some more traditional funds (especially the corporate VC funds, or CVCs, of large companies) provide little or no carried interest incentive to the personnel involved in the fund. In recent years, however, there have been some examples of Japanese CVCs introducing stronger incentive compensation systems.

Management fees, on the other hand, are provided to the GP as compensation for the GP's management of the fund's operations. These fees are usually a percentage (for example, 2%)

of the total fund size and are paid to cover operational costs and compensation for the personnel involved on behalf of the GP. The fixed percentage that applies to a fund's carried interest or management fee may be adjusted if certain performance thresholds are reached (in the case of carried interest) or based on the stage of the fund (in the case of management fees).

The GP typically has various obligations under the LPSA in respect of managing the partnership's assets, including proper disclosure, restrictions on the management of other funds and self-dealing, and the implementation of governance measures specified in the LPSA. These obligations are intended to ensure appropriate management of conflicts of interest and improve the transparency and fairness of the fund's operations.

2.3 Fund Regulation

When VC funds are organised as LPSs, they are primarily subject to regulation under the Financial Instruments and Exchange Act and the Limited Partnership Act for Investment. As a general rule, these funds are required to register in connection with their fundraising from LPs and use of LP funds for investing activities. However, due to certain financial requirements and the considerable time needed for registration, it is common for funds to take advantage of exemptions from the registration obligation by limiting their fundraising to investors with a certain level of assets and sophistication. In addition, under the Limited Partnership Act for Investment, investments by LPSs in foreign entities are limited to less than 50% of the total capital contributions of all partners.

At the time of the initial execution of the LPSA, the fund must complete a commercial registration process with the local Legal Affairs Bureau

registering its formation, and the fund is required to update its commercial registration upon the occurrence of a change in its registered information thereafter.

2.4 Particularities

Corporate VC (CVC) activity is an important part of the VC ecosystem in Japan. CVC investors view investments in, commercial partnerships with, and acquisitions of start-ups as a means to enhance their R&D and other innovation activities. As in other markets, many CVCs view commercial synergies as key part of their investment strategy and place a lower emphasis on financial return than traditional VC funds.

Additionally, the Japanese government is active in its support for start-ups and VC funds. For example, the government provides financial support to start-ups through the Development Bank of Japan and makes LP investments in VC funds through the Japan Investment Corporation (JIC). As of the end of January 2025, the JIC had announced 49 investments in VC funds since 2020. In 2024, the JIC made nine investments in both domestic and international VC funds, with investment amounts ranging from approximately JPY1.5 billion to JPY4.5 billion. Additionally, certain recent tax reforms, which are discussed in **4.2 Tax Treatment**, have been established to incentivise VC investments.

3. Investments in Venture Capital Portfolio Companies

3.1 Due Diligence

In Japanese VC financings, full legal due diligence is typically conducted by the lead investor, and more limited legal due diligence is sometimes conducted by follow-on investors.

The key areas of focus in legal due diligence are usually capitalisation, intellectual property, compliance and labour, but other areas may also be covered depending on an investor's risk appetite as well as the nature and size of the transaction.

Most investors conduct detailed intellectual property due diligence given the significant problems that may arise when a start-up fails to comply with Japanese laws regarding employee inventions. Investors also tend to scrutinise compliance with labour and privacy laws because these are areas often overlooked by many start-ups, particularly in the early stages of the company. In some cases, such as where a start-up is in a novel industry, investors will examine the start-up's business to ensure that it does not run afoul of any regulations covering such business.

Until recently, it was uncommon for Japanese VC investors to perform due diligence in the areas of anti-money laundering or anti-bribery and corruption compliance, export restrictions, and sanctions compliance, but the entry of large overseas institutional investors into the Japanese market has been leading an increasing number of investors to examine these issues as well.

Since start-ups typically do not pay the legal fees of the lead investor in a round, the lead investor is not considered to be conducting due diligence for the benefit of all investors. Accordingly, there are cases where multiple investors in a round conduct their own independent due diligence.

In addition to legal due diligence, investors typically conduct financial due diligence and occasionally business due diligence too, though usually only in larger rounds.

3.2 Process

The typical process for a new financing round, from the term sheet through the consummation of the investment, takes two to three months, assuming that no Foreign Exchange and Foreign Trade Act (FEFTA) filing is required (more detail on FEFTA filings is provided in **7.2 Restrictions**). There are, however, cases where transactions are completed in only one month while other cases may take more than a year to complete.

