

Interview with Kunihiro Tanaka, Founder & CEO, President, SAKURA internet Inc. (April 9, 2024)

# Generative AI at the Core of Japan's Startup & Growth Strategy

By Japan SPOTLIGHT

## Self-Introduction

**JS:** First of all, please give us a brief history of your background.

**Tanaka:** I am the founder, CEO and president of Sakura internet Inc., which I established in 1996 at the age of 18 while still a student at the National Institute of Technology Maizuru College (Maizuru city, Kyoto Prefecture). In 2005, we were listed on the Mothers section of the Tokyo Stock Exchange, and in 2015 we were listed on the First Section of the TSE. Currently, I am mainly involved in digital infrastructure services. I also personally invest in more than 30 startup companies as an angel investor.



Kunihiro Tanaka

## Japanese Startups

**JS:** In Japan, there seems to be an increase in the number of startup companies and young people aiming to start their own businesses. What do you feel about the trends in the software field?

**Tanaka:** I believe that startups in the past 30 years, from the 1990s to the 2010s, were mainly software companies and Internet companies. I am 46 this year, and when I was a child, parents everywhere told you to go to a good university and join a good company. However, in the 1990s, with the spread of the Internet and the advance of globalization, Japan's economic bubble burst and large companies went bankrupt, and the world became unstable. As employment difficulties increased during the so-called "ice age" in job searches, people began to realize that working for a large company was not a guarantee of job security, and this may have partly created an incentive for people to start their own businesses.

Recently, the ratio of job offers to applicants has been increasing, but I believe that people are thinking less of large companies than before and that more people are going to work for venture companies because startups have more growth potential. However, in terms of young people starting their own businesses, I think there

were more young people starting their own businesses in the 1990s, when I began my own business.

**JS:** It is said that the support system for startup companies in Japan is weak compared to other countries, especially the United States. Some say that there are not enough venture capitalists in Japan.

**Tanaka:** Regarding the number of venture capital firms, I think the US, or rather Silicon Valley, is unique.

**JS:** I feel that AI is being introduced to the world at a very fast pace, and I have the impression that the

widespread use of ChatGPT will enhance the capabilities of each individual, but I have also heard some negative feedback. Do you think that AI will help startup companies and early-stage management?

**Tanaka:** Compared to the past, fewer resources are needed in running a business, and the cost of starting a business has dropped dramatically. For example, when starting a business, there is no need to rent an office or get a landline phone. I feel that IT has made it simpler to do business, and AI is one of many tools.

## Japan's Economic Situation Regarding Entrepreneurs

**JS:** It can be said that the hurdles for starting a business are decreasing. Will the increase in the number of venture companies under such circumstances lead to the mobility of human resources? Some people say that the reason human resources are not more dynamic in Japan is because the lifetime employment system and seniority system are still in place. But I feel that the situation is

## changing even in major companies these days.

**Tanaka:** We believe that lifetime employment and seniority systems are making it increasingly difficult for employees to continue working for the same company. Even if someone says, “You will get a good salary if you work for us for 30 years,” we do not know what will happen 30 years later. Today’s young people have experienced only deflation. In an inflationary environment, corporate pension funds can be important assets because they can expect investment gains, but in a deflationary environment they do not know the difference between savings and corporate pension funds.

## JS: In order to end deflation, it is important to achieve a virtuous cycle of rising prices and higher wages, as the government has said.

**Tanaka:** Essentially, industries that are in need should be able to raise the prices they offer, and salaries should go up as well. Also, in the past, many businesses were in the manufacturing industry, but now that the service industry is becoming more mainstream, it no longer makes sense to lower prices. If you save money on intangibles, they will go to other companies. The same goes for employees. I feel that Japan has been pulled into the trend of saving money in the sense of purchasing from the manufacturing industry, and this, combined with deflation, has caused it to atrophy.

In addition, in Japan there are in fact too many companies remaining that are not needed. I believe that society would be better if the number of zombie companies (companies that are practically bankrupt but survive with the support of financial institutions or the government) are reduced and replaced by new businesses.

## JS: So you are saying that we may be helping too many companies that should be exiting the market. That is an important point.

**Tanaka:** In such cases, small and medium-sized companies are often singled out for criticism and there are cases that young heirs in their 20s to 40s are growing their companies as if they were ventures. On the other hand, there are also large companies that have not grown, and there is no room for startup companies because of those large companies’ continued existence. Regardless of the size of the company, human resources will not become more dynamic unless companies with no room for growth are replaced.

## JS: This means that we must improve metabolism. In order to sell services at a fair price, productivity must grow, and I think it is important for the sustainable growth of the economy to create a virtuous cycle by having companies that cannot make real efforts to increase their productivity exit the market.

**Tanaka:** Yes, it is. Increasing productivity is very important. However, I think that productivity is sometimes mistaken for

efficiency. Increasing productivity by reducing inputs is efficiency, but essentially increasing productivity means increasing outputs. In many cases we try to lower costs, but it is simpler to increase sales. The problem in Japan is that we have not been able to do that.

Japanese companies tend to think of prices in terms of a piling-up method, adding processing costs to material costs, but this is not the case with foreign companies. For example, Apple’s iPhone is quite expensive, and NVIDIA’s high-performance GPU is also quite expensive considering the cost of raw materials. When considering how to increase output versus input, it is necessary to try to increase the selling price, and if you do not think about how to sell at a higher price, productivity will not increase after all.

## Problems in the Japanese Software Industry

### JS: It is said that Japan’s IT software industry is very far behind the rest of the world.

**Tanaka:** I think we are clearly behind the international trend. We have purchased far too much software from overseas. At that point, we are already losing out in the global competition.

