Risk and the Interaction of Customer Relations and Finance:

Voices of High Technology Entrepreneurs in Japan

David T. Methé
Professor International and Technology Management
Institute of Business and Accounting
Kwansei Gakuin University
Nishinomiya, Japan
dtmethe@kwansei.ac.jp

Abstract

This paper is concerned with how managers, either operating as independent entrepreneurs or as intrapreneurs in an established company, view the risks involved in starting up a new project in a high technology industry. It presents the findings of interviews that were conducted over a two-year period. This study focuses on the perception of risk. Sources of risk are seen as primarily related to factors that can cause the project or business to fail or go bankrupt. One critical source is finding customers. This source interacts with financial risk, especially in new ventures.

Introduction

An area of continued fascination for both scholars and practitioners alike is the study of entrepreneurship and entrepreneurs and intrapreneurs (Busenitz, et.al. 2003). This study begins with a straightforward research question concerning how managers in various types of organizations perceive the risks inherent in their activities and how do those perceptions affect managerial behavior directed at coping with risk?

The fostering of high technology start-ups is particularly important in that these types of organization forms tend to be more likely to generate radical innovations (Methé, Mitchell, Swaminathan, 1996) and are also seen as a primary engine of growth and renewal in economies. Entrepreneurs must be ingenious in coping with the risks inherent in starting a new business (Aldrich and Fiol, 1994). This is especially so when the new business is in a technology intensive industry and the entrepreneur is starting up in Japan (Methé, 2005; Methé, 2006). The institutional environment for business startups in Japan has been consistently rating as one of the most difficult (JSBRI, 2005; Methé and Bracker, 1994).

The research project was conducted over a three-year period from 2005 to 2007. An open-ended questionnaire was developed in 2005 drawing on previous research in the area of risk, risk perception, risk attitude, risk tolerance, and risk capacity (see for example, Sitkin and Pablo, 1992; Weber et. al., 1997; Weber et. al., 1998; March and Shapria, 1987; Bell, 1983; Xu and Ruef, 2004). After several revisions, the final version of the questionnaire in English and Japanese was used to conduct semi-structured interviews that ranged from one and a half hours to three hours in length. These interviews were conducted over a two-year period from 2006 to 2007, and involved about 21 companies and managers.

In summary, eight venture businesses (VB), seven established Companies (EC)

engaged in product launches involving new technology, two foreign subsidiaries of non-Japanese venture businesses (FS) and four venture angel companies (VA) which were also newly established ventures in their own right, were examined for this study. In some of the companies' cases, especially with the established companies, two or three managers were present during the interview, but in these companies cases the main person interviewed was the CEO. In the case of the venture businesses, the founder, president or CEO of the company was interviewed as was the founders of the venture angel companies. The two foreign subsidiaries mangers were the general manager in charge of the subsidiary. These foreign subsidiaries were formed from venture businesses that had started up overseas (in the US and UK) and then set up a subsidiary in Japan. This study uses the qualitative data collected during the interviews, supplemented where possible with data collected from other archival sources.

On Definitions of Risk, Classical and Empirical

Overall, our study supports the notion that there is a difference between 'risk' as a measure of the distribution of possible outcomes from a choice as is often the case in the classical literature on decision making under uncertainty (see for example Pratt, 1964; Arrow, 1971) and 'risk' as a problem or hazard as is often described by practicing managers as seen in these statements:

> Initiating a project or not initiating one, or taking an action or not taking an action in business involves risk.

> The image of risk is different. In Japan you lose everything if the business fails. You lose the business and you also lose your personal assets if the business fails.

In these comments the concept of risk as being related to bankruptcy or failure is quite evident. This perception was common among the respondents in this study. This is consistent with findings from other studies (March and Shapira, 1987) and is consistent with studies on loss aversion (Tversky and Kahneman 1991) or regret aversion (Bell, 1983). The last comment also illustrates the magnitude of the consequences of failure, for those involved in starting a venture business in the institutional context of Japan.

Perceptions of the Sources of Risk

These entrepreneurial managers identified a number of sources for risk. As one founder of a venture business that had been in business for about fifteen years noted:

> I have three major problems to contend with, especially at the initial founding stage. The first was money, the second was customer relationships and the third was hiring good engineers. All three are important and the third one is very important now, because this is a high technology business.

This comment is consistent with other studies that have cited the acquisition of business resources as a major source of risk for managers involved in new business development activities (Alverez and Busenitz, 2001). We focus on the acquisition of customer resources.

Finding Customers and Developing Customer Relationships

The ability to develop a steady and stable source of sales revenue is critical for moving the venture out of its earliest stage of development and into a stage where it can develop into a fully functioning company. Finding that first customer, especially if it is a large established company does a lot to legitimize the venture business and allow it to overcome its "liability of newness" (Aldridge and Fiol, 1994). Sometimes the first major customer is also a major investor. As one venture business president noted:

> We visited many large companies asking for funding but could not get anything. Venture capitalists were also not putting money into our company. FJH company (a large established electronics company) originally came in as a co-research partner and then about six months later invested a lot of money in us. After that we could money easily because we had the chip and a strategic partner and we had gotten good press.