If a FEFTA filing is required, the transaction will close only after receiving approval from the regulators. Preparing the FEFTA filing normally takes one to two weeks, and after the filing is submitted, it will typically take another two to four weeks to receive approval from the regulators. Regulators have recently started asking an increasing number of questions in the process of approving transactions, and parties are thus encouraged to submit the filing as soon as practically feasible.

As in many other jurisdictions, financing rounds in Japan typically require amending the start-up's shareholders' agreement (SHA), which in principle requires the consent of all shareholders that are party to the SHA. However, in cases where the SHA provides that it can be amended by a shareholder majority (or the majority holders of each class of shares), then approval from the applicable majority is sufficient in lieu of the approval of all shareholders. Separately, an issuance of new equity by a non-listed company generally requires the consent of the holders of two thirds of a company's capital stock under Japanese law, so it is ultimately necessary for start-ups to get supermajority shareholder approval for each financing. For start-ups that have already raised capital via the issuance of preferred stock, it is common practice for new financings to require the consent of a majority (or

higher threshold) of the holders of the company's outstanding preferred stock, typically voting together as a single class.

In small-scale Japanese start-up financings, legal counsel typically advises the client directly, with limited or no direct contact between legal counsel for opposing parties. Accordingly, in these cases, legal counsel's role in conducting due diligence and negotiating the terms of the transaction documents is significantly smaller than in the US market and other jurisdictions where legal counsel plays a more active role. However, in larger financings, it is more common for the legal counsel for the start-up and the lead investor to play a more active role and to communicate and negotiate directly with each other.

3.3 Investment Structure

Investors in the first round of outside investment often purchase common stock or "J-KISS," SAFE-like convertible equity instrument based on the Keep It Simple Security (KISS) developed by 500 Startups in the United States and subsequently adapted to the Japanese market. The economic features of the J-KISS are similar to those of the current post-money SAFE, except that the standard J-KISS is more favourable to investors because it includes both a discount and a valuation cap as well as a most favoured nation provision. In comparison to the SAFE, the J-KISS is significantly more complex and time-consuming to implement.

In subsequent rounds of outside investment, investors usually receive preferred stock. Some of the rights received by preferred stockholders typically include: liquidation preferences, anti-dilution adjustments, reserved matters and veto rights, pre-emptive rights for new share issuances, rights of first refusal and co-sale or

tag-along rights, drag-along rights, board and observer rights, and information rights.

3.4 Documentation

In convertible equity (J-KISS) financings, the key deal documents are the term sheet (though a term sheet is not used in all J-KISS financings) and the J-KISS, which is itself comprised of an investment agreement and “*terms of issuance*” document that sets forth the key terms and mechanics of the instrument.

In equity financings, the key deal documents are the term sheet, the investment or subscription agreement, the shareholders’ agreement, and the articles of incorporation. While the investor almost always prepares the term sheet, the start-up generally prepares the remaining documents. Parties sometimes choose to also enter into side letters.

In some cases, the shareholders’ agreement is split into two separate agreements: a distribution agreement for deemed liquidations (in contrast to “*true liquidations*” addressed in the articles of incorporation), and a shareholders’ agreement without the deemed liquidation provision.

The same investment or subscription agreement is typically signed by all investors, but there are also cases where different investors request customised provisions and thus sign slightly different investment agreements.

Most practitioners use a publicly available form of the J-KISS. While there are publicly available templates for the other deal documents as well, they are not used as widely as the standard form of J-KISS. Thus, documents used in Japanese VC financings are generally more varied than their equivalents in other markets with well-

established standard forms such as the United States.

Companies with many foreign investors sometimes opt to use English-language financing documents, but it is much more common for the documents to be prepared in Japanese, in which case foreign investors will need to rely on English translations that are prepared for reference purposes only. Even in the rare cases where English-language documents are used, Japanese will typically be the controlling language of certain provisions in the investment agreement that are required to be reflected in the start-up’s certificate of incorporation or commercial registration (eg, the rights and preferences of the preferred stock).

3.5 Investor Safeguards

Outside of the first financing rounds, when a J-KISS may be used, VC investors generally invest through preferred shares and receive a liquidation preference, which is often participating and uncapped. These liquidation preferences apply not only to “*true liquidations*” but also to M&A exits and other deemed liquidations, and therefore will benefit preferred stockholders in the event of portfolio company sales and liquidations.