### JS: Why has Japan’s IT software industry is fallen behind its foreign counterparts?

**Tanaka:** Basically, it is because it was oriented toward the same path as the manufacturing industry. Japan was strong in the software field until the 1980s. There was a time when the semiconductor business was the best in the world, and Japanese-made computers and telecommunications equipment were also strong. Today, telecommunications equipment is completely over-imported, but there was a time when Japan was an over-exporter. Simply put, we were late to the Internet society. However, I think this was partly inevitable. There is a term called “the innovation dilemma” (a phenomenon in which companies focus too much on the development of existing technology and fall behind in technological innovations that come later), but as in the manufacturing industry, the dynamics have shifted in the direction of focusing on improving quality and increasing functions in the software industry.

In addition, there are some areas where I think we lost the strategy. There is the fact that we accepted the strategy of the US, which was trying to position the digital industry as the axis of its industry. The symbolic example is the revision of the Copyright Act in 1985. The revision of the Copyright Law at that time recognized software copyrights. Unlike the intellectual property rights (patents), copyrights naturally arise when they are developed, and protection is granted almost simultaneously in all countries. Both the Ministry of Education and the Ministry of International Trade and Industry at that time were of the opinion that “creativity as a copyrighted work should not be recognized in industrial products,” but in the end Japan and other countries had no choice but to follow the revision of the US Copyright Act and revise their own copyright laws.

However, when software was attached to hardware such as PCs

and servers, there was still business with the hardware, so it was still good. However, as the business model of selling only software, such as Microsoft's, became more widespread, the development of individual business applications decreased, and there was a surplus of software engineers. In this trend, Japanese software companies became an industry that made and sold one-of-a-kind systems like *haute couture*. End-users did not want to change the way they conducted their business, so they did not want to install software commercially available, but instead wanted custom-made systems. At that time, there were not so many updates, and that was fine during the good economic times, but today many systems are custom-made, and maintenance costs are becoming an issue.

**JS: I think the reason is that the Japanese software industry only produces one-of-a-kind products that are customized for customers, and there is no functionality that can be deployed horizontally.**

**Tanaka:** The strength of software is that it is easy to copy. The initial process of software development is the same as in the manufacturing industry, where a system is designed through research and development and prototyping, but the subsequent phases are completely different. In the case of software, it is a collection of bits that can be copied immediately. In the case of manufacturing, there are production facilities and raw material costs, but in the case of software, in the past it was CD-ROMs, and now it can be downloaded online, so there are almost no material costs as there are for industrial products. Basically, productivity is completely different from the manufacturing industry because it is so efficient, as it can be copied endlessly and costs almost nothing. In spite of this, the Japanese software industry does not copy what can be copied, but instead operates in the manner of a manufacturing industry.

## **Is Generative AI the Key to Competitiveness?**

**JS: It is said that introducing AI is important to strengthen competitiveness, but will the widespread use of AI like ChatGPT change the competitiveness of the Japanese software industry?**

**Tanaka:** While AI may make manufacturing and service industries more efficient, in the software industry the more foreign AI services are used, the larger the digital trade deficit will be. While AI producers offer their services, users have to pay fees to overseas AI producers. For example, each time we use ChatGPT, we pay some dollars to overseas service providers, thus this would be a cost for us, the users. The same is true for searching on Google. Google users can use a search engine free of charge, because many companies pay Google advertising fees. These advertising fees are to be counted as imports for Japan. AI services such as ChatGPT, Google search, and cloud services such as AWS (Amazon Web Services) are all very useful and it is important to promote DX for

raising productivity. However, Japan's competitiveness will not increase if all of these services are imported from overseas. In particular, the Ministry of Economy, Trade and Industry (METI) predicts that if the situation with cloud services continues as is, the trade deficit in the computer services area will reach 8 trillion yen by 2030.

**JS: That would increase the trade deficit as foreign software and cloud services become more prevalent. At the G7 Hiroshima Summit in May 2023, Prime Minister Fumio Kishida announced the launch of the "Hiroshima AI Process" as a framework for discussions on the dissemination of generative AI. I think Japan is doing relatively well with its initiative on AI, but what do you think?**

**Tanaka:** I think Japan is responding quickly. Other countries are quite wary of AI, but Japan's opposition is not as loud as that of other countries. In this sense, Japan is a country that can easily use AI as a growth strategy, and I think it is in a very advantageous position.

**JS: Can we consider it a key to the development of the Japanese economy?**

**Tanaka:** To be the key to development, we must be able to create AI, not just use and utilize it. We must not forget that we are not only using the services of foreign companies, but also creating our own.

**JS: I believe that METI is also trying to nurture generated AI startups, and has put forward a variety of measures. How do you evaluate them, or what are your expectations for the future?**

**Tanaka:** The IT industry, including our company, has received considerable support, and we believe that this is a good industrial policy for the immediate future. The challenge is how to sustain this. It is important to make new industries, such as cloud computing, stable and strong, and to make them exportable to overseas markets, so I think there is quite a wide range of things that the government should work on.

**JS: What areas do you think Japan should focus on in the future with a view to exporting overseas?**

**Tanaka:** First of all, I think it is the manufacturing industry. Japan is a country with a large concentration of manufacturing industries, so I think it is important to DX these industries. Because manufacturing is the strongest industry in Japan, I believe that we can increase exports by drastically improving existing processes. **JS**

Written and translated by Naoyuki Haraoka, editor-in-chief of *Japan SPOTLIGHT*, with the cooperation of Naoko Sakai who is a freelance writer.