This strategy of using a major company as both a customer and an investor, however, has its own pitfalls, that can in turn increase risk for the venture business manager. As one venture business founder noted:

> Our first partnership was with RST company. They were looking for technology our company was working on. The managing director of that company convinced his company to not only tie up with us as suppliers, but also to investing us through a capital tie up. We became a production subsidiary. This relationship lasted three years and lead to our finding MNO as a customer. We had to terminate the capital tie up with RST company because staying with them makes it difficult to develop other customers. At that time a venture capitalist offered us an investment that would allow us to buy out RST and become independent.

Venture business managers often noted that they would trade on their unique capabilities in high technology research, especially before their own product was launched. However, they noted that they had to be very careful in selecting research partners. Usually they would select some company that was a potential customer, and therefore less likely to be an immediate direct competitor, especially if that company lacks some of the capabilities to do work in the technological area that the venture company is pioneering. As one venture business manager noted:

> One of my main customers is STU company. I do not sell to MNO company even though they are in the same business. STU is not as comprehensive as MNO so it cannot or at least does not copy my technology, but MNO can.

Even when a customer is found, who is willing to take a chance on an unknown company selling a product that has not been tested for a long time in the market, using some novel technology, there are difficulties in the way large companies treat smaller companies here in Japan. Again, it must be emphasized that one of the fundamental issues that venture companies have to contend with, is maintaining a positive cash balance, or they go bankrupt. Any delays in the payment for a product can be catastrophic for a fledgling company starting out. One venture business founder/CEO related how he had difficulty even after he had confirmed orders for his product, which was a specialized piece of semiconductor manufacturing equipment. After they had developed the prototype and had demonstrated it, they received an order for five

units. He went on to note that:

> We received an order for five sets from a large Japanese semiconductor materials company. We had the factory building, but we did not have enough money to start production. Because we had the order we could get money from a venture capitalist and we began our production and sent the five completed sets to the company. But the custom in this business is to give an oral order for equipment, so nothing is written down. The big company did not pay us for the equipment we delivered.

This venture business went bankrupt and part of it was sold to another more successful venture business, which eventually did get paid by the large company.

The knowledge needed to cultivate relationships with customers was fine grained in that it was very specific to the technology, products and customers involved. Further, some of this could be taught in training sessions but because of the idiosyncratic nature of the knowledge it was not easily learned except through direct experience. As stated by a founder of a venture business:

> This human relations form of contracting is particular to the business and even the geographical region in Japan. This same manager went on to say that:
> It is strict to the local culture. *Chiki micchaku gatta* or the local way of doing things, are important to entering and maintaining the relationship.

These relationships can become institutionalized to such a degree that they affect all aspects of customer development. This is a common problem for both the indigenous Japanese venture business company and for the foreign subsidiary setting up in Japan. Neither company has a history or reputation that is well known. Knowledge of who is doing what kind of work in the customer companies and would be the specific person to pitch your new product to is unknown and access is also guarded unless an introduction is granted. Persistence is required, but time and lack of cash are working against any new entrant. All interviewed managers noted that finishing a project is critical for survival here in Japan, because trust and credibility is an important factor in doing business here. One manager of a foreign subsidiary summarized this factor succinctly when he noted that:

> Once you fail with a customer, even one or two years later it is almost impossible to come back. In the United States even if you fail once, if you have a good product and price you can come back, but in Japan there is less of a second chance so if you fail once your reputation is hurt and it is almost impossible to come back.

He offered the following example:

> One Japanese company that did have relationships with other big Japanese companies began to shift its business over to Nokia because it was growing and the Japanese companies were not. After a couple of years this company tried to re-establish its relationships with the big Japanese companies and these companies said “no”, because a couple of years ago you did not support us so you are untrustworthy.

Many of the managers at venture businesses found it easier to go to the United States or overseas, even with concern for their lack of English language skills and their lack of knowledge about the market situation and customer relations’ etiquette. However, those that did go were able to get some results in spite of the difficulties. As

stated by a venture business founder:

> I made a decision to go to the United States (to find potential customers) and After finding a company, within four days I had a contract. It took up to one year for me to do the same thing here in Japan.

Some Concluding Thoughts

The data presented above is preliminary and should be seen only as a starting point for further research. This study focuses on the perception of risk and how this perception affects managerial behavior. Risk is seen as primarily related to factors that can cause the project or business to fail or go bankrupt. One key source of risk is the acquisition of customers. We observed that coping with this customer-based source of risk generated other risks that must also be confronted by new venture managers. The greatest risk to venture businesses in Japan often comes from the lack of knowledge and legitimacy from an institutional point of view, of new ventures for existing customer. New entrants to Japan, whether venture or foreign had to learn how to satisfy their customers' own risk aversion to the unknown. Consequently learning how to manage these relationships become important and often solving one customer related problem lead to others. This customer-based source of risk is particularly critical to new ventures in that it also interacts with financial risk.

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