Additionally, weighted average anti-dilution protections (broad-based or narrow-based) are typically granted to preferred stockholders. It is quite rare to see full-ratchet anti-dilution protections.

3.6 Corporate Governance

Each class of preferred shares is typically entitled to one seat on the start-up’s board, though this partly depends on the shareholding percentage of the class following the closing. A class that makes up a significant percentage of all outstanding shares may receive multiple board

seats, whereas a class with a low percentage may not receive any board seats at all.

The general market practice is that, if a class of preferred shares is entitled to a board seat, the lead investor in the class will have the right to designate the class director.

Observer rights are sometimes given to large investors that are not eligible for a board seat.

Under the Companies Act, if a company creates a new class of shares or takes certain other actions that will adversely affect the rights of existing shareholders, the company must obtain the consent of the holders of two thirds of each class of the company's shares (including common shares) before such actions are considered effective. In addition to statutory consent rights, preferred stockholders are typically given contractual consent rights with respect to other material matters. The approval of reserved matters usually requires the consent of a specified percentage, such as a majority, of holders of all classes of preferred shares, voting together.

3.7 Contractual Protection

In a financing round, the principal contracts include representations and warranties with respect to matters that are commonly covered in many other jurisdictions, including the valid existence of the start-up, its capitalisation, compliance with law, the accuracy of financial statements, the absence of litigation and bankruptcy proceedings, and certain employment matters, among other items. One additional item covered by the representations and warranties that may be unique to Japan is the absence of relationships with “*anti-social forces*.” “*Anti-social forces*” is a designation under Japanese law for organised crime groups and similar persons that engage in behaviour harmful to society, as well

as persons providing support to these groups. It is customary in Japan for commercial and corporate transaction agreements to include representations and warranties as to no relationships with anti-social forces and to allow immediate termination of the agreement if such a relationship arises.

The contracts in Japanese VC financings also typically include rights and covenants that are common in other jurisdictions, such as a right of first refusal, tag-along rights, drag-along rights, and certain veto rights for preferred stockholders. It is also common for the founders to agree to remain in their management roles at the start-up, to enter into non-compete obligations in the transaction documentation, and to agree not to dispose of any shares of the start-up. In addition, it is fairly common for founders and the start-up to agree to exercise reasonable commercial endeavours to complete a public listing of the start-up's stock within a specified number of years (often around six to eight years from the first outside investment round). If the founders or the start-up fail to exercise such efforts, they have an obligation to repurchase the investors' shares, but these repurchase provisions are very rarely enforced.

A breach of warranties or covenants can lead to disputes, with potential breaches of veto rights on material corporate matters being a particular area of focus for investors.

In Japan, it is rare to see formal legal claims arising from disputes in VC financings because the potential damages that can be recovered (which are usually quite low compared to other jurisdictions such as the United States) in most cases will not justify the cost of bringing the claim. Investors also may conclude that it is not in their best interest to bring suit against the start-up

or its management team, because the investors themselves are shareholders of the start-up and the start-up's success depends heavily on the performance of the individuals who would be the targets of the suit.

In many cases, investment agreements or shareholders' agreements grant investors a right to have their shares in the start-up repurchased by the start-up and/or the founders if the agreements are materially breached. Despite having this strong remedy, investors rarely exercise their put options because they are viewed as a drastic remedy that could cause the exercising investors to suffer reputational consequences.

Disputes are usually resolved amicably and the particular facts that gave rise to the dispute will determine the specific resolution. For instance, a company that breaches a post-closing covenant may agree, in a side letter, to implement remedial measures designed to prevent the recurrence of the breach. In a case where a breach of a representation and warranty that has the effect of diminishing the company's value is found post-closing, one resolution may be for investors to receive commensurate compensation in the form of warrants, though this outcome is uncommon.

4. Government Inducements

4.1 Subsidy Programmes

In 2022, the Japanese government announced that it was designating that year as the “*first year of start-up creation*” and announced “*Five-Year Start-up Development Plan*” (the “*Plan*”). The Plan aims to increase investment in start-ups from approximately JPY800 billion in 2022 to JPY10 trillion by 2027, more than a tenfold expansion. It is structured around the following three pillars:

- building talent and networks for start-up creation;
- strengthening funding for start-ups and diversifying exit strategies; and
- promoting open innovation.

As part of the Plan, several years ago the Japanese government established a tax incentive for individuals to invest in early-stage start-ups. The national government has also made some revisions to immigration procedures to make it easier for foreign founders to use in a bid to attract more overseas entrepreneurs.

4.2 Tax Treatment

As a general matter, start-up investments by individuals typically qualify for taxation at the capital gains rate (approximately 20%), which is generally lower than the tax rates applied to ordinary income.

The Japanese government has also introduced some special incentives through tax reforms implemented under the Plan. The “*open innovation tax incentive*” currently provides that when Japanese companies or CVCs acquire shares in start-ups in Japan or overseas, they can deduct 25% of the acquisition cost from their taxable income. This is a temporary measure set to expire at the end of 2025, but there is a possibility that it may be extended through future legislation. Individual investors may qualify for the so-called “*angel*” tax incentive, meant to incentivise angel investment. This tax incentive applies when an individual invests in a start-up that meets certain requirements, including being in business for less than five years. At the time of the investment, the investor may deduct the amount of the investment from their annual taxable income or capital gains from the sale of stock, resulting in a tax reduction. Furthermore, if the investor recognises a capital loss instead

of a capital gain when disposing of the investment, the investor can offset it against capital gains from the previous three years.

4.3 Government Endorsement

The Plan (see 4.1 Subsidy Programmes) is a policy initiative aimed at boosting start-up investment in Japan, with the Japanese government taking the lead in promoting such investments. As part of this initiative, the government seeks to stimulate private investment by actively encouraging government agencies to invest in VC funds, both domestic and international, that focus on start-up investments, as well as by promoting direct investments in start-ups through public-private funds.

5. Employment Incentives

5.1 General

It is common to provide incentives that allow founders and employees to benefit from the long-term growth of the company through stock options or stock ownership. This includes setting a vesting period for stock options and stock grants. In addition, although it is not typical for founders' initial equity ownership to be subject to vesting, it is fairly common for the founders' agreement to provide the remaining founders a right to purchase all of a departing founder's equity at a nominal price (or, alternatively, fair market value at the time of departure) if the departing founder leaves the company before an exit has been completed.

It is also common for the founders to agree in the investment documentation to continue their current roles at the start-up following the investment, most typically for an indefinite period. Under Japanese law, such agreements are generally considered valid with respect to founders

(who are serving as directors of the start-up) but are considered invalid if applied to employees unless limited to a certain permissible period of time under Japanese employment law.

5.2 Securities

Stock options and stock grants are the principal instruments with which founders and employees are typically incentivised. Start-ups typically allocate about 10-15% of their outstanding shares for stock options.

For the tax-qualified stock options referred to in 5.3 Taxation of Instruments, the exercise period must be between two years and up to 15 years after the grant date (depending on the period of the start-up's existence), and the exercise amount must not exceed JPY36 million per year (again, depending on the period of the start-up's existence). In addition, it is common for the exercise conditions to require that the founders or employees to whom the options are granted are still providing services to the start-up at the time of exercise. As mentioned in 5.1 General, stock held by founders is sometimes subject to purchase by other founders at a nominal price (or, alternatively, fair market value at the time of departure) in the case of the stockholder's departure from the start-up.

5.3 Taxation of Instruments

In Japan, there are two types of stock options: tax-qualified (the capital gains rate applies and taxation is deferred until the shares underlying the option are disposed) and non-tax qualified (the ordinary income tax rate applies and the exercise of the stock options constitutes a taxable event). Until recently, tax-qualified stock options had been impractical and were ill-suited for start-ups seeking M&A exits rather than IPO exits, but certain administrative and legislative actions taken in 2023 and 2024 have made stock

options a much more accessible tool for start-ups.

5.4 Implementation

In VC financings in Japan, the valuation of the company is typically negotiated such that the dilution from a new or expanded option pool is shared among the existing stockholders as well as the new investors. This contrasts with the USA, where the new investors typically do not bear the burden of any dilution from the option pool.

This difference may be due to the Japanese legal system. In Japan, until recently stock options could only be issued within one year following the board resolution approving their issuance, so it was not possible to create an option pool in the same manner as is commonly done in the USA. However, with the changes to the law in 2024, it will now be possible to establish an option pool in Japan, albeit subject to certain procedures. This development could lead to the establishment of market practices more closely aligned with those of the USA, such as a refreshed option pool for each financing round and the adoption of a pre-money valuation approach to VC investments.

6. Exits

6.1 Investor Exit Rights

Preferred stockholders have priority over common stockholders in the case of both actual liquidations and deemed liquidations, such as M&A exits. While *pari passu* liquidation preference among classes of preferred shares is not uncommon, it is more common for subsequent classes of preferred shares to have priority over earlier classes. In most cases, preferred stockholders' liquidation preferences are uncapped

and participating, meaning that, after receiving their preference, each of the preferred stockholders receives its pro rata share of the liquidation proceeds available to common stockholders as if its shares had converted to common stock.

Japan does not have an active secondary-share transfer market. Although there are no statutory restrictions on the resale of unlisted securities, it is almost always the case that transfers of shares in privately held companies require approval of the board of directors or the shareholders (if a company does not have a board of directors). In Japanese start-ups, rights of first refusal and co-sale provisions are common and, in most cases, bind all major shareholders, including both common and preferred holders.

For these reasons, investors in Japanese start-ups rarely sell their shares prior to an exit despite the lack of statutory restrictions on the sale of shares of private companies. Investors who wish to sell their shares typically do so in a sale to other investors as part of a subsequent financing.

6.2 IPO Exits

Japanese start-ups have traditionally favoured IPO exits due to the widespread perception that a start-up that exits through M&A has failed. Many founders and traditional VC investors aspire to a listing, and thus the number of IPO exits far outnumber M&A exits. However, M&A exits have been increasing in recent years as a result of pressure from investors (primarily those from overseas) who want to see a quick return on their investment, the slower IPO market in Japan, and the fact that many successful start-ups in other markets are exiting by M&A.

The typical successful IPO outcome for start-ups is to list their shares on the Growth Market of

the Tokyo Stock Exchange while raising capital via an issuance of new shares.

6.3 Pre-IPO Liquidity

As noted in **6.1 Investor Exit Rights**, no active secondary-share transfer market exists in Japan. Founders (and other key common stockholders) and preferred stockholders typically benefit from and are subject to rights of first refusal and co-sale (or tag-along rights), which means that all such stockholders wishing to sell their shares must comply with the required procedures for the rights of first refusal and co-sale (or tag-along rights).

Key challenges for developing a secondary trading market in Japan include the lack of established legal and regulatory frameworks and the need for standardised transaction processes, as well as restrictions prohibiting securities brokerage firms from dealing with shares of private companies except in certain limited circumstances. Company-facilitated tender offers are not particularly common in Japan. As noted in **6.1 Investor Exit Rights**, it is common for start-up investors to aim for an IPO and traditionally there has not been a great demand for pre-IPO liquidity in typical cases.

7. Regulation

7.1 Securities Offerings

In Japan, start-ups' activities involving marketing and selling shares in pre-IPO financings are subject to various restrictions under the Financial Instruments and Exchange Act (FIEA), including prohibitions on general solicitation. Due to these restrictions under the FIEA, the investors in start-up financings are typically limited to qualified institutional investors, a limited number of non-qualified investors, and existing shareholders.

For start-ups with numerous small shareholders, securing required supermajority approval (two-thirds for new equity issuances) can be logistically challenging.

7.2 Restrictions

The FEFTA regulates investments made by foreign investors in Japanese companies engaged in business in industries that have been designated as important from the perspective of national security and public welfare, such as the software and ICT industries among others. In these designated businesses, even minority foreign investments require advance notification to, and approval from, the Japanese authority. The statutory review period for notifications is 30 days from the acceptance of the notification, but depending on the circumstances, this period can end up being as short as one to two weeks or as long as several months.

A foreign investor seeking to appoint a related person as a board director of a company that operates in a designated industry must file not only the advance FEFTA notification for the investment itself but also the advance FEFTA notification with respect to the proposal for the election of the director.

Even in cases where the company is not operating in a designated industry, foreign investors in Japanese companies (together with their related parties) whose ownership or voting rights exceed 10% must make informational filings with the Bank of Japan after the closing.

Revisions to ministerial ordinances in this area are being planned with two key changes: first, investors who are legally required to co-operate with foreign intelligence activities (particularly Chinese investors under China's National Intelligence Law) will be prohibited from using the

prior notification exemption system; secondly, a new category of “*specified core business operators*” is to be established as a designated industry classification. Foreign investors who may be affected should monitor this issue carefully.